

## CHALLENGES AND PROSPECTS FOR THE BUILDING MATERIALS INDUSTRY IN CANADA

### Introduction

The building materials industry is an important contributor to the Canadian economy. Canada's domestic building materials industry contributed over \$24 billion or 3.5 percent of Canada's total Gross Domestic Product in 1995, including direct, indirect and induced effects<sup>1</sup>. In addition to its economic significance, the building materials industry also makes a major contribution to the quality of housing in Canada.

The industry is composed of a wide variety of companies that make a vast array of products used in both residential and nonresidential construction. Although their products may differ, the companies typically face many of the same pressures and constraints:

- they are dependent on the same source of demand (residential and nonresidential construction);
- they are subject to the same regulatory constraints (building codes and standards);
- they are exposed to shifts in demand for their products from constantly evolving building technologies and practices; and
- they operate within the same, increasingly competitive, global marketplace.

During the period 1990 to 1996, the building materials industry had to cope with a variety of pressures, not least reduced volumes of demand from both residential and nonresidential construction. However, the industry adjusted, partly with the assistance of a lower Canadian dollar, and became much more competitive internationally. Building material exports increased significantly over the period: wood product exports rose from \$9.6 billion (1996\$) to \$14.2 billion, and exports of other building products doubled from \$1.2 billion to \$2.4 billion. With the upturn in construction activity in Canada, the industry is optimistic about its long-term future; however, significant challenges remain.

This study was commissioned by Canada Mortgage and Housing Corporation (CMHC) and the Canadian Home Builders' Association (CHBA) to provide insight into factors that influence Canada's building materials industry, and the challenges and prospects it faces.



The study examines trends, challenges and prospects in the overall building materials industry, as well as the following specific sub-industries:

- Gypsum wallboard
- Plumbing fixtures and fittings
- Windows and doors
- Roofing
- Insulation
- Heating and air conditioning
- Exterior cladding
- Flooring
- Concrete products
- Wood products

The findings of the study are based on an extensive consultation process undertaken in 1997 with industry representatives and a review of other information on industry trends and prospects.

## Findings

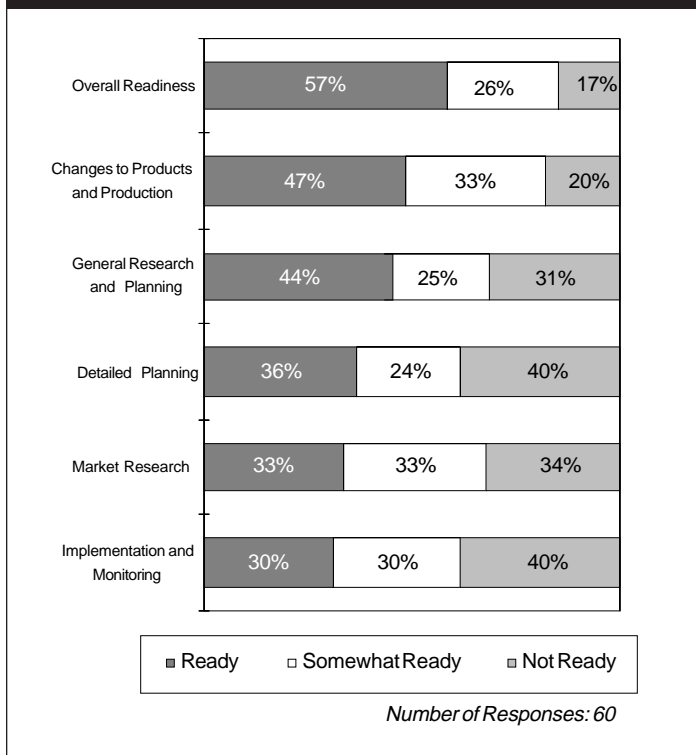
### Industry Views on Trends and Competitiveness

Building materials company representatives, in discussing industry trends and the international competitiveness of Canadian building materials companies, made the following points:

- Costs for both materials and labour are higher in Canada than for US manufacturers and other foreign competitors. Higher taxes and government-mandated costs were cited as major factors in this regard.
- Competition is increasing from both Canadian and foreign sources. Most companies believe they face increased competition, mainly from Canadian companies but also from foreign manufacturers.
- Margins narrowed during the mid-1990s. The companies indicated that wholesale prices did not keep pace with increases in production costs for most building materials, with the result that their profitability was reduced.

- The viability of firms in the industry has decreased. Over half of the companies believed that, due to reduced margins and intense competition, the viability of building materials companies declined over the period 1994 to 1997.
- Exchange rates were the most important factor leading to change in the industry. Most companies cited exchange rates as being a positive factor, much more important than other factors, such as trade agreements, global competition or corporate restructuring.
- Domestic regulations were the most commonly cited factor leading to negative changes in the industry.
- Investments in new plant and equipment, research and development (R&D), new product technologies and new products were being undertaken by most manufacturers.
- The largest investments were in new production technologies and new plant and equipment. Most building materials companies increased investments in these areas over the period 1994 to 1997. The incidence of these investments was greater for larger companies than for smaller ones: about 80 percent of firms with revenues of more than \$5 million had made such investments in the previous year.
- Most companies were satisfied with both their overall level of investment in new technology and in their use of new technology compared to foreign and Canadian competitors.
- Sales, particularly export sales, were increasing significantly: 86% of companies reported higher export sales compared to the late 1980s.
- Most of the companies believed that both they and their industries were poised for significant export growth (see figure); however, only 15 percent of firms responding to the survey considered themselves to be “completely ready” to take advantage of export opportunities.

**Figure 1: Company Readiness for Export Growth**



- Lack of personnel, high costs of market development and increased competition were the main barriers cited to growth in sales. All three of these problems were considered to be at least a moderate barrier to growth by more than half the companies. Other barriers (e.g., difficulty finding partners, lack of access to investment funds, lack of knowledge of opportunities, among others) were considered serious by some companies but were less important overall.

### Prospects

Most building materials companies were optimistic about the future. Rising domestic construction activity was expected to lead to higher sales, and most companies were actively pursuing export markets and with considerable success.

Profit margins were expected to improve, as more buoyant construction activity leads to higher sales and improved utilization of plant and equipment.

With higher demand for their products, some companies expected to be able to pass-through some of the increases in costs that they had previously had to

“swallow”. However, none of the building materials companies expected major price increases in building materials as there was adequate capacity to expand production to meet higher levels of demand for most products. Also, unless significant shortages occur, the threat of increased volumes of US imports was expected to dampen pressures to raise prices.

Building materials companies believed they could continue to be competitive in their main export markets (particularly the US), even with an increase in the value of the Canadian dollar. However, if the Canadian dollar were to rise above 80 US cents, many companies believed they would be significantly less competitive. Not only would exports be curtailed, but increased volumes of imports would put pressure on domestic Canadian building material prices.

### Challenges

The volatility of construction activity is clearly the main challenge for building materials companies. The resulting swings in sales volumes for building materials make business planning a major challenge. Due to the reduced volumes of construction activity during the 1990s, the Canadian market for building materials became highly competitive and, according to the companies involved in this study, prices did not keep pace with costs. To offset the volatile domestic market, most companies were actively pursuing export markets.

In addition, companies identified the following areas as significant challenges facing the Canadian building materials industry:

- Lack of consumer awareness of the price/quality tradeoff in their choice of building materials is a major problem. In most industries, there is a wide spectrum of product choices available to buyers, ranging from relatively inexpensive products that may perform poorly (and cost more in terms of energy or increased maintenance in the long term) to higher cost products that offer superior performance. Building product companies believe that many builders are substituting lower quality products in an effort to reduce costs. Many homeowners either are unaware of variations in the quality of products or are likewise driven mainly by considerations of cost. According to most companies, there is a need to educate builders, renovators and homeowners about the long-term costs of using inferior products.

When asked what they were doing to address this problem, the companies cited a variety of initiatives, including product labeling (e.g. with energy ratings), cooperative marketing with builders, attempts to market the building product company's reputation for quality products and industry-wide advertising. None of the companies indicated that they believed that they had successfully addressed the problem with the measures taken to date.

- Technological changes in both the building materials themselves and the processes to produce them are occurring continuously. Building materials have become more durable and energy efficient, and easier to install (being manufactured ready for use or requiring fewer steps in the installation process). At the same time, manufacturing processes have become more efficient and cost-effective as a result of innovations such as CAD/CAM and other new technologies. Many companies believe that ISO 9000 has helped to provide them with a competitive edge. In addition, because of environmental concerns, products used in construction tend to emit fewer harmful substances (e.g., formaldehyde), contain more recycled materials, use less embodied energy in the manufacturing process, and generate less waste both in manufacturing and in use than previously. Companies must maintain investments in R&D of new products to ensure that they remain competitive both in Canadian and export markets.
- Slow adoption of new products by the building industry, though the products may reduce costs or have superior performance, is a concern for many companies. Barriers include inertia on the part of builders and regulators (including inspectors) who often prefer a "tried and true" product or technique to risking problems with something new, no matter how promising it may appear. Despite their concerns in this regard, most companies also recognized the problem of product liability. The example of plastic furnace vents is often cited as a reason for the wariness of builders with respect to new products.
- The cost and time involved in obtaining approvals by materials evaluation agencies of new construction products and materials is an ongoing concern, as is confusion over the split between national and provincial jurisdictions.
- Changing codes and standards can have a significant effect on the demand for some products. Many companies expressed the view that authorities need to be more aware of the effects of changes in codes and standards on building practices and the products used in construction.
- Increased professionalism and continuing education among builders and renovators is seen as a means to encourage the adoption of new products and to promote the use of quality products, rather than simply those with the lowest cost. Consumer education on the value of selecting a builder or renovator on the basis of competence rather than simply cost is another key part of this puzzle. The building materials companies expressed strong support for current initiatives of the housing industry and CMHC in increasing the level of professionalism among builders and renovators.
- Increased trades training is a priority. The downturn in construction activity during the early 1990s, along with the aging of the construction work force, has led to a situation where many companies expect shortages of skilled trades. This could affect the demand for particular products and could cause shifts to other products or changes in the way buildings are constructed. The result could be buildings that may not perform as well. In addition, with shortages of skilled labour, installation quality may suffer, with follow-on problems for consumers and for builders and building materials companies trying to rectify problems.
- The move to "big box" retailers has created enormous opportunities and challenges for building materials companies. The strict requirements regarding bar-coding and delivery schedules are onerous and costly for companies to meet but are a necessary part of product distribution. Some companies consider meeting the strict requirements of big box retailers to be the most difficult (and important) challenge they face.
- Higher government-imposed costs in Canada than those faced by US competitors were a serious concern for most companies. Many simply expressed the wish that they be allowed to compete without the current heavy burden of government-imposed costs such as payroll taxes (employment insurance,

Canada Pension Plan, and provincial payroll taxes) and corporate and personal income taxes (which are significantly higher in Canada than in the US).

- Nonconforming products were a concern to some. While there are frequent complaints about the quality of some of the foreign products used in construction in Canada, according to many in the building materials industry, these concerns also apply to domestic products.
- While most companies were concerned about the costs associated with government regulation of building materials, most recognized the need to ensure that materials met minimum standards.
- Many companies expressed concerns about the level of taxes and charges that must be borne by the residential construction industry: this was seen as increasing the ultimate cost of housing and reducing the demand for new housing and hence for their products.
- Export market development is a key part of the strategy for growth for most building material companies, especially the larger ones. However, identifying opportunities and developing markets in other countries can be expensive and time-consuming. Many companies identified lack of personnel as a major barrier to expanding their markets. Most companies believe there is a continuing role for the government in export promotion and in working with the industry to identify and capitalize on opportunities. Many cited market development work in Japan as a model that is bearing fruit and should be replicated in other potential export markets.
- The harmonization of standards with those of the US and other export markets is important if Canadian products are to be recognized and useable in appropriate applications. Of course, harmonization will also expose Canadian building materials companies to competition from other countries; however, most consider this an acceptable price for enhancing access to foreign markets. The consolidation of North American markets is an accepted fact among building materials companies. In most cases, they are sufficiently confident of the ability of their products to compete if appropriate standards are applied.

The study includes analyses of trends, prospects and challenges for each of the ten building materials sub-industries.

## Notes

1. See *The Macroeconomic Impact of the Building Materials Industry in Canada*, CMHC research report PE0325.

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**Research Reports:** *Challenges and Prospects for the Building Materials Industry in Canada*

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A full report on this project is available from the Canadian Housing Information Centre at the address below.

### **Housing Research at CMHC**

Under Part IX of the National Housing Act, the Government of Canada provides funds to CMHC to conduct research into the social, economic and technical aspects of housing and related fields, and to undertake the publishing and distribution of the results of this research.

This fact sheet is one of a series intended to inform you of the nature and scope of CMHC's research.

The **Research Highlights** fact sheet is one of a wide variety of housing related publications produced by CMHC.

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