Case

Haverwood Furniture, Inc. (A)

Late in the evening of January 9, 2008, Charlton Bates, president of Haverwood Furniture, Inc., called Dr. Thomas Berry, a marketing professor at a private university in the Northeast and a consultant to the company. The conversation went as follows:

BATES: Hello, Tom. This is Chuck Bates. I'm sorry to call you this late, but I wanted to get your thoughts on the tentative 2008 advertising program proposed by Mike Hervey of Hervey and Bernham, our ad agency.

BERRY: No problem, Chuck. What did they propose?

BATES: The crux of their proposal is that we should increase our advertising expenditures by $225,000. They suggested that we put the entire amount into our consumer advertising program for ads in several shelter magazines.[1] Hervey noted that the National Home Furnishings Collaborative has recommended that wood furniture manufacturers spend 1 percent of their sales exclusively on consumer advertising.

BERRY: That increase appears to be slightly out of line with your policy of budgeting 5 percent of expected sales for total promotion expenditures, doesn't it? Hasn't John Bott [vice president of sales] emphasized the need for more sales representatives?

BATES: Yes, John has requested additional funds. You're right about the 5 percent figure too, and I'm not sure if our sales forecast isn't too optimistic. Your research has shown that our sales historically follow industry sales almost perfectly, and trade economists are predicting about a 4 percent increase for 2008. Yet, I'm not too sure. The stock market collapse last fall is worrisome.

BERRY: Well, Chuck, you can't expect forecasts to be always on the button. The money is one thing, but what else can you tell me about Hervey's rationale for putting more dollars into consumer advertising?

[1]Shelter magazines feature home improvement ideas, new ideas in home decorating, and so on. *Better Homes and Gardens* is an example of a shelter magazine.

This case was prepared by Professor Roger A. Kerin, of the Edwin L. Cox School of Business, Southern Methodist University, as a basis for class discussion and is not designed to illustrate effective or ineffective handling of an administrative situation. All names and data have been disguised.

BATES: He contends that we can increase our exposure and tell our quality and styling story to the buying public—increase brand awareness, enhance our image, that sort of thing. He also cited industry research data that showed that as baby boomers [consumers born between 1946 and 1964] age they become more home oriented and replace older, cheaper furniture with more expensive, longer-lasting pieces. Baby boomers make up 47 percent of all U.S. households. All I know is that my contribution margin will fall to 20 percent next year due to rising material costs.

BERRY: I appreciate your concern. Give me a few days to think about the proposal. I'll get back to you soon.

After hanging up, Berry began to think about Bates' summary of the proposal, Haverwood's present position, and the furniture industry in general. He knew that Bates expected a well-thought-out recommendation on such issues and a step-by-step description of the logic used to arrive at that recommendation.

EXHIBIT 1 **Haverwood Furniture, Inc. Bedroom Furniture**

Source: Courtesy of Haverwood Furniture, Inc.

THE COMPANY

Haverwood Furniture, Inc. is a manufacturer of medium- to high-priced wood bedroom, living room, and dining room furniture. (Exhibit 1 on page 295 shows an example of the company's bedroom furniture.) The company was formed in the early 1900s by Charlton Bates' great-grandfather. Bates assumed the presidency of the company upon his father's retirement. Year-end net sales in 2007 were $75 million with a before-tax profit of $3.7 million.

Haverwood sells its furniture through 1,000 high-quality department stores and independent furniture specialty stores nationwide, but all stores do not carry the company's entire line. The company is very selective in choosing retail outlets. According to Bates, "Our distribution policy, hence our retailers, should mirror the high quality of our products." As a matter of policy, Haverwood does not sell to furniture chain stores, such as Rooms To Go, or discount outlets.

The company employs 10 full-time salespeople and two regional sales managers. Sales personnel receive a base salary and a small commission on sales. A company sales force is atypical in the furniture industry; most furniture manufacturers use sales agents or representatives who carry a wide assortment of noncompeting furniture lines and receive a commission on sales. "Having our own sales group is a policy my father established years ago," noted Bates, "and we've been quite successful in having people who are committed to our company. Our people don't just take furniture orders. They are expected to motivate retail salespeople to sell our line, assist in setting up displays in stores, and give advice on a variety of matters to our retailers and their salespeople." He added, "It seems that my father was ahead of his time. I was just reading in the *Standard & Poor's Industry Surveys* for household furniture that the competition for retail floor space will require even more support, including store personnel sales training, innovative merchandising, inventory management, and advertising."

In early 2007, Haverwood allocated $3,675,000 for total promotional expenditures for the 2007 operating year, excluding the salary of the vice president of sales. Promotion expenditures were categorized into four groups: (1) sales expense and administration, (2) cooperative advertising programs with retailers, (3) trade promotion, and (4) consumer advertising (see Exhibit 2). Sales costs included salaries for sales personnel and sales managers, selling-expense reimbursements, fringe benefits, and clerical/office assistance, but did not include salespersons' commissions. Commissions were deducted from sales in the calculation of gross profit. The cooperative advertising budget is usually spent on newspaper advertising in a retailer's city. Cooperative advertising allowances are matched by funds provided by retailers on a dollar-for-dollar basis. Trade promotion is directed toward retailers and takes the form of catalogs, trade magazine

EXHIBIT 2 **Allocation of Haverwood Furniture Industries, Inc. Promotion Dollars, 2007**

Sales expense and administration	$ 995,500
Cooperative advertising allowance	1,650,000
Trade advertising	467,000
Consumer advertising	562,500
	$3,675,000

Source: Company records.

advertisements, booklets for consumers, and point-of-purchase materials, such as displays, for use in retail stores. Also included in this category is the expense of participating in trade shows. Haverwood is represented at two shows per year. Consumer advertising is directed at potential consumers through shelter magazines. The typical format used in consumer advertising is to highlight new furniture and different bedroom, living room, and dining room arrangements.

THE HOUSEHOLD FURNITURE INDUSTRY

The household furniture industry is divided into three general categories: upholstered, wood, and other (ready-to-assemble furniture and casual furniture). Total furniture industry sales in 2007 were estimated to be $31 billion at manufacturers' prices.

Household upholstered furniture sales represent 50 percent of total household furniture sales, followed by wood furniture (40 percent) and other forms (10 percent). The principal types of wood furniture are dressers, tables, and dining room suites. Bedroom and dining room furniture accounts for the majority of wood furniture sales.

In recent years, wood furniture manufacturers have increased their emphasis on quality by monitoring the entire production process from the raw materials used, to construction, finishes, and packaging. In addition to improving quality controls, companies also stress price points and basic styling features, and are trying to improve shipping schedules. Wood furniture manufacturers' dollar sales grew by 2.5 percent in 2007. Dollar sales were forecasted to increase by 4 percent in 2008.

About 1,000 furniture manufacturers operate in the United States. Ten manufacturers represent about one-third of furniture industry dollar sales. Furniture Brands International, Inc. (owner of the Drexel Heritage, Maitland-Smith, Hendredon, Broyhill, Lane, and Thomasville brands), La-Z-Boy, Inc., Ashley Furniture Industries, Inc., Klaussner Home Furnishings, Inc., Sauder Woodworking Company, Dorel Industries, Inc., and Ethan Allen Interiors, Inc. account for about 28 percent of industry sales (see Exhibit 3). Other well-known manufacturers/brands include Bassett Furniture Industries and Sherrill Furniture. The top 25 manufacturers account for over half of U.S. furniture sales.

EXHIBIT 3 **Top 10 U.S. Furniture Manufacturers**

Company	*Estimated 2006 Revenues ($ million)*
Ashley Furniture Industries, Inc.	$2,964
Furniture Brands International, Inc.	$2,321
La-Z-Boy, Inc.	$1,527
Klaussner Home Furnishings, Inc.	$ 804
Sauder Woodworking Company	$ 635
Ethan Allen Interiors, Inc.	$ 571
Dorel Industries, Inc.	$ 528
BerklineBenchCraft, LLC	$ 466
Lacquer Craft, Inc.	$ 451
Flexsteel Industries, Inc.	$ 369

Source: Company records.

Exports are not a major factor in the U.S. household wood furniture industry. However, imports, notably bedroom furniture from Asia, represent about 30 percent of industry sales. Also, many U.S. furniture manufacturers now outsource their furniture manufacturing. Imports have driven down furniture prices by as much as 30 percent in some furniture categories. U.S. furniture manufacturers have downsized significantly, closing more than 100 domestic furniture manufacturing plants between 2000 and 2007.

Consumer Expenditures for Furniture

Consumer spending for wood furniture is highly cyclical and closely linked to the incidence of new housing starts, consumer confidence, and disposable personal income. Because wood furniture is expensive and often sold in sets, such as a dining room table and chairs, consumers consider these purchases deferrable.

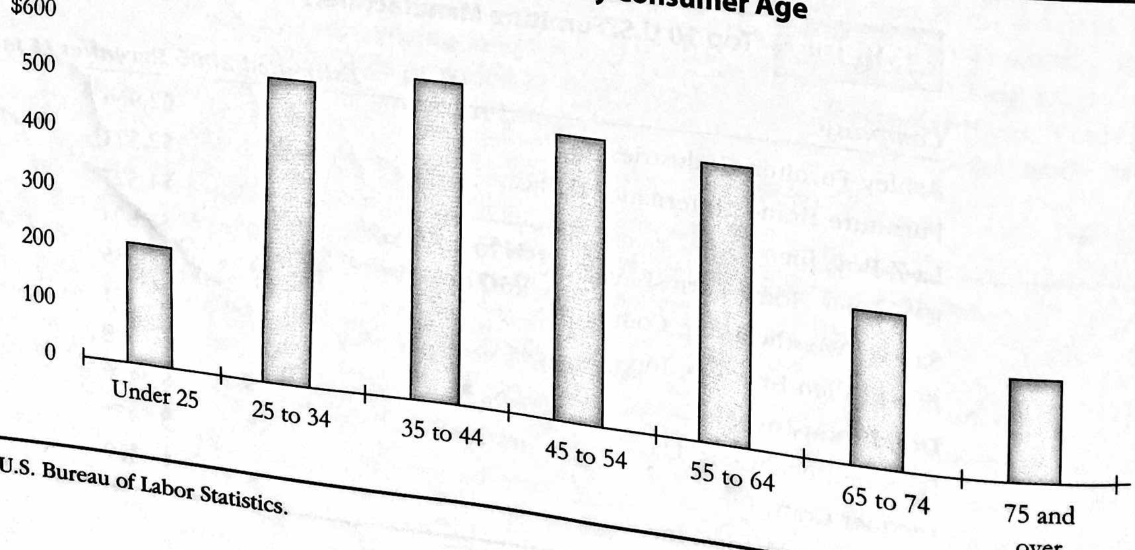
Expenditures for furniture of all kinds have fluctuated as a percentage of consumer disposable personal income. The most recent estimate is that about 1 percent of a U.S. household's disposable income is spent for household furniture and home furnishings. Furniture sales also vary by age. Exhibit 4 shows the average annual furniture expenditures by consumer age.

Furniture-Buying Behavior

Even though industry research indicates many consumers consider the furniture shopping process to be enjoyable, consumers acknowledge that they lack the confidence to assess furniture construction, make judgments about quality, and accurately evaluate the price of furniture. Consumers also find it difficult to choose among the many styles available, fearing they will not like their choice several years later or that their selection will not be appropriate for their home and they will be unable to return it. According to a recent summary of furniture-buying behavior published in *Standard & Poor's Industry Surveys*:

> Consumers are quite finicky when it comes to buying furniture—a procedure fraught with concerns that are often not associated with buying other consumer

EXHIBIT 4 **Average Annual Furniture Expenditures by Consumer Age**



Source: U.S. Bureau of Labor Statistics.

durables, such as appliances and cars. With appliances and cars, consumers may have a more limited selection, they can do their own research, and they know what they are buying and what to expect.

On the other hand, most consumers know little about evaluating the price or quality of furniture. It is also difficult for consumers to imagine how furniture will look in their homes, or whether they will still like their purchase in several years. Furthermore, there are questions about delivery—as in whether the item will arrive on time and in good condition and whether it can be returned for a full refund.

The furniture industry's efforts to educate consumers over the past years have failed for the most part. These efforts have included in-depth market studies to learn what consumers look for when they buy furniture, improved distribution, and new programs for training sales personnel. Despite these efforts, consumers still find the quality of furniture difficult to discern, and tend to base their furniture choice on price.

Results of a consumer panel sponsored by *Better Homes and Gardens* and composed of its subscribers provide the most comprehensive information available on furniture-buying behavior. Selected findings from the *Better Homes and Gardens* survey are reproduced in the appendix following this case. Other findings arising from this research are as follows:

- 94 percent of the subscribers enjoy buying furniture somewhat or very much.
- 84 percent of the subscribers believe "the higher the price, the higher the quality" when buying home furnishings.
- 72 percent of the subscribers browse or window-shop furniture stores even if they don't need furniture.
- 85 percent read furniture ads before they actually need furniture.
- 99 percent of the subscribers agree with the statement "When shopping for furniture and home furnishings, I like the salesperson to show me what alternatives are available, answer my questions, and let me alone so I can think about it and maybe browse around."
- 95 percent of the subscribers say they get redecorating ideas or guidance from magazines.
- 41 percent of the subscribers have requested a manufacturer's booklet.
- 63 percent of the subscribers say they need decorating advice to "put it all together."

Consumer research data have prompted both furniture retailers and manufacturers to stress the need for well-informed retail sales personnel to work with customers. For example, many manufacturers have established education centers where they train retail salespersons in the qualitative and construction details of the furniture they sell. Some manufacturers also distribute product literature to customers via retailers.

Distribution

Furniture is sold through over 100,000 specialty furniture and home furnishing stores, department stores, and mass-merchandise stores in the United States. Specialty furniture and home furnishing stores account for 68 percent of retail sales. Industry trends indicate that the number of independently owned furniture stores has declined while furniture store chains have grown. The top 10 furniture retailers in the United States captured approximately 26 percent of total U.S. furniture of retail sales, followed by Rooms To Go, and Ikea. Ashley Furniture HomeStores is the largest furniture retailer in terms of retail sales.

Furniture manufacturers have eschewed the Internet as a sales channel for the most part. Smaller manufacturers consider the up-front cost to build a Web site coupled with the ongoing cost to maintain a furniture Web site to be prohibitive. Also the costs of delivering and returning heavy items are a concern. These costs, plus the limited success of Internet furniture retailers, have led some larger manufacturers to instead build and operate promotional Web sites at roughly half the cost. These Web sites feature new styles and list retailer locations that sell their products. Examples of these Web sites are drexelheritage.com and thomasville .com. Ethan Allen is an exception. As a vertically integrated furniture manufacturer that sells exclusively through company-owned and franchised stores, Ethan Allen sells selected furniture and accessories at its ethanallen.com Web site.

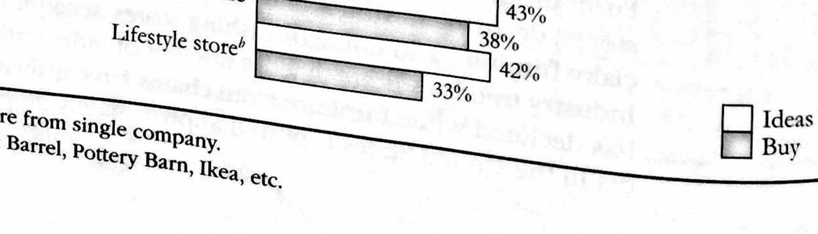
A significant trend among furniture retailers is the movement toward the "gallery concept"—the practice of dedicating an amount of space in a store and sometimes an entire freestanding retail outlet to one furniture manufacturer. Freestanding retail outlets that carry one manufacturer's products are called single-vendor stores. An example is Bassett Furniture Direct. There are currently 11,000 galleries, and it is estimated this number will reach 12,500 by 2007. Commenting on the gallery concept, Charlton Bates said:

> The gallery concept has great appeal for a furniture manufacturer, since product is displayed in a unique and comfortable setting without the lure of competitive brands. We have galleries in a small number of our furniture stores. The fact that we are not getting our full line in all of our retailers galls me because the opportunity to even discuss the gallery concept with many of our retailers doesn't exist.

Bates added: "Galleries and upscale furniture and department stores attract and serve our target customer, the 40- to 59-year-old homeowner with an annual household income over $100,000. That's where our customers get ideas and buy the quality furniture we sell" (see Exhibit 5).

The selling of furniture to retail outlets is centered on manufacturers' expositions held at selected times and places around the country. The major expositions occur in High Point, North Carolina, in October and April. Regional expositions are also scheduled during the June–August period in locations such as Los Angeles, New York, and Boston. At these *marts*, as they are called in the

EXHIBIT 5 Furniture Retailers That Upscale Shoppers (Household Income $100,000 and Up) Have Used for Ideas and Where They Buy



[a]Furniture from single company.
[b]Crate & Barrel, Pottery Barn, Ikea, etc.

furniture industry, retail buyers view manufacturers' lines and often make buying commitments for their stores. However, Haverwood's experience has shown that sales efforts in the retail store by company representatives account for as much as one-half of the company's sales in any given year.

Advertising Practices

Manufacturers of household furniture spend approximately 3.5 percent of annual net sales for advertising of all types (consumer, trade, and cooperative advertising). This percentage has remained constant for many years. The typical vehicles used for consumer advertising are shelter magazines such as *Better Homes and Gardens, Martha Stewart Living House Beautiful,* and *Southern Living*. Trade advertising directed primarily toward retailers includes brochures, point-of-purchase materials to be displayed on a retailer's sales floor, and technical booklets describing methods of construction and materials. Cooperative advertising, shared with retailers, usually appears in newspapers, but there are also some television and radio spots featuring the brands carried by retailers.

THE BUDGET MEETING

At the January 9 meeting attended by Hervey and Bernham executives and Haverwood executives, Michael Hervey proposed that the expenditure for consumer advertising be increased by $225,000 in 2008. Cooperative advertising and trade advertising allowances would remain at 2007 levels. Hervey further recommended that shelter magazines account for the bulk of the incremental expenditure for consumer advertising.

John Bott, Haverwood's vice president of sales, disagreed with the budget allocation and noted that sales expenses and administration costs were expected to rise by $65,000 in 2008. Moreover, Bott believed that an additional sales representative was needed to service company accounts because 50 new accounts were being added. He estimated that the cost of the additional representative, including salary and expenses, would be at least $70,000 in 2008. "That's about $135,000 in additional sales expenses that have to be added into our promotional budget for 2008," Bott noted. He continued:

> We recorded sales of $75 million in 2007. If we assume a 4 percent increase in sales in 2008, that means our total budget will be $3,975,000, if my figures are right—a $147,000 increase over our previous budget. And I need $135,000 of that. In other words, $12,000 is available for trade promotion, to assist our salespeople servicing new accounts.

Hervey's reply to Bott noted that the company planned to introduce several new styles of living room and dining room furniture in 2008 and that these new items would require consumer advertising in shelter magazines to be launched successfully. He agreed with Bott that increased funding of the sales effort might be necessary and thought that Haverwood might draw funds from cooperative advertising allowances and trade promotion.

Bates interrupted the dialogue between Bott and Hervey to mention that the $225,000 increase in promotion brought the budget up to the 5 percent percentage-of-sales policy limit. He pointed out, however, that higher material costs, pricing pressure, and a recent wage increase were forecasted to squeeze Haverwood's gross profit margin and threaten the company objective of achieving a 5 percent net profit margin before taxes. "Perhaps some juggling of the figures is necessary," he concluded. "Both of you have good points. Let me think about what's been said and then let's schedule a meeting for a week from today."

As Bates reviewed his notes from the meeting, he realized that the funds allocated to promotion were only part of the question. How the funds would be allocated within the budget was also crucial. A call to Tom Berry might be helpful in this regard, too.

APPENDIX: SELECTED FINDINGS FROM THE *BETTER HOMES AND GARDENS* CONSUMER PANEL REPORT—HOME FURNISHINGS[2]

Question: If you were going to buy furniture in the near future, how important would the following factors be in selecting the store to buy furniture? (Respondents: 449)

Factor	*Very Important*	*Somewhat Important*	*Not Too Important*	*Not at All Important*	*No Answer*
Sells high-quality furnishings	62.6%	31.0%	3.8%	1.1%	1.5%
Has a wide range of different furniture styles	58.8	29.2	8.2	2.9	0.9
Gives you personal service	60.1	29.9	7.8	0.9	1.3
Is a highly dependable store	85.1	12.7	1.1	–	1.1
Offers decorating help from experienced home planners	26.5	35.9	25.4	10.9	1.3
Lets you "browse" all you want	77.1	17.8	3.3	0.7	1.1
Sells merchandise that's a good value for the money	82.0	15.6	0.9	0.2	1.3
Displays furniture in individual room settings	36.3	41.2	18.7	2.4	1.3
Has a relaxed, no-pressure atmosphere	80.0	17.1	1.6	–	1.3
Has well-informed salespeople	77.5	19.8	1.6	–	1.1
Has a very friendly atmosphere	68.2	28.1	2.4	–	1.3
Carries the style of furniture you like	88.0	10.0	0.9	–	1.1

[2]Reprinted courtesy of the *Better Homes and Gardens* Consumer Panel.

Question: Please rate the following factors as to their importance to you when you purchase or shop for case-goods furniture, such as a dining room or living room suite, *1* being the most important factor, *2* being second most important, and so on, until all factors have been rated. (Respondents: 449)

Factor	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*No Answer*
Construction of item	24.1%	16.0%	18.5%	13.1%	10.5%	6.9%	4.9%	1.6%	0.2%	1.1%	3.1%
Comfort	13.6	14.7	12.9	12.3	12.7	10.9	8.2	4.5	4.0	2.4	3.8
Styling and design	33.6	19.8	11.1	9.6	4.7	7.3	4.5	1.6	2.9	1.6	3.3
Durability of fabric	2.2	7.6	9.8	14.5	15.1	14.7	12.9	5.6	5.8	7.8	4.0
Type and quality of wood	10.9	17.8	16.3	15.8	14.7	5.8	5.3	3.1	4.9	2.0	3.4
Guarantee or warranty	1.6	3.8	1.6	5.3	8.7	10.0	13.8	25.2	14.5	11.1	4.4
Price	9.4	6.2	8.7	8.5	10.0	12.5	14.2	11.8	6.9	8.0	3.8
Reputation of manufacturer or brand name	6.2	3.6	4.7	5.6	6.2	6.2	12.7	17.1	22.7	11.6	3.4
Reputation of retailer	1.6	1.8	1.6	2.4	4.0	7.3	7.4	13.6	22.0	34.5	3.8
Finish, color of wood	4.7	7.6	10.2	8.0	8.9	13.4	10.7	10.0	10.2	12.7	3.6

Question: Below is a list of 15 criteria that may influence what furniture you buy. Please rate them from *1* as most important to *5* as least important. (Respondents: 449)

Criterion	*1*	*2*	*3*	*4*	*5*	*No Answer*
Guarantee or warranty	11.4%	11.1%	26.3%	16.9%	5.3%	29.0%
Brand name	9.1	6.5	14.3	25.6	11.6	32.9
Comfort	34.7	27.8	14.5	8.5	4.7	9.8
Decorator suggestion	4.0	2.4	2.7	8.2	44.8	37.9
Material used	14.9	24.1	14.9	13.4	6.2	26.5
Delivery time	0.7	0.5	1.3	2.9	55.2	39.4
Size	7.6	10.7	13.6	30.9	4.0	33.2
Styling and design	33.4	17.8	21.8	13.6	2.2	11.2
Construction	34.3	23.6	13.1	11.4	2.9	14.7
Fabric	4.0	25.6	24.9	14.0	4.5	27.0
Durability	37.0	19.4	13.6	6.9	4.9	18.2
Finish on wooden parts	5.8	14.7	16.7	10.7	16.7	35.4
Price	19.4	21.8	16.0	10.9	15.4	16.5
Manufacturer's reputation	4.2	9.1	15.4	22.9	14.3	34.1
Retailer's reputation	2.2	4.7	10.5	21.2	26.5	34.9

Question: Listed below are some statements others have made about shopping for furniture. Please indicate how much you agree or disagree with each one. (Respondents: 449)

Statement	***Agree Completely***	***Agree Somewhat***	***Neither Agree nor Disagree***	***Disagree Somewhat***	***Disagree Completely***	***No Answer***
I wish there were some way to be really sure of getting good quality in furniture	61.9%	24.7%	4.7%	4.2%	3.6%	0.9%
I really enjoy shopping for furniture	49.2	28.3	7.6	9.8	4.2	0.9
I would never buy any furniture without my husband's/wife's approval	47.0	23.0	10.9	9.8	7.1	2.2
I like all pieces in the master bedroom to be exactly the same style	35.9	30.7	12.7	11.1	7.6	2.0
Once I find something I like in furniture, I wish it would last forever so I'd never have to buy again	36.8	24.3	10.0	18.9	9.1	0.9
I wish I had more confidence in my ability to decorate my home attractively	23.1	32.3	12.5	11.6	18.7	1.8
I wish I knew more about furniture styles and what looks good	20.0	31.0	17.1	13.4	16.7	1.8
My husband/wife doesn't take much interest in the furniture we buy	6.5	18.0	12.3	17.8	41.4	4.0
I like to collect a number of different styles in the dining room	3.3	10.5	15.2	29.8	38.3	2.9
Shopping for furniture is very distressing to me	2.4	11.6	14.3	18.0	51.9	1.8

Question: Listed below are some factors that may influence your choice of furnishings. Please rate them with *1* being most important, *2* being second most important, and so on, until all factors have been rated. (Respondents: 449)

Factor	***1***	***2***	***3***	***4***	***5***	***No Answer***
Friends and/or neighbors	1.3%	16.9%	15.8%	22.1%	41.7%	2.2%
Family or spouse	62.8	9.4	14.3	9.8	2.0	1.7
Magazine advertising	16.3	30.3	29.6	17.6	4.2	2.0
Television advertising	1.1	6.7	14.7	32.5	42.3	2.7
Store displays	18.9	37.2	22.1	14.0	5.6	2.2

Question: When you go shopping for a *major piece* of furniture or smaller pieces of furniture, who, if anyone, do you usually go with? (Respondents: 449—multiple responses)

Person	***Major Pieces***	***Other Pieces***
Husband	82.4%	59.5%
Mother or mother-in-law	6.2	9.1
Friend	12.0	18.9
Decorator	4.2	1.6
Other relative	15.6	15.4
Other person	2.9	3.3
No one else	5.1	22.3
No answer	0.9	3.1

Question: When the time comes to purchase a *major* item of furniture or other smaller pieces of furniture, who, if anyone, helps you make the final decision about which piece to buy? (Respondents: 449—multiple responses)

Person	***Major Pieces***	***Other Pieces***
Husband	86.0%	63.5%
Mother or mother-in-law	2.4	4.5
Friend	3.6	8.0
Decorator	3.1	2.7
Other relative	10.0	12.9
Other person	1.6	1.8
No one else	7.1	24.3
No answer	0.9	2.2