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The Context and Strategy for Growth of Small Furniture Enterprises: The Province of Guayas

By

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**THE CONTEXT AND STRATEGY FOR GROWTH
OF SMALL FURNITURE ENTERPRISES:
THE PROVINCE OF GUAYAS**

The objective of this study is to assess the growth constraints faced by small furniture manufacturing enterprises; to determine what conditions stimulate growth; and to identify strategies to encourage further development of these enterprises. My approach to this assessment begins with the environment for growth by small furniture firms--in this case, the structure of the furniture industry.

Central to an analysis of this structure are the firms constituting the population of the furniture industry as a whole. Table No. 1 below provides an overview of the number, size, and production levels of furniture enterprises for the province of Guayas. While these 1980 economic census figures are somewhat dated, they provide certain basic parameters of the furniture industry which place the subsequent analysis in a wider context.

Table No. 1

Composition and Concentration in the Furniture Industry:
The Number and Production Levels of Furniture Enterprises
in the Province of Guayas,
by Firms with Different Numbers of Employees
and Size of Assets

	Establishments		Total Production	
	Number	Percentage	Amount	Percentage
			(1980 sucres)	
Enterprises with under 10 employees	1,349	99%	536,934	84%
Enterprises with 10 to 19 employees	9	< 1%	29,295	5%
Enterprises with 20 or more employees	5	< 1%	70,880	11%

Enterprises with assets under one million sucres	1,249	92%	372,097	58%
Enterprises with assets from one to five million sucres	107	8%	174,294	27%
Enterprises with assets over five million sucres	7	< 1%	90,718	14%

Source: Censos Economicos 1980, Instituto Nacional de Estadística y Censos, (INEC). Breakdown by Number of employees and size of assets carried out with the kind assistance of Dr. Alberto Moyano of the Instituto Nacional

de Estadística y Censos (INEC).

As is evident from Table No. 1, small firms, understood to be firms with less than 10 employees or with assets of less than one million suces, constitute between 99 and 92 percent of the population of furniture manufacturers in Guayas. These firms account for between 84 and 58 percent of total production.

The larger enterprises with five million suces or more in assets, numbering seven firms, account for 14 percent of total furniture production in the Guayas province. Similarly, the five enterprises with 20 or more employees accounted for 11 percent of total production.

In effect, the furniture industry in the province of Guayas is characterized by the presence of large numbers of small firms, a very small number of large firms, and a lack of a predominant market share by large firms. Knowledgeable industry observers in Guayaquil, as well as Quito, fully agree with the characterization that furniture is a fragmented industry in the province of Guayas. A critical characteristic of a fragmented industry is the lack of market leaders with the power to shape industry events. (1)

These observers also mention that this same industry is noted for its segmented markets. Firms in the same industry in the same city often compete in separate markets, as they produce a different products for a different target buyer.

**SMALL FURNITURE MANUFACTURERS
IN A FRAGMENTED INDUSTRY:
METHODOLOGY**

This fragmented structure of the furniture industry has provided small firms with opportunities. In Ecuador, small furniture manufacturers have a significant presence and influence in the industry. This environment does place limitations on firms' developing economies to scale and using mechanization to significantly lower costs. In turn, this restricts the capacity of large firms to expand their market share to the point of strongly influencing the direction of the industry. However, small firms can maximize the opportunities inherent in this fragmented structure to grow and increase their market share.

I have approached this analysis of growth constraints and potential of small firms by examining the fragmented structure of the industry; and then evaluating the primary competitive forces in the industry from the perspective of the small manufacturer. Industry structure analysis identifies the following as the principal competitive forces

to be used as a basis of analysis: the threat of new entrants, rivalry among existing firms, the threat of substitute products, the bargaining power of buyers and the bargaining power of suppliers. (2)

Sources of information for such an industry analysis from the perspective of small furniture manufacturers in Ecuador are few and incomplete. They include recent studies on the wood-processing industry, on small manufacturing and on artisans.

Statistical information is extremely limited. The national statistics and census institute further broke down data gathered in the country's 1980 economic census. However, the census information on enterprises with less than 10 employees is based on a sample and not on a fully developed directory. Supplementary surveys by private organizations have been carried out on small wood-processing enterprises for various provinces. However, these surveys combine saw mills and furniture enterprises, which limits the value of such broad-based information for an industry analysis.

To supplement these written sources, interviews were personally conducted with dozens of industry informants. Those interviewed included managers of large, medium-sized and artisan furniture enterprises; managers of subcontracted enterprises; managers of retailing outlets; consumers of furniture; suppliers of wood-working machinery; suppliers of credit; commercial intermediaries supplying lumber and plywood; technical specialist observers of the industry; representatives of the chambers of small industry and the association of industrialists in the wood industry; and others.

For a data base on a specific group of small firms, I designed and personally carried out a survey of 22 owner-operators of small furniture enterprises in the Guayas province. As I wanted to develop a relatively representative population of small manufacturing firms, I relied on a diversity of sources. These included the 1985 listing of the Chamber of Small Industry of the Province of Guayas; the listing from the 1985 Directory of the Ecuador's Ministry of Industry and Commerce of firms registered under the Law for the Promotion of Small Industry and Commerce; the 1983/84 listing from the Ministry of Agriculture Census on Wood-Processing; as well as word of mouth for the names of clandestine manufacturing enterprises of the same approximate size, which were not registered in any organization.

My attention was directed principally to those furniture manufacturing enterprises with an average of less than 10 employees. However, some of the enterprises in the survey had more than ten employees, which was due to the listings

available.

I chose not to restrict myself only to "small industry" as defined in the Law for the Promotion of Small Industry and Artisans. Some firms registered with the Chamber of Small Industry of the Province of Guayas were operating as artisans, while other firms operating as clandestine enterprises had a level of sales more equivalent to small industries. I did this to ensure inclusion of enterprises which were not registered in any institution.

My decision to concentrate the survey in one industry in one major province was based on the belief that a focused industry analysis would best be conducted regionally as the market for furniture is largely segmented by province, city or neighborhood, not nationally. Time and finance were also limited, but the principal reason was that a more widely dispersed population would have increased the difficulty of developing a coherent information base. It would have been too dispersed to establish an understanding of the relationships between producers and buyers; producers and competitors; producers and suppliers.

The data base was developed with two principal objectives. First, the questionnaire was designed to provide information about the structure of and the effect of various competitive forces in the industry, from the perspective of the small producer. The second objective was to gather specific information about the enterprise itself: its products; its production process; its sales; its labor force; etc. to assess its growth potential in the given environment.

The data base's principal limitation is the lack of reliable information on the costs of production, particularly of inputs, such as lumber, glue, upholstery material, etc. The lack of norms in measuring lumber, the differentiated products and the seasonality characteristic of the industry make data on production costs and sales difficult to analyze.

Nonetheless, the advantage of complementing the survey with extensive interviewing of managers of different size enterprises, retailers, suppliers, buyers, industry observers, among others, gave the information gathered in the survey a broader, more industry-specific perspective. Characteristics of firm, such as subcontracting or extensive use of retail outlets, could be best analyzed in terms of the structure of the industry.

FURNITURE AS A FRAGMENTED INDUSTRY IN ECUADOR

Furniture tends to be a fragmented industry both in

developing and developed countries. Comparative studies on seller concentration in developed and developing countries have examined the size distribution of establishments for individual industries. The general conclusion of these studies with regard to the wooden furniture industry particularly in developing countries was that it is noted for its relatively low levels of concentration. Also, the wooden furniture industry was characteristically populated by relatively smaller establishments by average employment size in both developed and developing countries. (3)

The furniture industry in Ecuador has several attributes contributing to this fragmented structure. These characteristics include low entry barriers, a limited capacity for economies of scale, high inventory and storage costs, a diverse product line, and high exit barriers.

The overwhelming presence of large numbers of small firms cited above is the most convincing evidence of low entry barriers.

The nature of the manufacturing process in the furniture industry severely limits the ability of firms to benefit from cost declines based on economies of scale. The production process in the furniture business is characterized by an inherently high labor content and a diversity of production functions.

In Ecuador, the majority of production activities such as carpentry, carving, staining, upholstering and finishing, are completely manual processes. The only exceptions are sawing, planing, and lathing of the wood. (4) Cost declines, based on further mechanization of production for increased economies of scale, have only a limited application in the furniture industry.

Sales fluctuation, also characteristic of the furniture industry in Ecuador, militates against economies of scale. Holidays have a decided influence on consumer purchases of furniture; the peaks of pre-holiday sales and troughs of post-holiday periods of standstill reflect this tendency.

In a "small industry" survey in the province of Guayas, managers of wood products industries noted a decided seasonality in production, particularly in the October/December and the April/June periods. The rationale most commonly mentioned for this trend was the increased demand for the end of year holidays. (5) . While this survey includes both saw mills and furniture manufacturers, interviews with furniture industry observers consistently confirm this trend.

Furniture manufacturing firms with large-scale facilities have not been easily able to scale down production

and to absorb output shifts, even though the large scale firms may be more efficient than smaller firms at full capacity. Also, the costs associated with maintaining an inventory or and storing a stock these bulky final products are high. Building up a large scale production capacity has little purpose if this increased volume has to be stored at a cost is greater than the advantage of lowering costs, given economies of scale.

In Ecuador, there are indications that economies of scale in the furniture industry have significant risks. First, several large-scale furniture manufacturers are operating at a loss or are in severe financial difficulty, a assessment confirmed by authoritative industry observers. Second, very sizable stock build-up is characteristic of the larger enterprises, in the view of recent surveyors of large-scale industry. Carrying the cost of this high inventory may be contributing to these financial difficulties.

At the same time, small furniture manufacturing enterprises have consciously avoided the costs associated with the development of inventory and a stock capacity. Seventy-seven percent of owner-operators of small manufacturing operations surveyed carry out production on the basis of specific orders, with only a small percentage combining order-based production with production on a continuous basis.

Another factor which reinforces this tendency to fragmentation in the furniture industry is that wooden furniture is a differentiated product. Consumer taste and style, as well as income levels, are often critical to the sale of furniture. As a result, the changeable nature of demand severely diminish the value of developing a standardized, mass produced product.

Moreover, the trend towards a slow decline in the number of competitors suggests that exit barriers in the industry are high. Owner-operators interviewed stated that they personally knew of four firms, on average, which have gone bankrupt or dropped out of the competition, since 1980. The estimate given for the number of new competitors is over three times higher than the estimate of the number cited to be dropping out of the competition.

Emotional and economic exit barriers also serve to discourage departure of competitors from the furniture industry. The large majority of the owner-operators interviewed - 83 percent of the total - were fully experienced in the trade before establishing their enterprise. These years of experience; the family involvement in the business; the bias for an independent life; their preference for investing in their own firm over any other investment; -- all these factors suggest that their

emotional ties to the business are strong.

Another factor discouraging exit from the industry is that the liquidation value of wood-working machinery is not high. Machinery suppliers confirm the low resale value of used wood-working machinery. Also, among the surveyed owner-operators, several who wanted to retire or sell off their businesses lacked the incentive because the cost of liquidating the workers was too costly to contemplate.

SMALL FURNITURE MANUFACTURERS: THEIR LEVERAGE RELATIVE TO THE COMPETITIVE FORCES IN THE INDUSTRY

The competitive forces in the industry -- threat of entry, intensity of rivalry, substitute products, the bargaining power of buyers, and the bargaining power of suppliers -- do influence the growth of small furniture manufacturing enterprises. The question at this point is: in what way do these forces affect their growth prospects?

THREAT OF ENTRY

The entry of new competitors has been a real and growing problem for small furniture manufacturers in the Guayas province. Since 1980, there has been a marked increase in the number of new competitors, particularly artisans and commercial retailers, in the small-scale furniture industry, in the view of the small firm owner-operators surveyed.

The rise in the number of new establishments has apparently far outweighed the number of establishments dropping out of the market in the past five years. Owner-operators surveyed knew personally of an average of fourteen new competitors since 1980. On the other hand, they knew personally of an average of four firms dropping from the competition in this same time period.

Knowledgeable industry observers estimate that there has been a 20 to 40 percent increase in the size of the furniture industry market since 1980. The net rise of an average of 10 firms since 1980 by the surveyed small manufacturers confirms such an estimate.

The Increasing Presence of Artisans: The Threat of Low Profitability

The entry by artisans and very small production units, (e.g. one to four person workshops) is perceived by small furniture manufacturing firms as a most significant threat. Artisans constitute 40 percent of the competitors, based on the survey of owner-operators of small firms. (6)

A breakdown of the number of enterprises by number of employees, available from the 1980 Economic Census figures, indicates the very large number of enterprises in the one to four worker size category. Table No. 2 below gives the number of establishments by size for the province of Guayas for 1980.

Table No. 2
 Furniture Manufacturing Establishments
 in the Province of Guayas
 Establishments by Number of Employees
 in 1980

Employees	Number of Establishments
From 1 to 4	1,198
From 5 to 9	151
From 10 to 19	9
From 20 and over	5
Total	1,363

Source: Censos Economicos 1980, INEC. Breakdown kindly prepared under the direction of Dr. Alberto Moyano, INEC.

Entry by artisans is also a threat that appears to be growing. Basic wood-working experience, though essential, has not represented a significant barrier to entry. The reason is that workers have had the opportunity to easily acquire such experience. The large majority of owner-operators interviewed, in fact 83 percent of the total, already had significant experience in the carpentry or furniture industry prior to establishing their own firm.

Industry informants, as well as managers, describe small industry as a very active "training ground" for the entrepreneurs and the establishment of new firms. The trend among owner-operators surveyed has been to decrease or maintain constant the size of their labor force from 1980 through 1985, as Table No. 10 indicates. As a result, "maestros" or masters formerly employed by these firms have become independent and established their own firms. Follow-up interviews with owner-operators, artisans and industry observers confirm this trend.

Individual artisans or groups of artisans will most likely not have the capacity to expand production to the point of securing a significantly larger market share. Rather, the threat is that profits for the entire industry will be lowered as a result of the continued presence of large numbers of very small producers, in the view of industry representatives interviewed.

A principal reason for the fear of entry by artisans is the differing motivation of this sizable group of competitors. The primary motivation in establishing the firm for nearly forty percent of the small owner-operators interviewed was "to be independent and not an employee of someone else," as Table No. 3 below indicates.

Table No. 3

Small Furniture Manufacturing
in the Province of Guayas:
Owner-Operators' Rationale
for Establishing Their Enterprise

To be independent and not an employee of another	38 %
To earn more than a worker or employee	29 %
To develop a large enterprise	29 %
Other	4 %
Total	100 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

The diversity of the competition influences the development of the industry. Owner-operators of small firms tend to be satisfied with a subnormal return on their invested capital which allows them to maintain the independence of self-ownership. (7)

For larger, more established industrial establishments, this independent attitude of artisans and other small producers is perceived as "disloyal competition." The fact that these competitors offer a similar product at a lower price, while remaining in the market, can have the effect of forcing prices overall to come down, thereby reducing the profitability for all those producing a given product.

The threat of entry of artisans as competitors for market shares with more industrialized enterprises is much less easily realized. The capital requirements of developing a retail outlet, the cost of leasing space for a showroom in a business district, are significant enough to represent a barrier to entry to furniture manufacture and retail for the small production units. Artisans and small production units, which customarily operate in the backyard of their home, are compelled to sell individually to consumers coming directly to their factory/workshop or they sell to retailers.

Some clandestine manufacturing enterprises surveyed, which were not necessarily registered as "artisans" nor as "small industry" either, have a significant production capacity. The production levels of several of the unregistered firms interviewed was comparable, if not superior, to those in "small industries" represented in the Chamber of Small Industry for the Province of Guayas.

Nonetheless, artisans will remain a significant presence in the furniture industry, but the effect will be to

stimulate continued entry by retailers, their principal buyers.

Retailing of Artisans: The Low Cost Wave of the Future

The entry of retailers as competitors is an increasingly important development in the furniture industry in Guayaquil. A significant number of new firms -- discount houses, department stores, retail stores in shopping centers - have emerged in the last five years specializing in the commercialization of furniture.

Factors critical in influencing their decision not to engage in production have been the current cost of wood-working machinery, labor problems, the availability of low cost producers and the difficulty obtaining working capital for production, according to several retailers and other industry informants interviewed.

Some of the large scale retailers have had relatively easy access to short-term credit, since their capital circulates relatively rapidly. On the other hand, furniture manufacturing firms have had increasing difficulty in obtaining credit for working capital often because their turnover of capital is slow, in the view of local credit analysts. A large portion of capital, in the form of lumber, may be idle for months to years given drying requirements.

The growth in the number of small furniture producers, principally artisans, and their requirements for a marketing outlet has served to stimulate the need for retailing enterprises. Some retailers customarily extend credit to small production units, which never have had access to credit or have increasing difficulty in sustaining access to working capital. Some in fact operate as "managers at a distance" orienting the nature of production of the firms, which they subcontract or purchase from.

One discount house retailer interviewed subcontracted and directed the production of dozens and dozens of small production units. In effect, the level of his sales, his involvement in the production process of his subcontracted firms, and his relatively low operating costs makes his entry a threat to small industry operating on a more traditional basis, which offers a similar product.

Two factors will be critical in determining the further entry of retailers. First, the more working capital is unavailable to small manufacturing firms, small production units will have to rely increasingly on retailers to overcome capital and marketing constraints. Second, the more labor problems continue to pressure owners to restrict the number of workers in their firm, retailing will continue to be an attractive alternative to in-house production.

As the scarcity of working capital and labor problems are fully anticipated to be serious constraints in the future, there will continue to be sustained entry by retailing operations.

Industrialized Small Firms: A Difficult Future

The rising cost of capital and the high cost of specialized machinery strongly suggest that significant investment by new industrial competitors will not take place in the medium term. In recent years, there has been increased entry of small manufacturing enterprises managed by professionals with formal technical experience in production processes and management. They have tended to enter niche product areas with potential for industrial applications, such as kitchen cabinets, stereo component boxes, modular shelving. Nonetheless, the sharply rising cost of capital and of specialized imported machinery will limit the extent of new entry.

Capital for the purchase of the heavy wood-working machinery, necessary for operating as a small industry, is increasingly becoming a barrier to entry. The cost of the basic complement of the heavy wood-working machinery purchased new has risen from approximately \$2,400 in 1980 to nearly \$24,000 in 1986. The cost of this heavy machinery is out of the range of many new potential new competitors, not only artisans. (8)

The majority of owner-operators surveyed --88 percent-- purchased the heavy wood-working machinery new, and most often made the purchase more than five years ago, a trend confirmed in follow-up interviews. These owner-operators started up their businesses with their own finances principally. Bank and private sources of finance were used to a much lesser extent.

Table No. 4

Small Furniture Manufacturing in the Province of Guayas: Source of Financing for Enterprise Establishment

Source of Finance	Percentage of Firms
Personal or Family Finances	60 %
Bank Financing	20 %
Loans from Private Sources (Money Lenders, Suppliers, others)	14 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

However, as the cost of the machinery has increased so markedly, credit has become of increasing importance as a source of finance.

A number of years ago, suppliers readily extended credit for the purchase of the heavier wood-working machinery, but the interest charges for the purchase particularly of imported equipment, coupled with the cost of machinery itself has significantly dampened demand, according to machinery suppliers interviewed. At the same time, the cost of purchasing locally manufactured equipment or credit from suppliers has also increased, as the finance charges reflect the increase in the cost of credit nationally.

Another source of credit for the purchase of machinery has been subsidized credit available to small industry, under existing government programs supporting this sector. Fifty-eight percent of the owner-operators interviewed have had access to subsidized credit for the purchase of machinery.

These subsidized interest charges are significantly lower than commercial rates; for example, a 22 percent annual interest rate is charged to qualified small industry for the purchase of machinery, under the World Bank-sponsored FOPI AR program. This rate is considerably more acceptable than the 33 percent rate charged by commercial lenders. Nonetheless, the financial costs of purchasing much of the heavy wood-working machinery are considerable, even at the subsidized rate for small manufacturers.

Threat of Entry : The Strategy of Small Furniture Manufacturers

Small furniture manufacturing firms have made a strategic response to the increased presence of large numbers of artisans and the recent entry of retailers. Established small industries, usually managed by well-established former artisans, are specializing in the final assembly and the commercialization of the furniture. The tendency among small manufacturers is to integrate forward into retailing.

Some have retained a significant amount of production in-house, while establishing a separate enterprise specializing in retailing the firm's product. Others have decided to spin off those parts of the production process which are the most costly to manage. These would include for example, the preparation of unfinished furniture, staining, upholstering.

Like the retailers, they take advantage of the lower production costs of the artisan producers. Their approach is to reduce the role of their firm to principally to that of a final assembly operation, while upgrading the marketing capacity of the firm. In both cases, the forward integration

into retailing gives them leverage to limit the impact of retailers as entrants into the market.

The threat of entry of new small manufacturers operating on a more industrial, predominantly assembly-line basis is limited, given the cost of capital and specialized machinery. The strategy of established small industries to ward off entry of similar industrial producers and retailer/artisans is to consolidate and modernize. As established, known industrial enterprises, they have access to subsidized credit, and a strong interest in capitalizing on their capacity to lower costs and increase the efficiency of production.

INTENSITY OF RIVALRY AMONG EXISTING COMPETITORS

Competition for small furniture manufacturers in the province of Guayas is diverse, in part because the various manufacturers tend to produce for different targeted markets e.g. low-income/middle-income/ high-income; residential/ office/ industrial. As many industry observers comment, furniture producers face segmented markets.

Artisans are perceived to be the most significant, consistent source of competition, in the sample survey. Retailing outlets, which operate as commercial intermediaries for artisans and small industries, are another important source of competition. In Table No. 5 below, those citing "other" (*) as a source of competition were consistently referring to commercial retailers.

In some product lines, particularly those lending themselves to more industrial production, large and small manufacturers are perceived as significant competitors. Also, imports are not a source of competition, in part because of the government's restrictions on imports of wood products, including furniture. (9) Table No. 5 provides an overview of the composition of the competition for small furniture manufacturers surveyed.

Table No. 5

Small Furniture Manufacturing in the Province of Guayas: Composition of Competition Facing Owner-Operators

	Percentage
Large Firms	2 %
Small Firms	27 %
Artisan Workshops	4 %
Imports	0 %
Other*	1 %

BARGAINING POWER OF BUYERS

Buyers have a very powerful influence over small furniture manufacturers. Buyers include commercial intermediaries, such as retail outlets, department stores, discount houses. Buyers are also industrial intermediaries, such as final assembly operations with a retail capacity or firms which have subcontracted your enterprise for specific production. In other cases, buyers are end users, such as individual consumers, hotels, restaurants, institutions, construction companies.

A critical factor in the furniture industry influencing the firm's leverage is whether the firm manufacturing the furniture has its own marketing capacity, or can establish a direct link with its buyers. Marketing capacity gives a producer significant bargaining power relative to the buyer, as the firm is able to sell as a retailer or wholesaler directly to the user, to to a commercial intermediary.

The manufacturer selling from his furniture workshop or industry relies on intermediaries, such as retailers or subcontractors, as their principal buyers. The firm also sells directly to end users at the industry door, but the manufacturer is not able to benefit from the value-added obtained through the marketing of the product.

Table No. 7 below gives an very general overview of the composition of the buyers as identified by the owner-operators surveyed. The category for small enterprises need to be broken down further, because many of the small enterprises identified as purchasers were also in effect retailers.

Table No. 7
Small Furniture Manufacturing
in the Province of Guayas:
Composition of the Buyers

Individual Consumers	52 %
Small Enterprises	32 %
Large Enterprises	8 %
Independent Retailers	8 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

Commercial Intermediaries

The identification of small firms as principal buyers, by owner-operators surveyed, reflects the growing importance of commercial intermediaries in the small scale furniture industry. Some small and large firms, such as department stores, discount houses, retail shops, operate exclusively as retailers buying up the production of one or large numbers of producers. In other cases, buyers are small enterprises which manufacture some products in-house and purchase the rest from outside suppliers.

Of the twenty-two owner-operators of small furniture manufacturing operations interviewed, half do not have the capacity to sell their products on a retail basis. While some of those without a retail capacity sell to individuals coming directly to the door of the firm, the principal buyers are retailers and these final assembly operations.

The lack of influence in the market of those without a retail capacity is evident from a comparative look at their level of sales relative to those with a retail capacity. The average level of monthly sales for those firms lacking a retail capacity was \$ 1,775, while the average monthly sales level for those firms operating as retailers was \$13,353. In other words, the sales volume for those able to retail their own products was over seven times higher than for those without a retail capacity.

On the other hand, commercial intermediaries have considerable base of power. They are fewer in number than the small manufacturers selling to them. Many have a well-developed information base about their supplier's, the furniture manufacturer's, production costs. Small retailers are often former artisans of furniture, who logically have a well-established knowledge of production costs. Also, many of these intermediaries advance working capital to these small manufacturers. Since they will be purchasing the product at a later date, a knowledge of the costs of production becomes essential.

Another important group of buyers are small enterprises which carry out the final assembly and the retailing of furniture. They tend to purchase unfinished furniture by the item, e.g. chairs, tables, etc. or to buy the services of enterprises specializing in staining wood or upholstery. In some cases, they buy the product through a subcontracting relationship.

These firms are partially integrated or are characterized by "tapered integration," which places them in a strong position to demand bargaining concessions. (11) Many were originally manufacturers, not final assembly operations. As they retain a productive capacity, they pose

a credible threat to backward integration. Also, the final assembly firms have considerable leverage because partial manufacturing in-house gives them extensive, current information about production costs.

Like other intermediaries, it is common for these final assembly and contracting firm to extend credit and/or raw material supplies to the manufacturing supplier. Fifty-seven percent of firms in the sample, who have been subcontracted, received credit from their contracting buyers.

The rising costs of production in the furniture industry and the accompanying increased requirement for working capital has strengthened the bargaining power of all these commercial intermediaries relative to small manufacturers. Each of the owner-operators surveyed stated that their working capital requirements were greater relative to their requirements in 1980. As a result, their need for the working capital advances by the intermediaries increases, as does their dependence on these retailers.

Similarly, several factors have seriously raised the risk for retailers of extending credit to consumers. The sharp rise in the cost of credit and inflation have drastically inflated the finance charges associated with the purchase. As the retailer makes sales on an installment plan, the retailer is facing the more difficult problem in attempting to recover these installed payments. At the same time, the longer the delay in receiving payment, the lower the value of the money received, given inflation and local currency's exchange value with international currencies.

As a result, the retailers are more concerned with keeping their costs down, which implies that they make greater use of their bargaining power with the small manufacturers. This trend is most evident in the terms of payment established between small manufacturers and buyers. For example, it is increasingly common practice for retailers to pay small manufacturers with post-dated checks, a trend noted in follow-up interviews and confirmed with industry observers. In effect, the buyer has negotiated an extension of credit, at the expense of the small producer. The need of the small producer for cash to sustain production often leads him to accept whatever is offered.

Individual Consumer As a Buyer

A principal buyer for small furniture manufacturing firms, predominantly those with a retail capacity, is the individual consumer. Owner-operator of firms able to retail are not reliant on commercial intermediaries to market and sell their product. As a result, the benefit of selling directly to the public is that they are able to retain the percentage of the sale, which the intermediary would make in

buying and reselling.

While the manufacturer is able to get the value-added as a result of retailing, the principal source of power of the individual consumer is his capacity to play off one retailer over another. The buyer seeks the most competitive price, credit, delivery terms for the product desired from a number of different retailers. As a result, consumers compel retailers to compete among themselves to make the sale. The rise in the competition among retailers has given the buyer greater capacity to bargain with the retailer.

The large majority of small enterprises surveyed - 71 percent - offer credit to their buyers. This credit is usually in the form of installment payment plans, over a period of three months to a year depending on the enterprise. For the small retailer in recent years, payment on a credit basis has meant the strong potential for financial insolvency, in the view of owner-operators interviewed. The problems faced in recovering the payments have made more obtaining working capital from the bank more difficult.

The large retailers, such as department stores, have relatively greater influence over the individual consumer as buyer. They can attract the business because they characteristically offer better credit terms and a relatively large stock of products to consumers, in the view of informants interviewed. Their access and management of consumer credit, as well as their volume of business, gives them a distinct advantage over small retailers. Moreover, their strong ties with the financial community and banking institutions increase their leverage with consumers in terms of payment on an installment basis.

Institutions As Buyers

Offices, hotels, restaurants are the principal institutional buyers of small furniture manufacturers. They have considerable intrinsic bargaining power, especially in standard residential furniture products, such as living room, dining room and bedroom suites.

These institutional buyers have very little problem in "shopping around" for furniture manufacturing suppliers in the province of Guayas. They tend to be located in a major urban area, Guayaquil, where a large number of furniture manufacturers are also based. While there are considerable variations, this buyer group as a whole tends to be price sensitive. Furniture represents a significant portion of fixed costs, and standardized products tend to be adequate for their needs.

The leverage of such institutions drops significantly once they are based outside of Guayaquil. The transaction

costs -- locating the supplier, negotiating the price and transporting the goods -- are logically higher.

From the point of view of the small manufacturing firm, institutional buyers with more specialized requirements are preferable, but in Guayas, they are much fewer in number. Only three manufacturers in the entire survey were not producing residential furniture.

For example, a small industrial firm manufacturing kitchen cabinets has targeted as buyers construction companies which are building apartments and residential housing. In this case, alternative sources of sufficient volume and uniform quality are not available in the region. Similarly, the costs of finding a new supplier or switching suppliers for the buyer are also high. Construction companies don't have the expertise to integrate backward into manufacturing such items, which can be built at a lower cost on an industrial basis. The indications that the residential building industry in Guayas will be improving in coming years is good sign of a long-term buyer.(12)

Institutional buyers - large and small - constituted 48 percent of the buyers for the small furniture manufacturers surveyed for the province of Guayas. However, follow-up interviews with those firms with considerable sales to institutional buyers indicated that the specialized institutional buyer was by far the exception. The large majority sell to restaurants, offices, and hotels and tended to complain about their relative lack of bargaining power with these institutions, e.g. over credit terms, price, delivery dates.

The Bargaining Power of Buyers: The Strategy of Small Furniture Manufacturers

Small furniture manufacturers in the province of Guayas have different strategies to cope with the bargaining power of their diverse buyers. Table No. 3 below represents the basis of competition in the view of owner-operators surveyed. The owner-operators were asked to cite two factors.

Table No. 3
Small Furniture Manufacturing
in the Province of Guayas:
The Basis of Competition

Price	25 %
Quality	27 %
Location	9 %
Distribution	23 %
Targeting of Buyers	9 %
Other	7 %
Total	100 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

While such a listing has limited value in identifying and evaluating specific strategies, it does highlight three principal factors influencing their actions in the market.

Price appears to dictate the strategy of the majority of firms which sell to commercial intermediaries. The type of product sold by these producers was almost uniformly unfinished furniture; individual items, such as chairs, tables, etc.; or the upholstery or the staining of furniture. Producers without retail capacity tend to enter into a subcontracting relationship with a buyer. With one exception, all the owner-operators interviewed whose firms had been subcontracted were enterprises which lacked a retail capacity. This dependence increases the likelihood that price is the determining factor.

Given the very intense competition in this low cost market, a basis for leverage was to establish a stable, working relationship with a given buyer. However, the capacity to accumulate capital appeared to be very limited. Another low-cost strategy for improving bargaining power in this environment was specialization in a given product type, which was relatively standardized and could be produced on a continuous basis, such as modular shelving.

Constraints for these firms without their own retail capacity are their dependence on a very small number of buyers and their lack of working capital. As average sales figures of these without a retail capacity mentioned previously indicate, these firms are marginal producers with little growth capacity.

Price, as well as distribution, were the critical factors influencing the strategies of the small final assembly enterprises with a retail capacity. They tended to specialize in moderate to high price sets of fully finished residential furniture, with either several showrooms throughout the city or a sales force.

Those owner-operators of firms with a retail outlet are more optimistic about how much they could expand their product market than those owner-operators without such a marketing capacity. The majority in both cases believed that they could expand the market, but the margin of anticipated expansion was significantly higher - an average of 63 percent - for those with a retail capacity compared to those without such capacity - an average of 35 percent.

The distribution capacity of retailers of essentially the same or a similar product, coupled with the increasing use of credit, still has the potential to undermine the

BARGAINING POWER OF SUPPLIERS

Labor, lumber, and machinery are the principal inputs which account for the largest proportion of furniture manufacturing fixed and variable costs. Other basic inputs include electricity, assorted complementary inputs, (e.g. upholstery material, glue, nails). The suppliers of these inputs - principally labor, lumber and machinery - have an important influence on the development of small furniture manufacturers.

The table below indicates an important reason for understanding more fully the leverage of the suppliers of these inputs. The three inputs which have increased the most as a production expense since 1980, in the view of owner-operators surveyed, are wages and salaries; wood; and imported inputs.

Table No. 9
Small Furniture Manufacturing
in the Province of Guayas
Rises in Production Costs: 1980 Compared to 1985

Production Inputs	Percentage of Firms citing Rises in Costs
Wages/Salaries	30 %
Wood	31 %
Machinery Upkeep	6 %
Electricity	4 %
Rent	0
Transportation	3 %
Other*	24 %
None	4 %
Total	100 %

* Other refers to imported inputs overall, which was cited consistently.

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida McKean, 1985.

Labor - A Restraint on Growth

The production process in furniture manufacture is inherently labor-intensive. The number and type of processes required, and the differentiation characteristic of the final product, severely limit the capacity of the enterprise to mechanize production and reduce the number of workers. While estimates vary given different production processes, labor accounts for approximately 35 to 50 percent of a firm's production costs, usually the largest percentage of the total (13).

In addition, a certain percentage of skilled or semi-skilled labor is required. A short survey of furniture manufacturers nationwide estimated that forty-four percent of the labor force in the industry was either semi-skilled or skilled; 36 percent were semi-skilled and eight percent were skilled. (14) Similarly, a study of small wood-processing enterprises in Pichincha (including both sawmills and furniture) found that 40 percent of the total firms surveyed employed skilled workers to some degree. (15)

The labor intensity of production and requirements for skilled and semi-skilled labor are limitations on the leverage that managers have in negotiating with their work force.

In addition, the bargaining position of labor has been strengthened by the government's minimum wage and labor legislation. The labor code is a staunch supporter of the aspirations of workers and has a strong bias against private enterprise. (16) The government has set a minimum wage for small industry which represents to the employer the equivalent of paying for 16 monthly salaries, instead of 12, given the benefits allowed. Moreover, reform of this legislation is essentially taboo in the current political and economic climate.

Workers also have the right to establish a "enterprise committee" once a firm employs fourteen workers. This "enterprise committee" is a precursor to the establishment of a union. In Ecuador, employers can not dismiss employees arbitrarily, and employees have the right to full severance pay.

A government decree in 1982 increasing the minimum wage improved the leverage of labor relative to employers in small furniture enterprises. Owner-operators assumed a significant increase in their labor costs in this time period. Wages, along with lumber, was the expense which had increased the most as a percentage of production costs since 1980. Even though the majority of small enterprises - 67 % in the survey - hired workers on a piecework basis, the minimum wage hike improved the income of these non-salaried employees.

Labor's Bargaining Power: The Strategy of Small Furniture Manufacturing Firms

The effect of the existing labor legislation and owners' fear of unionization has severely restricted the real bargaining power of labor. As the table below indicates, this factor was one of the principal reasons given by owner-operators surveyed as to the size of their firm's work force. The other principal factor influencing these managers in determining the size of their work force was their labor

requirements given the level of current sales.

Table No. 10
Small Furniture Manufacturing
in the Province of Guayas:
Principal Rationale for
Size of Firm's Work Force

	Percentage
Effect of Labor Legislation and Fear of Unionization	33 %
Cost of Labor, Given Minimum Wage Levels	8 %
Requirements, Given Level of Current Sales	36 %
Lack of Trained Personnel	10 %
Other	13 %
Total	100 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

In this period 1980 through 1985, the trend in the enterprises surveyed was for the total number of workers employed to decline or remain constant. Table No. 11 gives the breakdown of the trends in the size of the work force in the surveyed enterprises over time, from their origin to 1980, then in 1983, and then again in 1985.

Table No. 11
Small Furniture Manufacturing
in the Province of Guayas:
Trends in the Size of the Work Force
in Owner-Operators' Firms

Action with Regard to Size of Work Force	1980	1983	1985
Firms Increasing the Number of Workers	13	6	4
Firms Keeping Constant the Number of Workers	4	9	8
Firms Decreasing the Number of Workers	2	6	9
Not Available	3	1	1
Total Number of Firms	22	22	22

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

As this table reveals, the number of surveyed firms increasing the size of their work force from their origin to 1985 has dropped by nearly 70 percent. On the other hand, the number of firms decreasing the size of their work force rose by 350 percent. In addition, the number of firms maintaining constant the size of their work force doubled. This trend holds true for the size of the occasional labor force of these surveyed enterprises.

An expansion in sales does not encourage these surveyed owner-operators to increase the size of their permanent labor force. As the Table No. 12 below indicates, the tendency of owner-operators is to reduce labor as a fixed cost to the maximum extent possible.

Table No. 12
Small Furniture Manufacturing
in the Province of Guayas:
The Response of Owner-Operators to
A Significant Expansion of Sales

Response	Percentage of Firms
Contract Occasional Workers	41 %
Contract Permanent Workers	9 %
Increase Overtime or Increase Use of Installed Capacity	14 %
Subcontract Production From Enterprises Outside the Firm	32 %
Other	4 %
Total Responses	100 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida McKean, 1985.

In response to a significant increase in sales, the owners of small manufacturing firms surveyed stated their preference for employing occasional workers or subcontracting the production from another enterprise, rather than expanding their existing work force. This suggests that fewer permanent positions will be available and greater job insecurity for a larger number of workers.

Wage and salary practices in small firms reflect this tendency of managers to increase their flexibility with labor as a production cost. In the firms surveyed in Guayas province, the large majority of workers, sixty-seven percent, of workers were employed on a piecework, rather than on a salaried basis. In follow-up interviews, paying workers "off the books" was found to be a common practice among the owner-

operators interviewed, even though the actual extent of this practice could not be established.

Table No. 13
Small Furniture Manufacturing
in the Province of Guayas:
Means of Payment to Workers

Weekly Salary	21 %
Piecework	67 %
Part Salary/ Part Piecework	8 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

Over half of the enterprises surveyed did not provide any form of insurance to their workers, even though such a right is established by law. This might consist of either artisan insurance under the Ley de Defensa del Artesano or insurance under the Ley de Promocion de la Pequena Industria y Artesania.

Similarly, small manufacturers have developed a means for coping with the cost that full severance payment represents. Thirty-two percent of the surveyed owner-operators maintained contracts of less than one year with their workers. This did not oblige them to make severance payments. Some of employers paid out severance pay on an annual basis, and then rehired the same group of workers. As a result, they were rid of the potentially devastating problem of a massive severance pay award, which could bankrupt a small firm, while at the same time, retain their work force.

In response to legislation permitting the establishment of unions, owner-operators of small manufacturing firms have adopted a strategy of limiting the size of their firm to just under 14 workers. A common tactic has been to divide the enterprise into several different, independent firms, a trend confirmed in follow-up interviews with managers and industry observers. The effect achieved in both cases is to discourage the establishment of a union.

In fact, workers in the small furniture manufacturing enterprises are very rarely unionized. Only one enterprise out of the entire survey for Guayas had an "enterprise committee" ("comite de empresa"). Even among informants interviewed in the larger firms, an "enterprise committee" was by far the exception, not the rule. In firms employing 14 or more workers, the effort is directed toward creating a working environment which discouraged attempts at unionization. The outcome in these cases was payment on a

salaried basis with insurance and full benefits.

The survey of owner-operators of small furniture firms surveyed confirm a tendency to keep the size of the firm small and to subcontract, instead of maintaining a large work force. Half of those surveyed subcontracted other firms - almost always artisans - to supplement their production. Owner-operators have sustained such contractual relationships with small producers for considerable periods, eight years on average. The principal reason for subcontracting given by those interviewed was the labor difficulties associated with increasing the size of their work force, and the flexibility afforded by subcontracting in responding to sales fluctuations.

Given the competitive, fragmented structure of the furniture industry, labor is fundamentally vulnerable. Management in small manufacturing has had the leverage to bend the rules and create alternatives to reduce the increased costs implicit in existing labor legislation.

Still, for owner-operators of small firms, the threat of a legal suit or a strike represents a significant real cost. The strategy of small furniture manufacturers has been to reduce the effect of this increased leverage of labor to the maximum extent possible. The phasing down of the size of the permanent labor force and the preference for occasional workers or subcontracting is testimony to this effect.

Lumber and Plywood - Dependence on Intermediaries

While labor is a most critical input to furniture manufacture, lumber still represents a considerable portion of a firm's production costs -- from 25 to 35 percent, depending on the type of product and the size of the firm.

In the case of small manufacturers in Guayas, the principal supplier of lumber are commercial intermediaries, as Table No. 13 below indicates. They are usually truckers who sell wood on a cash basis right at the firm's site, but in some cases urban lumber warehouses or deposits are the supplier, principally for the smaller firms. To a lesser extent, producers who exploit timber in the forest and transport it themselves are the suppliers.

Only in less than a fifth of the cases have small furniture manufacturer perceived lumber to be important enough input to contract someone else to exploit wood specifically for the firm.

The factors with the greatest influence over the price of wood have been its scarcity, in other words, its distance from road ways, and the transportation costs. As a result, the suppliers have a more powerful bargaining position because they are assuming the increased costs associated with the more difficult and expensive exploitation of the forest, and the longer distances travelled. The logistics of lumber exploitation are complex and very labor intensive, and therefore the costs associated with exploiting the lumber also rises.

Table No. 16
 Small Furniture Manufacturing
 in the Province of Guayas:
 Factors with the Greatest Influence
 over the Price of Wood

Factors Cited	Percentage of Firms
Scarcity of Timber (e.g. distance from transport routes)	23 %
Seasonal Changes	16 %
Excessive Number of Intermediaries	5 %
Demand of Large-Scale Firms	9 %
Transport Costs	36 %
Other	11 %
Total	100 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida McKean, 1985.

For the small furniture manufacturers, wood is an input which influences the quality of the product. However, the cost of obtaining the best lumber supply from Guayas often far exceeds the purchasing capacity or the cash on hand of the small furniture manufacturer. The transaction and transportation costs of obtaining lumber are high, while the amount of lumber required is small, ranging from fifty to several hundred cubic a month. Estimates on the volume of wood purchased were extremely difficult to obtain, and managers of small furniture firms usually have no knowledge of cubic footage. Therefore, as a general rule, small furniture manufacturers in Guayas have made few demands on commercial intermediaries.

As it has traditionally been the custom, wood often arrives at the small furniture factory mixed species in log form or as board lumber. Small manufacturers have little knowledge of lumber measurements, nor much capacity to distinguish between wood types. This lack of knowledge gives the supplier tremendous leverage in compelling the owner to

Table No. 14
 Small Furniture Manufacturing
 in the Province of Guayas:
 Composition of the Suppliers of Wood
 in View of Owner-Operators

Suppliers	Percent of Firms
Commercial Intermediaries	53 %
Producers	26 %
Persons Contracted by the Enterprise to Supply Timber	18 %
Enterprises Contracting Your Firm	3 %
 Total	 100 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

Suppliers of wood as a group have a very considerable influence over the small manufacturers purchasing this input, for a number of reasons. The extent of this influence is first evident in that the nearly 70 percent of the owner-operators surveyed felt they had little to no capacity to choose between suppliers.

Table No. 15
 Small Furniture Manufacturing
 in the Province of Guayas:
 Capacity to Choose Between Suppliers of Wood

None	26 %
Little	43 %
A Great Deal	30 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

Another indication of the growing influence of lumber suppliers is that previously wood was sold by on a credit basis even to small manufacturing operations, in the view of several intermediaries interviewed. However, for the last few years, suppliers sell wood uniformly on a cash only basis, with credit extended only for a week or ten days as a maximum.

Other factors have strengthened the leverage of the suppliers, principally the commercial intermediaries. First, the price of wood has more than tripled in the last two years, in the view of local commercial intermediaries. Apart from salaries, wood is an input which has increased the most in price relative to other production expenses since 1980, in the view of the owner-operators surveyed.

purchase "what's available."

For those manufacturers with specialized requirements, e.g. a certain species, specific measurements, the problem is much more serious. Given the traditional lack of discrimination of the purchaser of lumber in the Guayas area, suppliers are in a strong position. Why sell to a specialized client, when the others will purchase whatever is on the truck.

Part of the problem is the fragmented nature of demand in the area. Demand for lumber is growing in Guayas, but the purchasers are small in size and not organized. Also, the number of suppliers is inadequate in view of the demand, in the view of several intermediaries and industry observers.

Problems associated with using lumber as an input have encouraged the use of plywood and press board by small furniture manufacturers. Plywood and press board are wood-based inputs which are increasingly used in furniture manufacture. Large manufacturers of industrialized wood interviewed were especially optimistic about the potential demand from small manufacturing enterprises, such as furniture manufacturing concerns. Their own marketing studies confirmed that the artisan and small manufacturer represented a strong and growing market.

Half of the surveyed owner-operators used it as principal raw material, together with lumber. Its attraction is that the wood is uniform in size, already dried and chemically treated. Those using plywood or press board who were interviewed were conscious of the time lost in drying board wood.

In the view of those small manufacturers interviewed as well as knowledgeable industry observers, the monopoly of the manufacturers of plywood and press board is the critical factor influencing the price of these products. In effect, these wood products industries are characterized by a very high level of concentration, controlling between 50 and 95 percent of the domestic market. (17) As they are selling to a very fragmented industry with a large number of small producers, the leverage they have in setting the price is considerable.

Bargaining Power of Wood Suppliers: The Strategy of Small Furniture Manufacturers

The leverage that small furniture manufacturers have over suppliers of lumber and industrialized wood is minimal. The volume requirements of most small manufacturers are not sufficient to make improved bargaining power with these suppliers critical. Moreover, the drop in the availability of working capital is further increasing supplier's

control.

The strategy of those small firms with sizable and specialized requirements has been to establish a contractual relationships with given intermediaries to supply the lumber required. In almost all cases, it is the few firms with sizable production levels and with continuous, assembly line production, which have made such arrangements.

Small furniture manufacturers also have a strong interest in industrial wood driers. Nearly 30 percent of the surveyed enterprise expressed a desire to purchase such equipment. This same group of firms also tended to have the asset and sales level necessary to make such a purchase.

Machinery - Stalemate with Retailers

Apart from property, heavy wood-working machinery is the principal fixed asset of small furniture manufacturers. The purchase of jointers, thickness planers, mortisers, band saws, shapers, drill presses and lathes all represent a considerable expense. Even though a firm will not necessarily purchase all this machinery, either initially or in the process of modernization, these are basic items demanded by furniture producers.

The owner-operators surveyed had eight machines valued at approximately 23 thousand dollars on average. The tendency of these small manufacturers has been to purchase new, as opposed to second-hand, machinery. Eighty-eight percent purchased the bulk of their equipment new. Also, the origin of the bulk of their machinery was international, in over 90 percent of the enterprises surveyed. As was mentioned previously, these purchases tended to have been made over five years ago.

Suppliers of heavy wood-working machinery have considerable leverage over the small furniture industry. Two to three companies have principal control of the domestic market for heavy wood-working machinery in Ecuador for at least the past decade, in the view of knowledgeable industry observers. As one large retailing firm dominates imports and several manufacturers dominate local production, these suppliers are significantly more concentrated than the purchasers of their machinery.

The purchasers of such equipment tend to be from furniture or construction companies, known to be populated by large numbers of small firms in a competitive market. The fragmentation of these industries decreases their bargaining power relative to this small concentrated group of suppliers.

Increasingly, the critical factor in the relationship between suppliers and small manufacturers is the cost of the

equipment itself. While most of these owner-operators --75 percent of those surveyed --are interested in purchasing additional machinery, the major problem they face in considering such a purchase is the high price.

Table No. 17 below reviews the problems perceived by these owner-operators in obtaining more machinery.

Table No. 17
Small Furniture Manufacturing
in the Province of Guayas:
Problems in Acquiring Additional Machinery

Problems Cited	Percentage of Firms
Lack of Information	9 %
High Prices	32 %
Inadequate Conditions for Purchase	9 %
Bank Policy Regarding Machinery Purchase	4 %
No Problem	14 %
Other	32 %
Total	100 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

In the case of imported machinery, the supplier adds several items to the final price to cover his costs for imported machinery. A standard ten percent is added to the price to cover for inflation in the U.S. and elsewhere abroad. Another percentage is charged to account for recent increases in import duties on wood-working machinery. As machinery remains in customs two to four months before it is released, the supplier passes this additional new expense on to the final purchaser.

As the supplier requires foreign exchange to import wood-working machinery, his costs are also influenced by the availability of foreign exchange. When international banks deemed that Ecuador was not worthy of lines of credit, as was the case in the mid-1980's, the financial costs of importing became astronomical. This cost of foreign exchange has become a relatively more significant expense than was the case previously. The supplier also passes these additional costs on to the final consumer, in this case, the small furniture industry, immediately, even when the equipment has been in stock. The reason is that his costs as an importer are affected immediately. (18)

The price of locally manufactured products have also risen significantly. Ecuador's metallurgy industry is dependent on imported raw materials, specifically coke and

iron. When the industry was first developed, the government permitted the importation of these raw materials. However, with the government's prohibition on the import of these items, the local wood-working machine industry has had to rely to a certain extent on scrap metal, which is fragile as an input. These local manufacturers have succeeded in obtaining import licences anyway despite the prohibition, but their costs increase as a result of the preparation required to secure these imports.

These price considerations have diminished the leverage of the suppliers in that the market is shrinking. Fewer furniture manufacturing firms are able to afford such capital investments. At the same time, suppliers have a decreasing capacity to make use of their other source of leverage, extending credit.

As the cost of the product and the cost of credit nationally rises, the problem for the supplier becomes default on installed payments. As a result, the supplier has become increasingly restrictive in its credit policy, but the risk is a further reduction in the size of his market, in the view of suppliers interviewed.

In addition, the access of small industry to subsidized credit for the purchase of machinery has traditionally been an added bonus to machinery suppliers, enabling them to increase their sales further. Sixty-four percent of the surveyed owner-operators are currently paying back subsidized loans for the purchase of machinery. However, small furniture manufacturers interviewed expressed reluctance in assuming loan with a 22 percent interest rate, which is the subsidized rate, for the purchase of wood-working machinery.

In effect, the wood-working machinery suppliers' dominance in the market has given them substantial bargaining power with small furniture manufacturers. However, their ability to exercise this power has been undermined by inflation, a changing financial market and declining profits in the local machinery and import business. The sharply rising costs of importing and of local production can not be easily passed on to the consumer. Suppliers and industry observers acknowledge a declining trend in the sales of heavy wood-working equipment in the last five years.

Wood-Working Machinery Suppliers: The Strategy of Small Furniture Manufacturers

The small furniture manufacturer has few alternatives in negotiating with heavy wood-working machinery suppliers. The costs of new machinery can not be easily brought down, and the cost of credit is not expected to drop.

The strategy to date of most small residential furniture

manufacturers has been to postpone the purchases of new heavy equipment. Even though they have the desire to modernize their equipment, a number already have sufficient equipment to get by. Established producers will repair and rebuild existing machinery before embarking on major expansion or modernization.

Those manufacturers operating on an industrial, assembly line basis, targeting a specialized, niche market will continue to modernize, in the view of industry observers and managers. For them, the cost of subsidized credit for small industry is still affordable, and without an efficient enterprise, they may lose the market.

STRATEGY FOR ASSISTING SMALL FURNITURE MANUFACTURERS

The purpose of this examination of the structure and competitive forces of the furniture industry, and the response of small manufacturing firms is to assist in identifying strategies for growth. How certain groups of small firms have coped with the threat of entry, rivalry among competition, the bargaining power of buyers and of suppliers provides a basis for developing specific alternatives.

First, it is important to incorporate the preoccupations and commitment to the industry of small furniture manufacturers.

The Concerns and Responsiveness of Small Furniture Manufacturers

Small furniture manufacturers interviewed identified several major problem areas which have impeded the development of their enterprise. Half of the owner-operators interviewed stated that the lack of sufficient working capital was a critical constraint. Another large group - 32 percent - identified labor problems as a serious problem area. Still another group - 18 percent - affirmed that insufficient space was a severe restraining factor on the underutilization of their installed capacity.

Owner-operators surveyed desired assistance in a wide variety of areas. Table No. 18 below gives an overview of their responses to which three areas would be preferred:

Table No. 18
Small Furniture Manufacturing
in the Province of Guayas:
Areas of Assistance Desired by
Owner-Operators

Areas of Assistance	Percentage of Firms
Use and Selection of Raw Materials	3 %
Production Processes	11 %
Management	9 %
Credit for Purchase of Fixed Assets	12 %
Credit for Working Capital	18 %
Marketing	14 %
Quality Control	9 %
Other	11 %
None	14 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

The principal areas for targeted assistance would be related to credit for working capital; marketing; credit for the purchase of fixed assets; and production processes. The selection of "other" referred in the large majority to enterprises concerned with the labor force, its skill level and management concerns.

Other factors of importance in developing a strategy are expectations about the future of small industry and commitment to investment in their enterprise. The large majority of owner-operators interviewed - nearly 80 percent of the total - were optimistic about the future. An even larger proportion would prefer to invest in their own enterprise over other alternatives, given availability of capital, as Table No. 19 below indicates.

Table No. 19
Small Furniture Manufacturing
in the Province of Guayas:
Investment Preferences of Owner-Operators
Given Availability of Capital

Preferences	Percentage of Firms
Invest in their Enterprise	86 %
Invest in Financial Assets	4 %
Invest in Purchase of Property	0
Invest in Other Activity	10 %

Source: Survey of Small Furniture Manufacturers, Province of Guayas, conducted by Cressida Mckean, 1985.

In both cases, managers of small furniture manufacturing enterprises are committed to the future of the industry and their firm.

The Existing Strategies and Some Preliminary Recommendations

Small furniture manufacturers have responded to the sizable presence of artisans and the growing entry of retailers in two ways. First, they have integrated forward into retailing. Second, they have spun off those parts of the production process, which are responsible for excessive fragmentation.

Similarly, intense rivalry in the industry has led firms to isolate themselves from the competition by specializing by product type, such as kitchen cabinets, for example. Another approach is to recognize and capitalize on the fragmentation in the industry, by dividing up the enterprise into a series

of small, semi-autonomous firms, with tight central control.

The analysis of the bargaining power of buyers suggests that the low cost market is very difficult to compete in. The large number of artisan competitors and the increasing leverage of retailers as buyers makes a low cost strategy very risky. Rather, the strategic targets are the manufacturers with a retail capacity operating in a niche market or those selling to an industrial buyer with growth potential.

Labor's strong capacity to influence the development of small furniture manufacturing firms suggests that dividing up a firm into a series of semi-autonomous enterprises is an advisable strategy.

This discussion suggests that the target groups of enterprises with the greatest growth potential are those manufacturers with a retail capacity and those organizing production to make use of the fragmentation in the industry. In other words, the more viable firms may be those engaged in final assembly or those which have subdivided themselves into several semi-independent enterprises.

At the same time, another target group of firms with high growth potential are those operating on a industrial basis in a niche market and with the capacity to modernize their machinery.

Specialized technical assistance directed towards these targetted firms would be most valuable in the areas of production processes, managment and marketing.

The most sensible strategy with regard to suppliers of wood and machinery may be a defensive one, which stresses approaches to reducing on-going working capital costs. For some firms, it may be best to decrease the amount of working capital left idle, for example, lumber left to sun dry. Having wood dried industrially might improve the circulation of capital. Secondly, small firms might be able to modernize, if the second-hand machinery market, and the machinery repair and rebuilding industry were further developed.

FOOTNOTES

1. M. Porter, *Competitive Strategy*, (New York, 1980), 191.
2. M. Porter, *ibid*, 6.
3. M. Porter, *ibid*, 192-195; P. Meller, "The Pattern of Industrial Concentration in Latin American," *Journal of Industrial Economics*, 27:1, (1978); R. Banerji, "Average Size of Plants in Manufacturing and Capital Intensity: A Cross-Country Analysis by Industry," *Journal of Development Economics*, 5 (1978).
4. Centro de Desarrollo Industrial Del Ecuador (CENDES), *Diagnostico Actualizado del Sector de la Madera en El Ecuador*, (Quito, 1985), I, 55.
5. Proyecto CAPIG-ESPOL, *Camera de la Pequena Industrial Del Guayas*, (Guayaquil, 1985). Also, personal interviews with industry informants consistently confirmed this trend.
6. See Table No. 5, for a breakdown of the composition of the competition, as perceived by the owner-operators surveyed.
7. M. Porter, *ibid*, 19.
8. Interview with Arturo Fried, Owner of Principal Supplier Nationally of Wood-Working Machinery. (February, 1986)
9. CENDES, *ibid*, II.
10. Small furniture manufacturing firms surveyed purchased from \$1,000 to \$8,000 in lumber on a monthly or bi-monthly basis.
11. M. Porter, *ibid*, 25, 319-320.
12. Republica de Ecuador, Programa de Encuestas de Coyuntura, *Industria de la Construccion*, (Quito, March 1985), 5-6.
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