
Asian Rattan, Inc.¹

CEBU CITY, THE PHILIPPINES

Armand “Jun-Jun” Hernandez stood framed in the harsh tropical sunlight streaming through the door of his silent, unlit furniture factory. As he moved into the darkened factory building, he was taken aback by the scene that unfolded before his rapidly adjusting eyes. The ancient boiler that had fed the factory’s steam chamber was pitted and stained with rust from a hole in the roof above; the rattan poles stacked in the back were now mottled with mildew and mold; and everywhere the work tables, wooden jigs, finishing stations and other fixtures of the once busy factory were covered with a thick layer of dust and bound together by cobwebs. It had been more than a year since he had last walked onto this factory floor, ever since the National Labor Relations Board of the Philippine Department of Labor and Employment had sealed the factory pending resolution of the labor strike. After more than a year’s worth of acrimony and angry recriminations from both sides, a settlement had at last been reached between his company, Asian Rattan, Inc., and the KMU labor union negotiators. The agreement required Jun-Jun to pay each of his former workers a cash settlement, after which he would be free to restart his export furniture manufacturing operations with an entirely new work force, if he so desired.

Now as Jun-Jun inspected his derelict factory with its stilled machinery and workstations, he recalled the events that led up to the strike a year ago, and pondered what he could do differently to avoid repeating this

situation in the future. What had turned his once-tranquil and patrimonial relationship with his workers sour? What guarantees did he have that it would not happen again? His mind was filled with doubts as he considered the limited alternatives he faced regarding the possible resurrection of his once-thriving rattan furniture manufacturing business.

Asian Rattan and the Export Furniture Industry in the Philippines’ Cebu Province

Asian Rattan (AR) was one of the many small- and medium-sized export furniture manufacturers that had capitalized on the rattan furniture manufacturing boom that had swept through the metropolitan region of Cebu City, the Philippines, in the 1980s. During this decade, furniture exports from Cebu to the United States, Europe, Japan and other developed-country markets rose at an annual rate of nearly 13%, from approximately \$30 million in 1980 to over \$88 million in 1989.

The island province of Cebu was located in the Central Visayas region of the Philippines, in the approximate middle of the Philippine archipelago (see map on page 44). The metropolitan region of Cebu City, the provincial capital, was the country’s second largest, with a 1990 population of over 2.6 million, second only to Metro Manila. Cebu grew rapidly through the 1980s, as many local and foreign investors began to turn away

from the traffic, congestion, electrical brownouts and other chronic infrastructure shortages of Manila. Much of the investment in Cebu and the resultant growth was in the export sector, in no small part because of Cebu's Mactan Export Processing Zone, which offered special incentives to export industries that located within its fences. Exports from Cebu grew almost 100% between 1987 and 1991, from \$334 million to over \$660 million; exports from the Mactan Export Processing Zone accounted for slightly more than one third of the 1991 total. The city and provincial governments were considered to be probusiness and proinvestment. Foreign investors were actively courted, and the city administration had developed a comprehensive investment promotion scheme around the slogan "Cebu, an Island in the Pacific." Central government officials in the capital were reportedly angered that Cebu was trying to attract investors by failing to mention that the "Island in the Pacific" is a part of the Philippines. Despite its obvious successes, Cebu was not so easily divorced from the problems that faced the rest of the Philippines. The local water supply was fast being outstripped by increasing demand. Electrical brownouts were still common if not quite the major problem they were in Manila. It could take months or even years to have a phone line installed, and the roads were quickly becoming choked with traffic. Local cynics would collectively refer to these phenomena as the creeping "Manilization" of Cebu.

Cebu's labor force in 1990 stood at close to one million, and was growing rapidly due to a high rate of natural population increase and migration from the surrounding provinces. In spite of the relatively rapid economic growth rate in Cebu, the rate of new job formation could not keep up with the number of new entrants to the labor force each year. The unemployment rate in Cebu Province in 1992 was estimated to be 9.5%. Of those who were employed, 32.7% were judged to be underemployed, meaning that despite their desire to work full-time they were actually working fewer than 40 hours per week. The corresponding figures for 1988 were 6.6% unemployment and 25.2% underemployment. The deterioration in these indicators from 1988 to 1992 showed that despite the rapid regional economic growth, new job formation was still lagging behind the number of new entrants to the labor force.

The manufacture of furniture for export was a critical link in the economy of Cebu, with 1992 export sales of nearly \$105 million. This was more than 55% of the total Philippine furniture exports of \$190 million, giving credence to the claim of the Cebuano furniture manufacturers' that Cebu was the furniture capital of the Philippines. It was the province's third largest export industry, behind only the extraction and processing of copper concentrates from the region's mines and the production of semiconductors by the multinational corporations in Cebu. The furniture industry's status as third largest belied its true importance to the economy. It was far more labor-intensive than either mining or semiconductor production, and consequently employed more workers than either of these industries. Those close to the industry estimated that it directly employed between 30,000 and 50,000 people. Also, unlike mining and semiconductors, furniture production was heavily integrated with the local economy, from which most of the raw materials and components were sourced. As a result, the percentage of total value added generated locally was quite high, and there were a number of upstream support industries that were dependent on the industry.

Approximately 100 firms were actively engaged in export furniture manufacturing in the Cebu City metropolitan area, and more than triple that number of small backyard operations catered to the local market and/or worked as subcontractors to the exporters. The four largest furniture exporters accounted for approximately 20% of total exports. The largest market for Cebu's furniture was the United States, which imported 53% of the total output. Of the remainder, 25% went to Europe, 10% to Japan and the rest to Australia, South America and the Middle East.

Progress in Cebu's furniture industry has been measured by the increasing number of downstream value added activities undertaken by local producers. Many of Cebu's current furniture manufacturers were incorporated in the late 1960s and early 1970s as rattan pole traders, who exported raw rattan poles to furniture manufacturers in the United States, Japan, Taiwan and elsewhere. When the Philippine government banned the export of rattan in 1977 to spur the development of the local industry, many of the traders responded by upgrading their production to unfinished furniture parts, such as chair backs, legs and seats, which were

then exported to furniture assemblers and finishers in other countries. Building on their success with furniture parts, in the 1980s Cebu's manufacturers began to produce completely assembled (though unfinished) furniture from designs provided by their overseas buyers. By the late 1980s, local manufacturers began to complete the value added chain, undertaking their own product development and design, construction and final finishing. The success of Cebu's furniture manufacturers in incorporating higher value added activities into their production can be traced by the growth of their exports, which climbed from less than \$3 million in the 1960s to over \$100 million in 1991.

Beginning in the mid- to late-1980s the Cebu industry began to be hit by a series of dramatic price increases for its primary raw material, rattan poles. The price increases were brought on by many factors, including massive deforestation from legal and illegal logging, the communist insurgency in the main rattan cutting areas and new resource taxes from the Philippine Department of Natural Resources. Importation of rattan could not provide much relief to the supply bottleneck. It was difficult to find reliable overseas suppliers and the large exporting countries such as Indonesia and Malaysia were banning or heavily taxing rattan exports to develop their own rattan-based furniture industries. Indonesia's efforts to develop its domestic rattan industry were becoming increasingly successful, and with their lower labor rates and much lower raw material costs, Indonesian suppliers began to take away much of the low- to medium-end market from the Philippine producers.

Many of the Cebu manufacturers took refuge from the increased international competition by building up their furniture design and finishing capabilities. With improvements in these areas they could target the higher-end markets, where their superior skill and experience still gave them a competitive advantage. Others looked for alternative raw materials, such as wrought iron, wood and fossil stone instead of rattan. Even with these shifts in raw materials, Cebu's furniture manufacturers continued to serve the so-called "designer" market for hand-crafted, as opposed to mass-produced, furniture. Production runs of a particular furniture design rarely ran to more than 100 pieces, and these would cater not to the mass-markets but instead to the designer markets in the developed coun-

tries of the world. Even the largest manufacturers would joke that they didn't run furniture factories so much as the world's largest custom furniture shops.

The Founding of Asian Rattan, Inc.

The Hernandezes were a locally prominent family with business interests in a number of different industries. For several generations, the Hernandez family had owned and operated a small sugar mill and plantation close to the northern tip of Cebu Province. When Jun-Jun's grandfather, Jose Hernandez, was in charge of the family's sugar operations, the Philippines lost its preferential access to the American sugar market. Now subject to the extreme price volatility of the international sugar markets, the family's income from its plantation began to swing wildly and unpredictably from year to year. At this time, Jun-Jun's grandfather decided it was time to diversify the family's economic interests, and over the succeeding years he initiated several businesses, installing a son or daughter at the head of each. Jun-Jun's father, Augusto "Ting" Hernandez, was placed in charge of an animal feed business that had prospered greatly in recent years with the growth of the prawn farming industry in the Philippines. Jun-Jun's uncles and aunts operated several other local businesses, including an auto distributorship, a large fish farm, a dried fruit processing plant and a costume jewelry manufacturing and export business. The extended family lived together in a "compound" surrounding Jun-Jun's grandfather's house. His aunts, uncles and father had all lived in his grandfather's house until they were married; then an adjoining house was built for them.

Jun-Jun's father kept a close watch on economic developments in Cebu through the extensive network of ties that he fostered in the local business community. Some of these ties were through formal means, such as his membership in the local Rotary Club and the Cebu Chamber of Commerce, but many more were informal, such as the strong links he maintained with his classmates from college, high school and even grade school, and the associations he made through his membership at the Cebu Country Club. Through this network Jun-Jun's father learned about Cebu's increasing export trade in rattan furniture in 1980, and he resolved that the family should set up a rattan furniture factory. Jun-Jun graduated from the University of San Carlos

with a degree in business administration that same year, and his father decided that Jun-Jun would lead the new company.

Asian Rattan (AR) was formed with an initial investment of approximately \$35,000. The factory was little more than a covered workspace, a compressor, a hand-fabricated boiler and steam chamber and an assortment of hand-tools. To manage the factory start-up, the family hired a production manager with significant experience in the industry, recruited from another rattan manufacturer in the Manila area. To staff the factory floor, the Hernandez family brought 35 workers from the family's home town in the north of Cebu province, many of whom were the sons and daughters of the family's sugar workers. They built rudimentary housing for these workers on a site near the factory. Another 20 workers with experience in rattan production were hired from the local Cebu City area. The front office positions, including the accountant, personnel director, purchasing officer and clerical staff were filled largely from the ranks of Jun-Jun's extended family—his cousins, nephews, sisters-in-law, etc.

Asian Rattan began its operations in December of 1980 by acting as a subcontractor to two rattan factories whose owners were family friends of the Hernandezes. In their first months of operation they produced only simple furniture parts such as chair seats and backs. As their experience grew they were given subcontracting orders for completely assembled pieces. In 1982 AR received its first direct export order from a buyer in the United States for a 20-foot container of a simple rattan dining set. In the succeeding two years they developed contacts with several new foreign buyers and gradually reduced subcontracting to only 20% of their total production.

Growth in the 1980s

Asian Rattan grew rapidly through the mid- to late-eighties, their growth mirroring the boom that hit the entire Cebu rattan industry in these years. By 1989 the factory had expanded twice, and the ranks of workers had expanded to close to 300. Sales had increased to approximately \$1.5 million per year. Fifteen international buyers were actively sourcing from AR—nine from the United States and six from Europe. Their top four buyers accounted for more than 70% of their sales.

Most of AR's buyers were importer-wholesalers, who purchased furniture from AR and other international suppliers, imported them into their home countries and sold them to furniture retailers. A few buyers specialized in so-called "contract" furniture, which was designed and purchased for commercial uses such as hotels or restaurants. Jun-Jun made most of his new buyer contacts through the personal reference of his existing buyers and other local manufacturers (primarily those who produced noncompeting lines of furniture such as wrought iron or inlaid stone). Jun-Jun also tried to travel to at least one of the major international furniture shows each year, such as those at High Point, North Carolina or Milan, Italy, so that he could make new contacts and get a feel for what types and styles of furniture were selling well.

Despite the growth, AR's operations remained largely the same as in the early years. In a typical transaction, a buyer would provide Jun-Jun with a design and ask for a product sample and price quotation. If the buyer was pleased with the sample and a satisfactory price could be negotiated, the buyer would open a letter of credit and request a containerized delivery of the finished goods to the Cebu container port within four to six weeks. AR also continued to serve the "medium-end" segment of the U.S. and European rattan markets. A medium-end rattan furniture would be characterized by good-quality materials and construction with a relatively simple design and finish. AR's F.O.B. Cebu price for a typical chair would usually be between \$25 and \$35, which would sell in the retail markets of the United States or Europe for between four and five times that price.

Furniture Production

When AR received an order, the dried and skinned rattan poles of the appropriate diameter would be pulled from inventory, cut to the lengths needed for the particular design and sent to the steam chamber. High pressure steam made the rattan highly bendable, and once removed from the steam chamber the poles would go to the benders, who would bend each individual piece to its final shape using a wooden jig as a guide. The prebent component pieces would then go to the framers, who would assemble and bind the individual pieces to form the final structure of the furniture piece,

using staple wires, wood screws and leather or cane bindings to fasten the component parts together. Framers checked their work against a wooden sizing board, which was marked with the finished dimensions of the piece to ensure consistency of dimension from one piece to the next. Depending on design, the completed frame might next go to the weavers, who would weave wicker, rattan split, leather strips or other materials to form the chair seat or back or other decorative elements on the furniture. The completely assembled pieces would then go to the sanders, who would sand the entire piece by hand before handing it over to the finishing department. The finishing department would use spray equipment to apply the multiple coats of sealers, stains, paints and lacquers that would comprise the furniture's final finish.

A minimum of capital investment was required to start up a factory. A sheltered work area, a steam chamber and a boiler to feed it, a compressor, a generator (because of the frequent power outages, or "brown-outs"), spray equipment and simple hand tools such as saws, staple guns and drills were sufficient to start operations. It was estimated that a factory with a capacity of two 40-foot containers per month would require a capital investment of only \$40,000.

Decision Making

Decisions in every functional area of AR were made by Jun-Jun and, in some cases, his father. In addition to the traditional roles of a company president, Jun-Jun took on many added responsibilities, acting also as AR's *de facto* director of marketing, sales, new product development, purchasing and production. Major finance and capital budgeting decisions were made jointly with his father. Jun-Jun personally handled almost every external relationship maintained by Asian Rattan; he alone communicated with AR's buyers, qualified and negotiated with the vendors offering raw materials or services to AR and negotiated the trade financing with the banks. The flow of information within AR was similarly centralized. All accounting and other information related to AR's performance was reported only to Jun-Jun, who considered this information too sensitive to disseminate.

Mid-level employees of AR generally did not resent their lack of authority within the company, because

this was in line with their expectations. Jun-Jun and the Hernandez family owned the business, and it was expected therefore that they would hold all the power and make all of the important decisions. The typical production worker at AR knew very little about the internal or external workings of the company. If asked about a particular furniture piece he was working on, the production worker would generally be unable to name who the customer was, what was the cost of the raw material, when the order was due or how much the finished product cost.

Labor in the Cebu Furniture Industry and at Asian Rattan

The entire production process in the furniture industry was extremely labor intensive. Jobs were generally low-skilled and repetitive, and could be learned very quickly. The labor force in the furniture industry was highly mobile between the different factories as well as in and out of the industry, and there was always a large pool of experienced workers available for hire.

While most (approximately 80%) of the production workers at AR were literate and numerate, generally their level of educational attainment was quite low. The average worker had left school after only five of six years of primary education (free education was provided by the government up to but not including high school). Most left school to help support their families.

AR provided no formal job training for its production workers. New workers were paired with an experienced worker for several days and then expected to perform the job on their own. First level supervisory workers, who were generally chosen from among the best production workers, were placed in their roles with no supervisory training or other formal training related to their positions. Training at AR was confined to "values formation." The personnel director would hold training sessions for groups of new employees on behavioral issues related to working for an industrial enterprise. Typical topics might include the importance of showing up for work every day and being on time, the need for safety consciousness, showing proper care for company property, the importance of honesty, etc.

LABOR REGULATIONS: THE LABOR LAWS

Regulation of employment and the enforcement of the Labor Code of the Philippines was the responsibility of the Philippine Department of Labor and Employment (DOLE). The Labor Code of the Philippines guaranteed the rights of all workers to unionize, engage in collective bargaining with their employers and strike. It also guaranteed employers the right to lock employees out and provided a prescribed mechanism for the binding resolution of labor disputes. The entire labor code filled a volume of more than a thousand pages. For the furniture industry, however, the pertinent regulations were confined to three: minimum wage legislation, regulations protecting workers from arbitrary termination or layoff (known as “retrenchment” in the Philippines) and the legal provisions against the use of “labor only” subcontracting.

The National Labor Relations Board (NLRB) of DOLE was charged with periodically reviewing the legal minimum wage and making minimum wage recommendations to the national legislature. All employers that employed over five people were required to pay the minimum wage. The furniture industry and other manufacturers in Cebu were subject to a minimum wage of P105 (\$4.20) per eight-hour day. Legislators had raised this figure often over the past decade; P105 per day represented a more than five-fold increase over the legislated minimum in 1980. Business owners charged that legislators practiced a cynical electoral calculus when considering new minimum wage legislation; they would gain the votes of thousands workers for every increase they approved but lose the votes of only a small number of business owners. While the P105 minimum wage was known to be barely a subsistence wage, the supply of un- and underemployed labor was so great in the Philippines that P105 was acknowledged to be well above the equilibrium wage for unskilled labor. In practical terms this meant that employers could attract all the unskilled labor they needed even if the wages they offered were well below the legislated minimum.

Under the Philippine Labor Code a newly hired employee may be considered to be on a probationary period for the first six months of employment; during this probationary period the employer would have broad rights to terminate the worker’s employment. After six months, however, a worker’s employment

would be considered “permanent” and he or she would enjoy increased legal restrictions against termination or retrenchment. Employers could layoff workers to prevent losses, but the burden of proof as to the necessity of such moves fell to the employer. In practice it was extremely difficult to terminate or layoff “permanent” workers.

The final restriction on the employment of labor that affected the furniture industry was the prohibition of “labor only” subcontracting. Because there were many subcontractors in Cebu whose small size let them operate outside of the formal labor laws, many of the large manufacturers tried to keep only their most critical and difficult to control activities in-house and subcontract the rest of their production. This allowed the large manufacturers to reap a cost savings because the subcontractors’ labor costs were lower and also enabled them to insulate themselves from the labor-related consequences of an economic downturn by keeping their own headcount low. The Labor Code anticipated this by banning “labor-only” subcontracting, which was defined as:

... where the person supplying workers to an employer does not have substantial capital or investment in the form of tools, equipment, machineries, work premises, among others, and the workers recruited and placed by such person are performing activities which are directly related to the principal business of the employer. In such cases, the person or intermediary shall be considered merely as an agent of the employer who shall be responsible to the workers in the same manner and extent as if the latter were directly employed by him.

DOLE’s ability to enforce labor regulations was limited by its small budget. It could not field enough inspectors to ensure compliance, and even the inspectors that could be fielded were so low-paid that they were subject to “incentives” to look the other way. As a result, only the largest employers were subject to close scrutiny by DOLE; most medium and small firms could flaunt the labor laws with little risk from DOLE’s enforcement divisions.

The labor environment of Cebu pushed the labor unions into the unusual role of being the primary enforcer of the labor code regulations. Employers faced no real pressure to conform to the code, because employment was so scarce that many workers were

willing to work under far worse conditions than those mandated by the law. In this environment, the labor unions functioned not so much as labor representatives and advocates, but as watchdogs over the small- and medium-sized employers, to see that they conformed to the labor code.

LABOR SITUATION AT ASIAN RATTAN

AR had operated for nearly 11 years, from its founding in 1980 until 1990, with relative harmony between labor and management. The relationship between the Hernandez family and the workers was driven by the traditional Filipino value of *utang na loob*, or reciprocal obligation. For their side, the Hernandez family provided their workers with jobs and tried to help them meet their other needs where they could. They provided company housing, for example, for the workers that had been brought from the Hernandez's home town in the north of Cebu province. Every week a doctor and nurse would be brought to the factory to attend to the workers' routine health needs. If a worker needed to be hospitalized, the company would help with the bills. Workers could come to the family for a salary advance if they met with a sudden and unexpected financial crisis. The Hernandezes built a chapel on the factory site and arranged for a priest to say Mass once a week and on Feast days, which was very important to the majority of the workers who were devout Catholics. In return, the workers paid their *debt of gratitude* by offering their loyalty to the Hernandez family and Asian Rattan. In keeping with traditional Filipino values, the Hernandez family and its workers tried to bind themselves closer together through a web of mutual favors and the resulting obligations.

Jun-Jun had little direct contact with his production workers. His first-line supervisors were his eyes and ears on the factory floor, and most communication between the workers and Jun-Jun would go through them. If an issue was bothering the workers, for instance, a particular work rule or wages, the supervisors would report the workers' grumbling and its cause to Jun-Jun so that he could address it. Similarly, if Jun-Jun was disturbed about the workers' performance or the way that they were handling their jobs, this information too would go through the supervisors. If a worker needed to make a request of the company, for instance, for a salary advance or a leave of absence,

this request would also generally go through a supervisor. The use of intermediaries between Jun-Jun and his workers was not a formal policy of the company, but a natural consequence of the need of the people involved to keep *hiya*, or face. Filipino values stress the importance of smooth interpersonal relations, or *pakikisama*, and to instigate or participate in an open personal conflict would cause everyone involved to lose *hiya* (face). Similarly, it was considered rude and a breach of *pakikisama* to answer an outright "no" to a proposal or a request—both parties in such a situation would lose *hiya*. By using intermediaries, however, Jun-Jun and his workers could avoid any open conflict, and they could also avoid having to deny any proposal or request while face-to-face. Using the informal intermediaries of the supervisors allowed everyone to keep *hiya* while keeping the channels of communication open.

Throughout the years AR had been paying their workers about 25% less than the minimum wage. AR's workers were aware that the law entitled them to more, but they did not agitate because they were bound by *utang na loob* (debt of gratitude) for the work that Jun-Jun had provided, and they knew there were very limited opportunities for them elsewhere. Jun-Jun tried to keep a close eye on the prices of rice and other commodities that the workers needed so that AR's wages could be adjusted with inflation. Whenever Jun-Jun failed to anticipate the need for a cost of living increase, the increase in the level of worker grumbling would be reported to him through his supervisors. Because of lax enforcement from DOLE, AR was under no pressure from the government to pay more.

UNIONIZATION

The labor situation at AR changed dramatically in 1989, when, in a round of expansion, the company hired three workers who were agents of the KMU labor union. The unions would actively target a specific firm for unionization if they felt that its workers would benefit from unionization, and through its networks the union learned that AR had been thriving as a company but was paying less than minimum wages. At this time the KMU was striking a rattan factory in another part of the city, and the union asked three of its activist members from the striking local to try to get jobs at AR. Once hired, their task was to increase the workers' awareness of the difference between what they were

being paid and the legal minimum, and to convince them that the union could help them get the wages and benefits that were their right under the law. AR was not aware of their status when they were hired.

The activism of the union agents caused great division on the factory floor. The workers who had been with AR for years, especially those that the Hernandez family had brought down to Cebu City from their home town, were solidly against the union. They felt a very strong debt of gratitude to the Hernandez family that for many of them went back several generations. They thought of the union as the enemy of the Hernandezes, and therefore they felt it was their duty to oppose it. The message of the union activists struck a responsive cord among a large number of the newer employees, however, and there soon developed a nucleus of union support within AR's workforce. Eventually this group grew to include the 25% of the workforce required under Philippine law to call for a unionization vote.

The union vote was a major conflict for the workers of AR, with forces pulling them in both directions. The promise of better wages (which most desperately needed) was a powerful inducement to vote in favor of the union. To do so, however, would ignore the obligation of gratitude they had to the company and the Hernandez family. They also feared reprisal. Other factory owners had closed their factories and thrown everyone out of work rather than work with a union. Under all the other more objective considerations, however, the union activists had been successful in building up resentment among the workforce because they were entitled to more under the law.

Jun-Jun did not address the workers directly about the union decision, but through his supervisors he let it be known that he was squarely against the union and he would consider a vote in favor of unionization to be a betrayal. While he never explicitly made the threat to close down the factory, he told his supervisors that AR could not compete against the other Philippine and Indonesian manufacturers if it had to pay higher wages, and asked them to consider what their alternatives might be if AR were to close down. For their part the union activists promised the workers that they could use the courts to prevent an arbitrary closure of the business and asked them to consider whether Jun-Jun could drive the expensive car he did and live in Cebu's

wealthiest residential development if the company could not afford to pay higher wages.

On the day of the vote the workers voted in favor of the union by a narrow margin. The vote was polarized by length of service to the company. Long-term employees voted against unionization, while the newer employees voted for the union.

ASIAN RATTAN UNDER THE UNION

As soon as the union was voted in, it called for negotiations with Jun-Jun and AR's management over the wage issue. The negotiations proved to be very difficult for both sides. Neither Jun-Jun nor the worker representatives were used to speaking face-to-face about an issue as sensitive as wages, and it made both sides extremely uncomfortable. The uneasiness of both parties about the negotiating process made a dispassionate discussion of the relevant issues next to impossible, and the negotiating sessions quickly devolved into angry and emotional recriminations from both sides. Jun-Jun accused the worker representatives of ungratefulness and disloyalty and charged their union advisor with being more interested in union dues and union power than in the true welfare of his workers. The workers accused Jun-Jun of exploiting them through a greedy unwillingness to share the profits that he received from *their* hard work. Jun-Jun pleaded that he already paid more than many of his competitors and that AR would price itself out of the market if wages went up any more. Finally the union demanded that Jun-Jun open up AR's books to support his claims. Jun-Jun refused, and the union broke off negotiations and called for a series of work slowdowns and stoppages.

Jun-Jun held firm for three weeks, until his buyers started to flood him with nervous inquiries about the delays in the shipments of their orders. Several of his buyers had been putting strong pressure on him recently over AR's prices, and Jun-Jun was concerned that any performance problems on AR's part might send them to his competitors in the Philippines, or more likely, Indonesia. Anxious not to give his buyers any reason to defect, Jun-Jun relented to the union's demand and raised wages to the statutory minimum.

The unionization of AR's workforce and the resulting increase in payroll costs came at an extremely awkward time for Jun-Jun and AR. The boom in Cebu's rattan

market had dramatically increased the domestic demand for rattan poles, yet availability of poles on the domestic and international markets was quickly falling. Rattan vines grew in the forest canopy, which was rapidly disappearing in the Philippines under the pressure of legal and illegal logging. International sources were drying up as well, because major suppliers such as Indonesia and Malaysia had banned pole exports to spur the development of their own furniture industries. With increasing demand and falling supply, prices to Cebu's manufacturers had increased by 25% in just 18 months, and many were scrambling to find a steady supply of poles at even the inflated prices.

Competition within Cebu had also increased as many new firms had entered the market to try to take advantage of the boom market of the previous years. Competition with Indonesia had become very stiff, as that country's ban on rattan pole exports was beginning to have its desired effect of developing the local industry. Because of their abundant local supply, Indonesian manufacturers were paying close to 30% less for rattan poles than their competitors in the Philippines.

The unionization of his workforce and the resulting increase in his payroll only deepened Jun-Jun's private despair over the future of AR. In an effort to pare AR's costs, Jun-Jun began to explore the possibility of subcontracting the bending and framing for some of his orders. Jun-Jun had tried to avoid subcontracting before, because he was loathe to lose any control over either the quality of AR's product or the company's reputation for timely delivery. Now that his own labor costs were spiraling, Jun-Jun was no longer sure that he could ignore the cost benefits of using subcontractors. Because of their very small size, subcontractors were beneath the notice of both DOLE and the labor unions and consequently they often paid wages significantly below the minimum wage. Their low labor costs and their extremely low overheads allowed subcontractors to offer prices to manufacturers that were significantly below the manufacturers' own production costs.

While Jun-Jun was convinced that he would have to start subcontracting a significant part of his orders, he could not begin while his factory was still fully staffed. He was sure he could not layoff any workers, because any retrenchment while giving orders to subcontractors would only invite more trouble from the union.

He could wait for the workers' ranks to thin through natural attrition, but Jun-Jun was not sure the company could stay financially healthy that long. As Jun-Jun was considering his options, the company was rocked by news that made his deliberations moot.

Within a two-week span Jun-Jun received notice from his largest buyer in the United States and two of his smaller European buyers that they were dropping almost all of their business with AR. Jun-Jun entreated each of them to reconsider, but they all responded that AR's prices were no longer competitive and they were facing market pressures to find less expensive sources of supply. Through his network of contacts in the furniture industry in the States and Europe, Jun-Jun learned that the Indonesian suppliers had just had a very strong showing in the Singapore International Furniture Fair, and it was likely that his buyers had been unable to resist the low prices offered by the Indonesian manufacturers.

With the loss of these buyers, Jun-Jun knew that AR could not possibly maintain all of its current workforce. He calculated that he would have to reduce the payroll by a third if AR was to just break even. Convinced that there was no alternative that would allow AR to survive, Jun-Jun called in the union representatives and, after explaining the reason, announced that in one month one hundred workers would be laid off based on seniority with the company.

The union leaders were incredulous and incensed. Coming so soon after the unionization of the plant, they were sure that the layoffs were a strategic move on Jun-Jun's part to try to break the union. Most of the union's strongest supporters had the least seniority within AR, and they would be the first to be laid off. They also feared that this move was merely a prelude to the closing of the factory. Several factory owners in the past had reacted to unionization by closing the factory and then reopening it across town under a new legal identity. A strike meeting was called, in which the union leaders expressed both their fears and a generous measure of invective against AR, Jun-Jun and his family. A strike vote was called, which easily passed with a 70% majority.

The strike quickly turned violent. The strikers tried to block access to the AR building while Jun-Jun and several of his staff were inside. When Jun-Jun tried to leave

the building he was stopped by a hail of bottles and rocks from the picket lines. The police observers present called in reinforcements, and several fights broke out between the strikers and the police as they tried to escort Jun-Jun and his staff through the picket lines. The police arrested several strikers and ordered the rest to disperse, and the National Labor Relations Board (NLRB) of DOLE ordered the factory sealed until the strike action could be resolved.

The strike took over a year to resolve. Considering the initial violence of the strike, the NLRB ordered a three-week cooling-off period before they would sponsor any negotiations. Jun-Jun kept his buyers apprised of the situation, and as the weeks passed they one-by-one began to cancel their orders. With no firm orders to reopen the factory, Jun-Jun's position hardened even further. He refused to reopen without a significant reduction in the workforce. The union was sure the layoffs were a deliberate ploy by the Hernandez family to break the union, so they would not give any ground. As it was clear that the situation was at an impasse, the NLRB gave up on the negotiations and sent the case to the labor courts.

The case languished for months in the court's backlog. After finally reaching the court's docket, the unions agreed to settle for a one-time cash payment of P7,500 (\$300) for each worker. Under the settlement, Jun-Jun was free to reopen the business and had no obligation to rehire any of the striking workers.

ASIAN RATTAN AFTER THE STRIKE

With the strike now behind AR, Jun-Jun was torn over the decision of whether to reopen the factory. He was sure of one thing—if he reopened the factory he was not going to rehire any of the strikers. It was the union's final agreement to that condition that convinced him to accept the settlement. Now that he was legally free to restart the business, Jun-Jun considered his options.

He was convinced that there was no long-term future in the medium-end rattan market that AR had been serving. The raw material advantages enjoyed by the Indonesians and the Malaysians were simply too great. The higher-end markets, however, had much more potential. Cebu's international competitors were still relative newcomers to the export markets, and it would probably be a decade or more before they could com-

pete with the high-end design and finishing skills of Cebu's better manufacturers. Jun-Jun was confident he could take AR's products upmarket, if he could count on a stable and reliable workforce for the two to three years it would take for the organization to assimilate the necessary skills and attract the high-end buyers.

Jun-Jun had real doubts about risking the start-up costs on the cooperation of a new workforce. He was confident that he could get enough orders from his old buyers to restart operations, but the margins on this business would be so thin that he could not afford to pay the new workers the minimum wage. Personally he was willing to pay the statutory minimum and accept losses for a couple of years in hopes of successfully reaching the high-end markets. He knew, however, that after paying the strike settlement his father would not stand for any more losses. It would be no problem to attract a workforce on less than the minimum wage, because there was so little work available relative to the number of potential workers. Once they were in the company, however, how could he be sure that the previous year's scenario would not be repeated all over again?

He could rely on subcontractors for the majority of his production needs. In fact, he knew of several "manufacturers" and exporters in Cebu who used subcontractors for *all* of their production. While this would keep AR's costs within the limits, Jun-Jun felt that the use of subcontractors would be inconsistent with his strategy to take the company upmarket. The production of high-end furniture required the greatest attention to detail and quality, and consistently maintaining these high standards with outside production would prove very difficult. He also doubted that AR could attract high-end buyers while relying largely on subcontractors. These buyers were very concerned with the long-term viability and stability of their suppliers, and would almost certainly be insecure about dealing with a manufacturer that subcontracted most its orders.

Other rattan manufacturers were gradually switching their furniture production away from rattan to more readily available raw materials, such as wrought iron and inlaid fossil stones. These manufacturers appeared to be doing quite well, but the level of investment required to make these furnitures was much higher than for rattan. Jun-Jun could just picture his father's

incredulous stare as he imagined asking for the additional investment funds, and almost hear his interrogation: “Are you crazy? Your business is dependent on a big workforce, and it’s a workforce that’s apparently so foolish that it will let a union lead it by the nose right out of a good thing and into a garbage heap. And you want me to sink more of this family’s money into such a business? What will you do when your orders fall off—and they will even if the long-term market is good—and you have to layoff workers? What will your workers do to you then?” Jun-Jun did not know how he would respond.

A Conversation with Jun-Jun

A conversation with Jun-Jun Hernandez, held on the veranda of the Hernandez family compound overlooking Cebu:

... I used to feel very good about what we were doing at Asian Rattan. We were providing jobs and a livelihood to three hundred people, most of whom would otherwise be working as day laborers without any security, or maybe even vending cigarettes one at a time on the street. We tried to help them out wherever we could, providing housing for many of them, medical care when they needed it, help in family emergencies, and in the end, where did it get us?

I know the way many of the other factories treat their workers—they threaten them with the loss of their jobs if they unionize or agitate, hire people for only the six-month probationary period allowed by the law and then fire them without cause, do all of their work through subcontractors, and split their factories up under several paper companies [i.e., new legal entities] to make it difficult for the unions to unionize or strike their whole operation. We didn’t want to work that way. We tried to do things straight, so that both our business and our workers could have as much security and stability as possible.

I know that even the minimum wage is not really much for a family to live on, but what can we do? We don’t set prices in the international furniture markets. We more or less have to take what the market offers. At the current prices, especially since the Indonesians and now the Chinese have entered the market, we just can’t afford to pay minimum wage. Labor is more than 20% of our total cost—how can we compete if I’m paying 50% more per day than the Indonesians and 25% more than my competition here in Cebu?

There are furniture companies here in Cebu that pay the minimum wage or maybe even a little more, but they’re in a different league and serving a different market than we are. These are the oldest companies with the highest skill levels, the best design capabilities and high-end finishing equipment, and they’re serving the very high-end designer furniture markets. These markets are very stable compared to ours—they don’t have all the peaks and valleys in demand that we do, and they aren’t so driven by price. They get a premium price for their products, and so can afford to pay their workforce more. Unfortunately there’s a lot more competition down in the medium end that we’ve been serving, and we can’t move our prices around like they can in the high end.

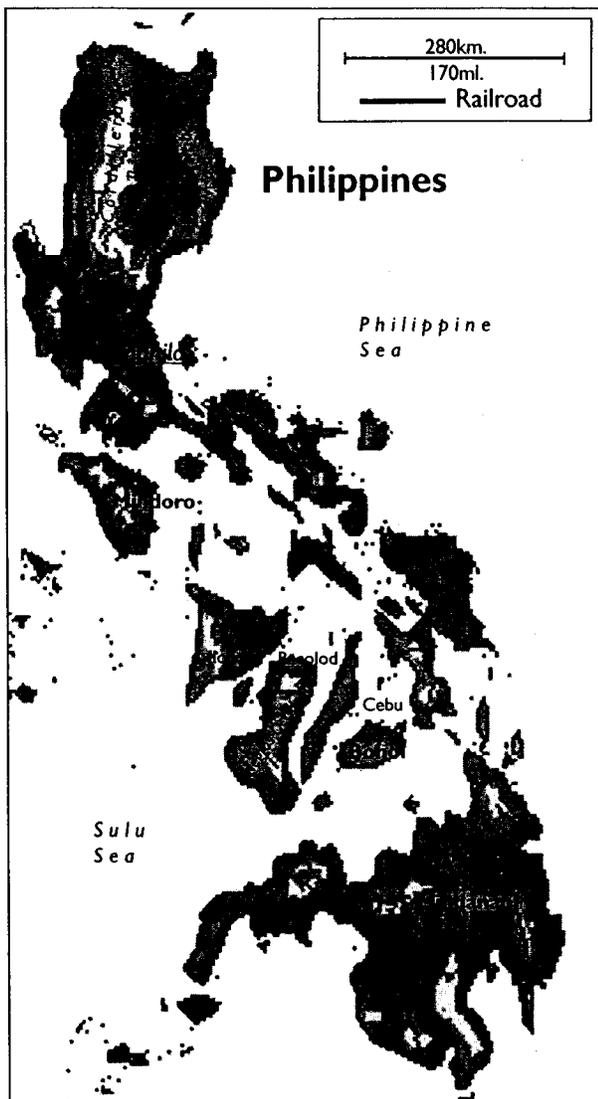
We’d like to move AR in the high-end direction—in fact, we were taking steps in that direction right before the strike. We’d hired a full-time designer and were looking into importing some more sophisticated finishing equipment. But you can’t get there overnight—it takes years to build up your capabilities and develop the reputation it takes to attract the high-end buyers. Personally, I’d like to continue to try to take Asian Rattan high-end if and when we restart operations, but I’m scared because that would mean a substantial increase in our investment and therefore our risks. How can I do that when I can’t count on a stable but flexible supply of labor?

I don’t know what we’re going to do about the restart yet. I’d like to try again, but my father has gone sour on the business and wants us to get out. He feels that there are a number of more lucrative opportunities opening up for our investment—and these without the headaches of dealing with a large ‘ungrateful’ labor force. We’ve had offers from other manufacturers for our factory, but I’d hate to just walk away from what we’ve accomplished so far ...

A Conversation with Pons Escalada, KMU Labor Official

The interview took place at the worker housing site of a major furniture manufacturer in Cebu. The housing consisted of a long bunkhouse of sheet plywood with a corrugated tin roof. Mr. Escalada explains that every married couple receives a 150-square-foot room in the bunkhouse with one bare bulb for lighting. Bath and toilet facilities were at the end of the building and were shared by all. Children were everywhere, darting in

MAP OF THE PHILIPPINES



and out of the tattered and faded ranks of laundry flying in the breeze outside every room. Many women could be seen in front of the rooms. These were the wives and mothers of the furniture workers, weaving baskets to supplement their families' incomes.

... When you see the way these people live and compare it to the way the Hernandezes live, you understand why our union is so quick to fight for our workers' rights. They drive around in million-peso (\$40,000) cars, live in the nicest neighborhoods, retain an army of maids, cooks, and drivers to attend to their every whim, while these people barely have enough to feed their families rice and dried fish—and they can afford that only because we fought to get them minimum wage. They have nothing, and no future. Maybe if we keep fighting we can earn a future for their kids.

The factory owners do so much to prevent workers from getting their rights—threatening their jobs, firing them before they work for six months, using subcontractors that pay slave-wages. It's easy for the furniture factory owners; their investment in a factory is so low compared to other manufacturers that they can always threaten to just close up shop, fire everyone, and move down the road; and mean it. They always plead that they can't afford to pay the workers the minimum wage—that their factories don't even turn a profit. They're all tightly held family companies, so of course we can't prove otherwise. But if it's true, how do they support their opulent lifestyles?

... The factory owners accuse us of upsetting what is a peaceful and prosperous relationship for both parties whenever we enter a factory. That's not true. We try only to get workers what is rightfully theirs *under the law*—we don't even try for anything beyond that. Look around you, at the way these people live, and you'll see that we aren't asking for much."

Note

¹This case was written by Sam McDowell of Washington University Business School in St. Louis. The case is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The name and some of the circumstances of the company and the individuals have been changed to disguise their identity.