

AN ANALYSIS OF THE CARPET INDUSTRY  
dated August, 1994

TO THE READER...

This report is the result of nine months of research and interviews conducted with representatives of carpet mills, fiber manufacturers, sundries manufacturers and distributors, carpet retailers, installers, and customers.

ORCON CORPORATION initially undertook this sizable effort as part of our sales/distribution strategic planning process. However, in the early stage of the research, it became abundantly clear that:

The profitability and viability of all participants in the industry are being severely challenged; and  
The industry must act collectively to resolve the major issues that are threatening the industry as a whole.

For ORCON, developing a plan in an industry experiencing these conditions required that we expand the scope of the research further in an effort to gain a clear understanding of the root causes of these pressures. In so doing, it became clear to us that dramatic changes are called for. These changes will require many of us in the industry to modify the assumptions under which we operate and adopt new strategic approaches to doing business.

While many of the findings are indeed sobering, we are not pessimistic about what they mean for us and our fellow participants in the industry. At ORCON, we have every reason to believe that the individual companies and trade associations that comprise the carpet industry will take the necessary actions to effectively respond to these new conditions if the right information is available.

ORCON CORPORATION is sharing this information in an effort to help those who participate in the carpet industry gain a better understanding of and effectively deal with the issues that affect all of our business.

To get the most out of this report I suggest that you:

- Approach the information with an open mind;
- Openly discuss the findings with your management team; and
- Use the information as part of your strategic planning process.

Conventional wisdom holds that there are three types of people in any industry-- those who make things happen, those who watch things happen, and those who wonder what happened. ORCON CORPORATION is sharing this information in the hope that it will help you make things happen in business.

Len DiGiovanni, Vice President/General Manager  
ORCON CORPORATION

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INTRODUCTION

As a whole, the carpet industry is experiencing a significant slowdown in its overall rate of growth--a signal that the industry is entering a state of maturity.

This transition to maturity represents a critical period for all participants in the industry. It is a time in which those who operate in the industry will need to make difficult strategic decisions to contend with the fundamental changes that are occurring in the marketplace.

In an attempt to gain a better understanding of these changes and how to best respond to them, ORCON CORPORATION-- the market leader in the manufacture of floor covering installation products and in the provision of technical services--retained the Industrial Performance Group, Inc. to conduct an extensive study of the carpet industry. The study was designed to provide answers to the following questions:

- What are the conditions that exist in the carpet industry today?
- What are the forces and factors behind these conditions?
- How are these conditions affecting ORCON as well as carpet mills, retailers, installers, and the ultimate consumer?
- What are the implications for the future?

## METHODOLOGY

The Industrial Performance Group conducted in-depth interviews throughout the U.S. with leaders in the various segments of the industry -- including fiber manufacturers, sundries distributors, floor covering retailers, floor covering installers, and consumers. The study began in November, 1993, and concluded in July, 1994.

## MAJOR FINDINGS

Participants in this study agreed that the carpet industry needs a “wake up call”-- i.e. the industry must be made to understand that the old ways of doing business are no longer producing the desired results, and that fundamental changes must occur if the industry is to remain viable.

The study discovered that the majority of problems experienced by industry participants can be directly attributable to four major industry realities:

- Despite a slowing rate of growth, carpet mills remain capacity driven rather than market-driven.
- The carpet industry has not embraced the “Total Quality Management” philosophy adopted by other U.S. industries.
- The mills’ primary sales and marketing efforts have been focused on the retailer rather than on the ultimate consumers of their products.
- Despite its importance to profitability and customer satisfaction, the industry places little or no value on the proper installation of carpet products.

## INDUSTRY REALITY NUMBER 1: A Capacity-Driven Industry

Historically, in an attempt to overcome commodity pricing, fiber manufacturers began aggressive advertising campaigns to create consumer awareness of and demand for the attributes of their products (e.g. stain resistance, wear resistance, etc.). This enabled the fiber manufacturers to charge higher prices for their products and reduced the bargaining power of the carpet mills.

The fiber manufacturers’ actions had the effect of increasing the mills’ manufacturing costs, while at the same time precluding the mills from differentiating themselves in the minds of retailers and end-users. As a result, the main point of mill differentiation at the retail level became price.

In an effort to gain a price advantage over their competitors, the mills have attempted to reduce manufacturing costs by:

- Placing intense pressure on suppliers;
- Vertically integrating into other areas of production; and
- Undertaking numerous mergers and acquisition to gain economies of scale and market share.

In so doing, the mills have become increasingly capacity-driven. To realize the cost advantages they so greatly desire, the mills have created a situation where they are forced to operate at full capacity. However, this operating philosophy runs counter to the need for the industry as a whole to adjust its manufacturing capacity to better fit with relatively flat consumer demand.

Also, the vertical integration and rapid consolidation undertaken by the mills in an effort to achieve cost advantages have resulted in inefficiencies and “dis-economies” of scale since the new and larger organizations have proven more difficult and costly to manage.

## INDUSTRY REALITY #2: A Lack of Focus on Quality

During periods of growth when consumer demand exceeds an industry's capacity to produce goods, consumers are often willing to accept uneven product quality. But as an industry enters maturity, consumer demand for quality becomes paramount.

Unlike most U.S. industries, the carpet industry has not successfully implemented quality management practices. While other industries have made marked gains in product quality, manufacturing defects remain a major issue among retailers, installers, and consumers.

The mills' approach to quality problems appears to be one of claim resolution rather than problem prevention. In fact, in the interests of customer good will and retailer volume, mills readily accept responsibility for claims related to problems other than manufacturing defects-- e.g. poor installation practices, unmet customer expectations, inappropriately selected products, etc.

## INDUSTRY REALITY #3: Retailer-Oriented Sales and Marketing Efforts

In their efforts to grow and maintain their market shares carpet mills have engaged in retail distribution strategies designed to create and satisfy demand by raising exposure levels and make their products available to a large number of people.

These strategies have proven effective in other industries where manufacturers have aggressively worked to create end-user demand for their products through aggressive marketing and product promotion. For the most part, however, carpet mills operate under the assumption that the retailer rather than the end-user is their primary customer.

The implications of viewing the retailer as customer are twofold:

- First, the mills' sales and marketing strategies are primarily designed to meet the needs and expectations of the retail community rather than those of the end-users.
- Furthermore, the mills have not recognized the importance of supporting the retailer in the creation of end-user demand through marketing and sales promotion efforts that focus on features and benefits rather than price.

The retailer-as-customer orientation of the mills has created even higher levels of price sensitivity in the marketplace as retailers are forced to compete on price rather than features, benefits, and service as points of differentiation. However, current and prior consumer research indicates that customers are willing to pay for features, benefits and increased levels of service if the value of doing so is clearly demonstrated. Mills and retailers are therefore passing up an opportunity to increase levels of customer satisfaction as well as their own profitability.

The lack of sales and marketing support for retailers also has manifested itself in a growing incidence of customer complaints. A generally low level of product/application knowledge at the retail level serves to create unrealistic customer expectations for product performance and installation. As a result, the industry is experiencing a growing incidence of claims related to unmet customer expectations. However, the mills have been willing to take responsibility for the resolution of these problems, placing little emphasis on preventing them from arising in the first place.

The recent emergence of a variety of brand identification programs instituted by the mills provides some evidence that they are now recognizing the value of providing added marketing and sales support to their retailers.

## INDUSTRY REALITY #4: Undervaluation of Installation

During the course of the study it became abundantly clear that the installation community has been negatively affected by the extended periods of heavy discounting in the industry. As retailers struggled in response to the industry's tremendous downward pressure for profit, they apparently lost sight of the importance of proper installation with respect to the sale and satisfactory use of the product.

Meanwhile, carpet mills were introducing new products that required higher levels of knowledge and skills for proper installation.

The industry has unknowingly created an environment where the performance demands placed upon the installation community have greatly increased while installer compensation has remained relatively flat and, in some areas of the country, has actually declined.

As a result of these conditions, many installers have been driven to alternative floor coverings for their livelihood or have left the industry altogether. The majority of the installers who remain in the industry do not have sufficient incentive to enhance their existing knowledge and skills. Additionally, potential apprentice installers are looking elsewhere for career opportunities.

The impact upon the industry can be seen in the rapidly increasing incidence of installation-related problems, and an accompanying decline in customer satisfaction regarding the installation process and how problems are resolved.

When asked what they view as the most pressing issue facing them today, retailers participating in the study pointed to installation-related problems. Most retailers indicated that the current situation has progressed to the point where they are beginning to lose sales due to the unavailability of qualified installers. Retailers also report that the resolution of installation-related complaints is consuming an increasingly large portion of their resources--i.e., time, money and people.

Although mills and retailers alike acknowledge that the cost of installation-related claims is extremely high, the industry in general has not devoted sufficient attention to determining the true costs associated with them and their impact on customer satisfaction. At both the mill and retail level, the current focus continues to be on claim resolution rather than problem prevention.

## CONCLUSIONS

For many years, the carpet industry enjoyed significant growth and prosperity. Today, however, there are major challenges to the industry's profitability and viability.

As the industry enters the transition to maturity, all of us operating within the industry will be required to make difficult strategic responses to the conditions that exist today and will exist tomorrow.

Making these changes will not be easy. Many within the industry will have trouble accepting that these conditions actually exist. Others will accept their existence but will be unable to implement changes in response. The successful ones will be those who accept, respond to, and ultimately prosper in this new environment.

## ABOUT ORCON CORPORATION...

Serving both the residential and the commercial carpet industries, ORCON CORPORATION is the largest supplier of carpet installation tape in the world. ORCON also provides innovative tools, installation materials, and technical services to the floor covering industry through its Floor Covering Installation Systems Division. Recognized as the foremost problem solver in the industry, ORCON has earned a reputation as "the solutions company."

ORCON was originally founded in 1962 to provide advanced expertise to meet the rigid requirements of the airframe industry by manufacturing lightweight, non-woven reinforced materials. ORCON's Aerospace Division serves many markets, ranging from commercial airlines to satellite manufacturers.

A privately-held and partially employee-owned company, ORCON CORPORATION is committed to maintaining its leadership position in the industries it serves--especially in the areas of product quality, customer service, and product improvement.

## ABOUT THE INDUSTRIAL PERFORMANCE GROUP, INC...

The Industrial Performance Group, Inc. is a firm that specializes in helping manufacturers and distributors improve the effectiveness and profitability of their sales and marketing efforts.

The Industrial Performance Group provides a variety of services designed to help manufacturers and distributors:

- Identify, understand, and respond to the changing conditions within an industry;
- Create sustainable and profitable competitive advantages in their respective industries; and
- Improve sales and marketing effectiveness through the development of strategic alliances.