

# C I N T R A F O R

## Working Paper 102

### Distribution Systems for Value-added Wood Products in China

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#### Executive Summary

In recent years, China has become a vital market for many US wood exporters. Now the fourth largest export destination for US wood products, exports from the US to China have increased an average of 30 percent per year over the past 10 years. From 1999-2004, US exports of softwood lumber increased from \$1.2 million to \$27.5 million and exports of hardwood lumber increased from \$29.9 million to \$150.8 million. While China predominately imports raw materials, exports of value-added products are increasing. For example, in 2004, US suppliers exported almost \$4 million in builders' joinery to China, replacing Canada as the leading supplier. Sales of wood furniture from the US are also increasing. Between 1999 and 2005, wood furniture exports from the US increased from \$1 million to \$6.8 million.

China's plentiful supply of cheap labor and comparatively low capital costs have made it arguably, the world's workshop. China consumes billions of dollars in raw materials and re-exports even more in value-added wood products. As the world's third leading importer of forest products, China has inevitably drawn the attention of the supplying nations and competition for China's business has become intense. Russian and Canadian suppliers dominate China's softwood lumber market and Southeast Asian suppliers are extremely competitive in China's hardwood market. US companies, however, are competitive suppliers of high quality raw and finished building materials. For US suppliers to maintain and improve their competitiveness in China however, they must understand what US products are in demand, the sales process, the distribution system, and their competition.

While raw materials, such as logs and lumber used in China's furniture factories, remain China's leading wood imports, the country is rapidly transitioning from a raw materials market to a diversified market with rising demand for value-added imports. Locally produced building materials dominate the regionally fragmented and price-sensitive market, yet US building materials are making inroads into certain niche markets. Yet, China remains a challenging market that can easily consume exporters' time and money. In order to improve their competitiveness, US suppliers must identify appropriate niches for their products, navigate through thousands of specifiers, and negotiate a fair contract. In addition to understanding market opportunities and competition, exporters must understand the markets for US products and how to introduce products into these markets.

This report presents information about opportunities, market size, factors affecting competitiveness, and makes recommendations for improving competitiveness and product positioning. These issues will be discussed throughout this paper and suggestions will be made to help US suppliers enter the Chinese market and increase their sales in China. Distribution systems for raw materials and value-added building materials will be presented and the purchasing process used by developers and contractors will be discussed. The information used for this report is a combination of secondary trade data and primary information derived through in-person interviews

#### Conclusions and Recommendations

Understanding government policy and directions of investments is critical for firms with long-term resource commitments in China. Although the Chinese government readily embraces the capitalist ideology, a number of housing developments are controlled by local government agencies and China has yet to develop an open exchange of information. Therefore, good relations with government officials and large real estate companies are extremely helpful for firms in obtaining project and bidding information. Most, if not all of the successful US building materials exporters spend a great deal of time developing contacts in government offices to learn about new government housing development contracts.

Over the past decade, China has invested heavily in fixed assets to maintain the country's recent level of economic growth. According to the Eleventh Five-Year Blueprint (2005-2010), the central government will recommit investments to "building a harmonious society" by improving people's living standards, particularly those of rural and low-income individuals. Therefore, analysts expect housing developments for middle- and upper-income consumers will gradually slow and subsidized affordable housing projects will increase. Land use restrictions for single family developments were expected to limit the number of luxury developments, but most of the large builders have already secured enough land with permits to enable them to continue to build.

Maintaining market presence is critical. Most US firms don't have inventory capacity in China and are selling their products via a variety of intermediaries such as: trading companies, sales offices, timber markets, distributors and home centers

Key findings of this report include: 1) policies enacted to achieve an economic "soft-landing" after years of double digit economic growth could curtail demand for housing and wood-based building materials, 2) distribution channels vary greatly depending upon the product and region, 3) distribution channels for value-added products are more complicated than those for raw materials, 4) long lead times and high prices hinder US suppliers' ability to compete with domestically produced building materials, 5) locating an aggressive local partner has an important influence on export success, particularly for technical products (e.g., treated lumber and wood windows) where technology transfer programs are required to educate builders, developers and architects, and 6) although competition from domestically produced building materials is intense, there are niche-market opportunities for hardwood lumber, hardwood veneer, windows, engineered roof truss systems, glulam bridges, treated lumber and naturally durable species, and high-end fine furniture from the US.

#### *Hardwood lumber and hardwood veneer*

While wages in China are increasing, China still has an ample supply of low-cost labor to fuel its value-added wood manufacturing plants, which will continue to drive demand for US hardwood and softwood lumber. US red oak, cherry, alder, maple, and walnut are among the most popular species for furniture manufacturing in China. Yellow poplar lumber and cherry veneer are also in high demand, due to an increasing shortage of supply. The American Hardwood Export Council (AHEC) has predicted double-digit export sales growth in the Chinese non-structural markets over the next few years.

#### *Wood Windows*

US wood windows have many advantages over their competitors in China, including high energy efficiency. As the Chinese government promotes energy-efficiency in buildings and building materials, Chinese window manufacturers face rising costs and high market-entry barriers with respect to window technology, quality and performance. The current market for wood windows is high-end villa projects located in the major Chinese cities. However, in the future, rapid urbanization is likely to provide new opportunities in second tier cities such as Chongqing and Nanjing.

#### *Engineered Roof Truss Systems*

As a major part of the government's campaign to renovate older urban districts, flat roofs of aged residential buildings are to be replaced with sloped roof systems. Slope roof modification has many advantages over flat roofs, including energy-efficiency and visual appeal. For most Chinese people, it is also a design that provides increased storage and living space in the house. This initiative could provide market opportunities for US engineered roof and truss systems.

#### *Glulam Bridges and Beams*

Outdoor applications such as bridges may be an opportunity since local wood is generally of lower quality compared to imports. Current uses for glulam timbers include bridges and clubhouses in upscale golf course developments as well as structural components in the outdoor walkways built around the water features that are becoming more prevalent in upscale residential developments.

#### *Treated SYP and naturally durable species*

Although competition is intense in the treated lumber market, there is a potential for US treated softwood lumber if the market is well educated and US standards are well recognized. Critical to the success of this product market

is educating Chinese construction professionals about the importance of proper lumber treatment on the long-term durability and performance of treated lumber. This is particularly challenging given the price sensitivity of this market. Another option is the use of naturally durable wood species such as western red cedar, Alaska yellow cedar, eastern white cedar and redwood. While these species provide attractive options for builders, availability and cost can be an issue.

#### *High-end fine furniture*

Import tariffs on furniture imports were totally removed in 2005. US furniture brands, such as La-Z-Boy and Ethan Allen, can already be found at the retail level in major Chinese cities. Buyers of imported furniture are largely limited to overseas expatriates and upper income Chinese who are pursuing western lifestyles. With China's increasing integration into the global economy, and continued economic growth, this high end segment of the market is expected to increase substantially.

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