

# Western Cabinets – Building a Cabinet or Building a Transformation?

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## INTRODUCTION

“How can I transform the company?” This was the main question occupying the mind of Mr. Smith, who became the CEO of Western Cabinets following the death of the founder in 2007. Not long after assuming office, Mr. Smith felt that the company was at a crossroads but was unsure as to whether it required a change in the business model/strategy or simply better execution. Mr. Smith has observed a number of issues – strategic, operational, personnel, financial, and control; he is keen on finding both short-term and long-term solutions.

Western Cabinets, founded in 1980 by cabinetmaker Sam Dod, manufactures and installs high-quality cabinets in residential homes and condominiums. (See Appendix 1 for the mission and vision of the company.) Sales are predominantly made directly to the homeowner or through contractors who are either renovating or building new homes. By 2009 Western Cabinets’ revenues had grown to \$60 million and it had more than 300 employees. Growth was primarily achieved through expansion by adding showrooms in each major city in western Canada.

## EXTERNAL ENVIRONMENT

The industry is best described as fragmented, with the major players in the industry as follows:

1. Big box store retailers (e.g. IKEA, Home Depot)
2. Large cabinet manufacturers

3. Medium cabinet companies (Western Cabinets)
4. Micro cabinet companies

Mr. Smith believes that competition is getting tougher and is eroding margins and profits. On the one hand, big box stores such as Ikea and Home Depot offer cabinets at very low prices, and their ability to offer customized solutions is improving. For example, Ikea has recently offered a modularized cabinet solution that customers can design on its website. Moreover, the big box stores and large manufacturers have the ability to achieve economies of scale through forming strategic alliances with key suppliers, thereby significantly lowering their costs. Still, their ability to customize and offer unique solutions is not as good as the medium cabinet companies, but this is improving as they invest in technologies to link customer choice with manufacturing flexibility. One notable trend is the increase in imports coming from China. The cost of the Chinese cabinets is low, but there have also been quality issues with the products. Product imported from China is also difficult to customize and is more appropriately suited for the basic cabinet product lines. Big box stores experience warranty and customer satisfaction issues as the existing modularized products don’t completely match the customer’s expectations. The relationships between big box stores and their suppliers (including large manufacturers) can be strained as both parties point the finger at each other and neither wants to deal with the dissatisfied customer or bear the cost of warranty. The big box stores and large manufacturers are relatively stable, in that new entrants have not surfaced in that industry segment over the past few years and future new

entrants are unlikely. Approximately one-third of the industry revenue is generated through this segment.

At the other end of the competitive spectrum are the micro cabinet companies that primarily consist of independent carpenters who build customized cabinets out of small shops or at the customer's site, with virtually no overhead. They may have a few employees but typically exist as a sole proprietor business. They can offer some degree of customization through the "hands-on" craftsmanship, but they often do not have access to all of the raw materials sourcing that even medium firms like Western Cabinets do. They have limited ability to produce, given their capacity constraints, and are often noted as being slow to deliver and lacking professionalism. The trend, however, is that micro cabinet makers are beginning to have the ability to produce more customized cabinets and have access to alternative sources of supply through the internet. They also enjoy the benefits of technology advances in the tools they use. The number of micro cabinet companies in the industry varies with the economic cycle. When the economy grows, the number of micro cabinet companies increases because carpenters are attracted to the industry and there are few barriers to entry. As the economy cycles downward and demand falls, some micro cabinet companies close their operations because exiting the industry is also easy. The micro cabinet companies represent approximately 20% of the industry.

The remainder of the industry is occupied by the medium-sized companies like Western Cabinets. Most small to medium-sized companies started as micro cabinet companies and grew over the years. In the cities in which it operates, Western is one of the larger firms; typically there are two or three other medium-sized firms that Western Cabinets competes with. Each of the competitors generally has customers and value chains similar to Western's. Competition among the medium-sized cabinet companies is fierce, with the continuing theme of increased customization at lower cost. The competitive forces of cost and customization appear to be dominant no matter what geographic region or product line Western expands into. Nonetheless, it has maintained a decent reputation with respect to its core value drivers: customer service, lead time of cabinets (the time between when a customer initiates a design to the final step), servicing for warranty, quality, and operational efficiency. Mr. Smith feels that other medium-sized cabinet companies face structural issues similar to Western's, and he is positive that all of these companies still orient their business around the manufacturing of the cabinets as opposed to a more customer-centric business model. There has been some consolidation of medium-sized

companies over the years, as firms try to create economies of scale, but eventually—whether growth is created through acquisition, organically, or through expansion—the dominating market forces of increased customization at lower cost seem to prevail. The economy recently turned recessionary, but there are signs the economy may now be in a recovery mode. The president is now asking a fundamental question: Should Western Cabinets alter its business model and strategy, or should it just execute better?

## THE VALUE CHAIN

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The current value chain of the company consists of six steps (see Appendix 2), described below.

### RESEARCH AND DEVELOP NEW CABINETS

The research and development (R&D) team, consisting of five full-time equivalents (FTEs), researches cabinet trends in the marketplace, surveys customers, and designs new cabinet products. The R&D personnel are also responsible for making design adjustments to existing cabinets, to ensure that a quality product can be manufactured by Western Cabinets. For example, if warranty or high manufacturing costs are continually occurring for a specific product line, the R&D team investigates how the cabinet design could be amended to manufacture the product more effectively. Mr. Smith's preliminary assessment is that the R&D team spends the majority of its time making adjustments to the existing product line.

### DESIGN CABINETS FOR CUSTOMERS

This process begins with the customer visiting a showroom. Customers may be renovating a kitchen or installing a kitchen in a new home. Alternatively, the customer may be a contractor building a new home or renovating an existing one; in many situations the contractor represents the homeowner. Regardless, the customer can choose from a variety of cabinets, ranging from basic low-cost cabinets to more customized higher-cost ones. The most significant driver of the product mix has traditionally been the economic cycle. In economic downturns, renovations and low-cost cabinets are popular, and in economic upswings, new homes and customized cabinets are popular. Mr. Smith feels that Western has followed a reactive approach to the product mix, meaning the business model has really focused on manufacturing products that are in demand by customers.

The showrooms have a number of cabinet displays that customers can view to assist in the selection process. Upon selection of the base model, customers can select the add-

ons and discuss any customization with the salespeople, who are also designers. Finalizing the customer specifications may take anywhere from just two or three hours for the basic cabinets to as much as two days for the customized ones—e.g. curved cabinet with a hand-painted finish and built-in lighting. There are approximately 35 designers located throughout the showrooms in the western Canadian cities. Some designers focus exclusively on homeowners, while others have specific contractor accounts. According to Mr. Smith, the contractor is an important customer segment because the contractor can influence the homeowner's choice. For that reason, he believes that it is important for Western's salespeople to enhance and maintain their relationships with contractors.

Mr. Smith's assessment is that the focus of designers is predominantly on designing the cabinets, exemplified by the fact that many of the designers used to work in manufacturing or research and development. He has seen a few designers who appear to have developed a more customer-centric focus, making house visits and interior design recommendations for customers. From a value perspective, Western does not charge the customer for the design; however, there is certainly value created at this stage that is captured in the final price of the cabinets. Basic cabinets that do not require sophisticated design or designer involvement have lower prices, whereas high-end customized cabinets that require greater designer effort have higher prices. Mr. Smith is wondering if there is not a further "untapped" value component where the product offering is more innovative (e.g. Bluetooth technology embedded in the cabinets, sound systems and video systems built into cabinets, incorporating hologram and LCD screen technology – see Appendix 3) and the designer engages with the customer at higher level (e.g., designer becomes an interior decorator for the end customer or project manager for contractors to coordinate multiple trades in the home-building process). Overall though, he has been somewhat frustrated because getting good information, such as customer profitability, customer behavior information, and sales statistics, is difficult with Western's existing information systems.

## ORDER ENTRY

The next step in the value chain is order entry, where nine FTEs key the specifications of a customer order into the information system. This step is critical because customers' preferences, as understood by designers in the previous step, are translated into manufacturing codes. This may take anywhere from two hours for simple cabinets to up to three days for the more complex ones. Accuracy of data entry is important in order to eliminate the manufacture of cabinets that do not

meet customer needs. Ensuring accuracy often requires the order entry staff to dialogue with designers to correctly capture the intricate needs of customers, especially on the complex cabinets. Mr. Smith feels that the order entry function is very administration-oriented and sometimes duplicative in nature; however, he also noted that order entry staff often finds errors that could have been costly downstream.

## MANUFACTURE CABINETS

Once the order is generated in the information system, it is scheduled for production. Although Western uses a certain level of automation, it is not comparable to the level of automation that large manufacturers use. Cost and space are major constraints with respect to the level of automation. Wood and paint account for 60% of the manufacturing costs. Currently Western does not have the buying power to negotiate costs with suppliers, largely due to the use of numerous suppliers and small order quantities. This makes the procurement process both cumbersome and inefficient. Similarly, the other support functions of scheduling, warehousing, and inventory management are also inefficient, primarily because these were developed over the years in an uncoordinated manner.

The remaining 40% of the costs account for labor and overhead, which are largely fixed costs. Manufacturing accounts for 120 FTEs, of which 110 are directly involved with production. Mr. Smith feels that such a large portion of fixed cost can prove to be costly to the company, especially during slow periods. Moreover, any price drop to increase sales volume can prove costly due to the low margins and high fixed costs.

## DELIVERY AND INSTALLATION

Finished cabinets are delivered and installed by one of Western's 25 experienced installers. The cabinet price includes delivery and installation, and varies depending upon the installation complexity that the designer anticipates based on his or her judgment. Installation is an important step in the value chain because the customer can directly interact with the installer and also observe the installation process. A bad experience with the installer or perceived quality of installation often leads to customer complaints. This is also the stage when the customer actually sees the completed cabinet and makes an assessment of whether it matches with the specifications, which can determine the customer's satisfaction level.

According to Mr. Smith, this step of the value chain can significantly impact the reputation of the company. Although he believes that the installation process is working well, he

recognizes that the installers have had a long tradition of working independently. He also wonders if there is not a greater value opportunity for the installation process wherein installers could become more professional and take on the role of a project manager to include plumbing, flooring, and other aspects of home-building. This expanded role might be more attractive to contractors as it partially relieves them from taking on the coordination role.

## **FOLLOW-UP WITH CUSTOMER AND WARRANTY THE CUSTOMER**

This step in the value chain involves three FTEs and essentially is comprised of ensuring that the job is completed to the satisfaction of the customer. As an example, the installer will call the customer service team if a component of the cabinet is missing from the package. Mr. Smith feels that this step is reactive as opposed to being proactive; it exists to resolve customer complaints rather than to anticipate problems and deal with them before the fact. He is not surprised, however, because the company is still about transforming wood into a cabinet.

## **ADMINISTRATION**

The administrative team consists of 15 FTEs, including the president, vice-presidents (VPs) of marketing and finance, plant manager, human resources manager, information technology manager, and three store managers, who are members of the management team. The remaining six employees are spread throughout the organization in various supporting roles. Although the composition of the administrative function is adequate, there may be a need to shift the resources across the supporting roles, depending on any changes to the company's direction.

## **MANAGEMENT CONTROL ENVIRONMENT**

The founder, Sam Dod, died in 2007, following which Mr. Smith was hired as the CEO, along with a management team consisting of qualified professionals. Sam was directly involved in the day-to-day operations and knew each of his employees by name. In contrast, Mr. Smith prefers a much more professional approach to management.

With respect to internal operations, Mr. Smith observed as follows: "I am trying to change the culture, because the old culture was centered on the founder, Sam Dod. Sam was everywhere and spent a significant amount of time talking and motivating employees. I am trying to implement more business processes and controls. I want to run Western Cabinets like a business, not a micro cabinet company. To

be honest, though, I think some employees have lost the passion and wonder where Western Cabinets is going. We also have a significant number of new employees because of the staffing changes we made and the tight labor market. We now have a mix of experienced and inexperienced employees, which impacts efficiency. This has led to a mix of behavioral issues such as work ethic and proper conduct in the workplace."

Mr. Smith also commented on performance and accountability. "I am really trying to promote accountability across the organization. I implemented a bonus program based on organizational performance; however, individual performance varies across the organization. I have tried to standardize practices and set targets for most positions, but the reality is that some designers sell twice as many cabinets as others. Often our top sellers bypass established procedures to speed up quotes to customers. The plant manager states that customer complaints and warranty issues are often a result of a problem with the design, not how the cabinets were built. The install manager's main complaint is that there is a lack of communication between the designers, the plant, and the installers. To address the lack of communication, the previous management invested \$2,000,000 in an enterprise resource planning system two years ago; however, it failed miserably, and we are now left with antiquated legacy systems. The technology investments and the economic cycle have put cash flow pressures on us."

Finally, Mr. Smith talked about planning and budgeting. "I also introduced a budgeting process to increase accountability and control. There have been complaints that the budget doesn't really inform management on the key value drivers: customer service, lead time of cabinets, quality, and operational efficiency. Our managers also complain that the budgeting process is labor-intensive, untimely, and doesn't contribute to Western Cabinets' understanding the risks in its external environment. We also are trying to tighten control by limiting the number of people who have the authority to purchase. Materials are our biggest expenditure, and we feel that there is substantial potential for savings in the supply chain."

## **A POTENTIAL BUSINESS MODEL**

The company appears to be squeezed between the big box stores and the micro cabinet businesses. Mr. Smith feels that simply fixing control issues may not help the organization grow. "I know we have execution issues, but I am leaning towards revamping Western Cabinets' business model. I am rethinking the company not only from a traditional 'low

cost vs. differentiation' strategic decision, but rethinking the entire business model and challenging how the company creates value. For 30 years this company has been about the wood. I don't know if we should be about the wood anymore. I think value creation is about solving the customer's problem. For the customer, the problem isn't that they need a cabinet; the problem is much more holistic. For example, the kitchen may be the solution to web-enabling a sound system, an internet system, or an integrated appliance offering. The kitchen becomes the central hub for all technology and entertainment home investments. Cabinets become 'wired' to enable customer solutions across an array of technology and entertainment issues. As a 'problem solver,' Western Cabinets should de-emphasize manufacturing to the point of questioning whether Western Cabinets should even be involved in manufacturing. Value creation would occur at the design stage as the designer solves the customer's problem. I envision customer site visits with 3D virtual technology to illustrate the possibilities of embedding solutions into the cabinets (e.g. Bluetooth, wireless, technology consoles, and sound systems – see Appendix 3). The question is not a strategic one positioned by a low cost/differentiation model. In fact, standardized solutions could be manufactured, either by Western Cabinets or outsourced, for the most common customer problems. The fundamental question is, 'What is our optimal business model and how is value created?'"

Mr. Smith picked up his can of Coke, looked across the plant floor, and wondered, "How should I transform this company? How can I make it happen?"

## QUESTIONS

### PART 1 – ASSESSING THE "AS IS" ENVIRONMENT

1. Assess the external environment of Western Cabinets.
2. Assess the internal issues at Western Cabinets.
3. What is Western Cabinets' business model and strategic position?

### PART 2 – DEVELOPING THE APPROPRIATE BUSINESS MODEL AND STRATEGY

1. What do you think of Mr. Smith's idea to create a new business model? Why?
2. What do you think Western Cabinets should do strategically? From a business model perspective? Why?
3. Do you think the fundamental issue is strategic, business model, or execution?

### PART 3 – EXECUTING USING THE APPROPRIATE MANAGEMENT CONTROL SYSTEMS

1. Give advice to Mr. Smith on how you would change the management control systems to improve execution.
2. How would you use technology to support your chosen business model/strategy or support strategic execution?

## APPENDIX 1: MISSION AND VISION

### MISSION STATEMENT

Our mission will be to create superior cabinetry, provide excellent customer service, and foster employee success.

### VISION STATEMENT

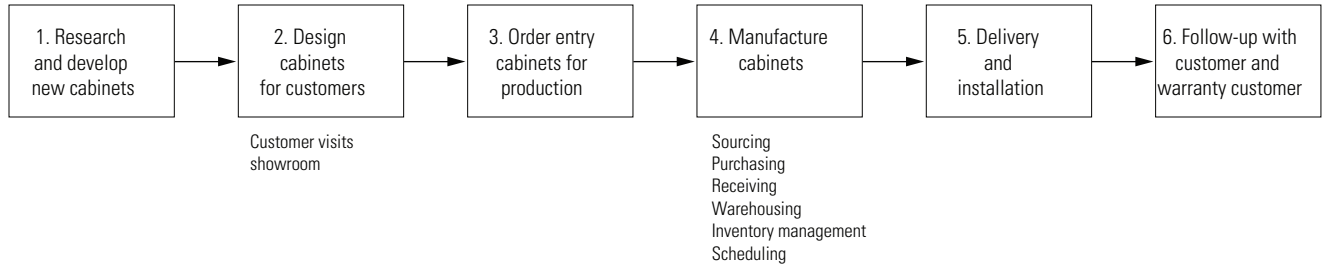
We will be the most respected cabinet manufacturer in North America. We will create cabinetry that our customers will be proud to have in their homes. Our team will realize these goals in an environment that promotes integrity, and rewards hard work and dedication.

### ABOUT IMA

With a worldwide network of more than 65,000 professionals, IMA is the world's leading organization dedicated to empowering accounting and finance professionals to drive business performance. IMA provides a dynamic forum for professionals to advance their careers through Certified Management Accountant (CMA®) certification, research, professional education, networking and advocacy of the highest ethical and professional standards. For more information about IMA, please visit [www.imanet.org](http://www.imanet.org).



## Appendix 2 Value Chain



## Appendix 3 Pictures



Left: "Small business (independent contractor)" approach to manufacturing. Right: Western Cabinets' automated approach.



Examples of Western Cabinets' prototype Bluetooth and hologram technology.