Competitive Advantage in the U.S. Paper and Paper Products Industry

by

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ABSTRACT

Many firms in the U.S. paper converting industry are engaged in the commodity business of manufacturing finished paperboard products from paper stock. Contrary to the typically held mindset, these firms do not have to be relegated to the low margin end of the business. This thesis applies the various dimensions of the Delta Model to the paper converting business of the Chesapeake Corporation to define a new competitive positioning that will attract, satisfy, and retain the firm's customers. The overall objective is to develop the key elements of a new business strategy for Chesapeake upon which the business strategic agenda can be built. A new business model for the firm is presented that is centered on the “Total Customer Solution” and “System Lock-In” options of the Delta Model. The future business scope created by this new competitive positioning is defined and discussed in terms of new products and services, market segments, geographic coverage, and unique corporate competencies. These factors are used to identify three initial market segments that provide Chesapeake important opportunities to offer added-value to customers. Specific value propositions by customer segment are presented. The intent of each value proposition is to engender deep customer relationships that ultimately make Chesapeake successful because its has enabled its immediate customer to serve its own customer in a superior way.

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1.0 INDUSTRY OVERVIEW

The United States is the largest producer of paper and paperboard\(^1\) with approximately 95 million tons estimated in 1999,\(^2\) or more than one quarter of the world market.\(^3\) Paper production accounts for about 7% of the total manufacturing output of the US.\(^4\) The US paper industry is recognized as a high quality, high volume, low cost producer that benefits from a large domestic consumer base, modern technical infrastructure, adequate raw materials, and a highly skilled workforce. The majority of the products offered by the industry are commodities making the industry highly dependent on economic conditions and the supply/demand balance. As a result of this cyclicality, the industry has struggled with excess capacity and low prices. A more recent industry trend is increasing competition from paper manufacturers abroad, particularly in Asia and Latin America.

An important characteristic of the industry is the interconnection of operations between pulp\(^5\) mills, of which there are about 55 in the US, and downstream processing of pulp into paper, paperboard, and building paper.\(^6\) There are about 300 non-integrated mill facilities that only manufacture paper from market pulp, and 200 integrated facilities that produce the pulp that they use for paper manufacture on-site.\(^6\) Many integrated facilities are involved in both manufacturing primary paper and paperboard products and “converting”; converting is defined as a non-milling process of manufacturing finished paper and paperboard products from stock.

Primary products are printing and writing papers, sanitary tissue, industrial-type papers, containerboard\(^7\), and boxboard\(^8\). The industry’s output is converted to finished products such as corrugated shipping containers, folding cartons, flexible packaging, envelopes, and sanitary

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\(^1\) Heavy paper thicker than 0.3 mm used for folding boxes, milk cartons, and disposable dishes.
\(^3\) [http://www.hoovers.com/industry/snapshot/0,2204,20,00.html](http://www.hoovers.com/industry/snapshot/0,2204,20,00.html)
\(^5\) Watery fibrous substance consisting of wood, rags, and other materials prepared chemically and/or mechanically for papermaking.
\(^7\) Solid fiber or corrugated combined board used in the manufacture of shipping containers and related products.
\(^8\) General term designating the paperboard used for fabricating boxes.
tissue products by independent manufacturing facilities or at facilities located adjacent to a mill. Paper and paperboard represent about 35% of the total value of paper shipments, boxes 20%, coated\(^9\) papers 10%, sanitary paper products 10%, bags 10%, and other sundry paper products 15%.\(^3\) The top thirty publicly traded U.S. paper companies showed net sales for 1999 of $131B, an increase of 7.5% over 1998.\(^10\)

Although the domestic market consumes more than 90% of its output, the U.S. industry has become a major player in the worldwide paper and allied products market. Exports as a proportion of total U.S. shipments of paper and allied products increased from 7.3% in 1993 to nearly 9% in 1998. On a value basis, exports have grown to nearly $15B. As much as 65% of the growth in U.S. shipments over the past decade is directly attributable to increases in foreign shipments of paper and allied products.\(^11\)

1.1 PACKAGING AND CONTAINERS

Corrugated containers and solid fiber\(^12\) boxes represent the largest segment of the packaging industry. More than 90% of all products in the US shipped to factories, warehouses, retail stores, offices, and homes are packaged in corrugated containers because of their strength and convenience.\(^13\) Corrugated boxes are manufactured from corrugated fiberboard, also known as combined board, that has two main components, the medium and linerboard. More specifically, corrugated boxes are characterized by a wavy, fluted inner layer referred to as the medium that is sandwiched between two flat layers of linerboard that is used as the facing material. The medium and linerboard are both manufactured from containerboard. A corrugating machine presses corrugations (i.e., flutes) into the medium and laminates a layer of linerboard to each side. The sheets are folded, printed, and glued or stapled to make a finished box. Corrugated containers are designed primarily to protect a product during shipping, but increasingly feature enhanced graphics that increase a product’s market appeal. There are about

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\(^9\) Smooth-surfaced paper coated with clay or glue, used for color-print jobs such as magazines.
\(^12\) A solid board made by laminating two or more plies of containerboard.
40 major converters in the US consisting of corrugators, paper or corrugated board converters, corrugated box and/or boxboard manufacturers.\textsuperscript{14} and more than 1,600 box plants that produce corrugated boxes.\textsuperscript{13}

1999 was the fourth consecutive year of significant growth for the sector as product shipments increased 2.9%. Domestic corrugators profited from both domestic and foreign demand leading the industry to ship a record 405.4 billion sq. ft. of finished corrugated boxes, cartons, and shipping containers. The principal driving force behind corrugated box demand in the U.S. was the strong growth in the economy in 1999 (real GDP increased by almost 2.7%) and increased domestic consumption that resulted in increased manufacturing output and higher shipments of industrial and consumer non-durable goods. Since 1989, the industry has continued to find excellent export opportunities as evidenced by increases in both the total quantity of exports and the actual number of markets. Although growth internationally was tempered in 1999 due to the Asian economic crisis, slow growth of many European and Latin American economies, and a strong U.S. dollar, exports as a percentage of total shipments reached nearly 4% from less than 1% in 1989. Although still a small percentage of total shipments, exports are one of the fastest growing end-use segments for domestic corrugating businesses. Mexico (60%) and Canada (20%) were the two principal countries to import US corrugated containers and finished packaging commodities in 1999.\textsuperscript{15}

As producers of a commodity product, corrugated container companies are subject to volatile demand and inconsistent earnings. In order to smooth out these variations, the corrugated industry has consolidated in recent years and is currently 80% integrated. The need to consolidate was viewed as a necessary means to balance supply with demand and thereby support pricing that would encourage the growth of the industry. The producer price index for corrugated boxes indicates that the sector has experienced higher current dollar value sales over the past several years. U.S. corrugators implemented several small price increases in 1998 and 1999. As a result, box prices were able to catch up with price increases for linerboard and


\textsuperscript{14} http://www.paperonweb.com/convert11.htm
corrugating medium taken in the final quarter of 1998. More recently, four of the major U.S. corrugated container manufacturers announced increases in the price of boxes of 11 to 12% to offset 1999 containerboard price increases.\textsuperscript{15}

Corrugated boxes are a $20B business. According to the Boxboard Containers journal, eight companies in the U.S. have sales of than $1.0B, the leading company being Smurfit-Stone. Prior to the merger with Smurfit, Stone Container had more than $2.4B in sales in 1996.\textsuperscript{16}

Shipments of non-durable goods represented about 76% of the total volume of corrugated boxes and related materials shipments in 1999. This share is forecast to decrease very slightly in 2000 to 75.5% as durable goods increase their share of the sector's shipments. The following table shows the leading end-user segments among non-durable and durable goods shipments:

\textbf{Figure 1}

\textbf{Leading End-Users of Corrugated Shipments}

<table>
<thead>
<tr>
<th>End-User Segments</th>
<th>% of Corrugated Shipments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food and related products</td>
<td>39%</td>
</tr>
<tr>
<td>Paper, packaging, and allied products sectors</td>
<td>22%</td>
</tr>
<tr>
<td>Other non-durable goods</td>
<td>15%</td>
</tr>
<tr>
<td>Toys, amusements, sporting &amp; athletic goods</td>
<td>6%</td>
</tr>
<tr>
<td>Electrical machinery, equipment, and supplies</td>
<td>4%</td>
</tr>
<tr>
<td>Stone, clay, and glass products</td>
<td>4%</td>
</tr>
<tr>
<td>Other durable goods</td>
<td>10%</td>
</tr>
</tbody>
</table>

Product shipments of corrugated and solid fiber boxes are expected to grow nearly 3% per year over the next five years.\textsuperscript{15}


An important trend in corrugated containers is micro-flute packaging. Approximately 9% of total corrugated shipments in North America are in the small flute segment, and the annual growth rate of micro-flute applications is 12-15%. This type of packaging offers the structural integrity of a corrugated box with the visual impact of a folding carton (see below). Micro-flute packaging is an alternative to heavy folding carton construction that addresses the needs and demands of new retail channels. In particular, the decline of master packaging has led to a need for carton-size boxes with the strength of corrugated. Typical constructions are E and F flute in combination with lithographic printing techniques.

Within the packaging industry, the folding paperboard box sector is becoming an increasingly more significant area for business growth. Folding cartons are a paperboard package designed to protect the product during shipment and on the store shelf. In addition, they are being used in a larger extent to enhance the product’s appeal to the consumer. Folding cartons typically feature high-quality graphics to maximize shelf appeal in a retail outlet and to provide information about the product and its use. Most folding cartons are made from a single ply of paperboard, specifically folding boxboard, that possesses qualities amenable to scoring and folding, and has variable surface properties depending on the printing requirements.

1999 marked the second consecutive year of growth for the folding carton sector. Product shipments in real terms increased 1.14% and prices for folding cartons increased modestly in 1999, resulting in a 1% increase in the current dollar value of shipments. In 1998, the value of shipments increased to $9.7B, up 3.5% from 1997. U.S. exports of folding-carton-related commodities were valued at $292M, up 5% from 1997. In addition, the value of finished folding cartons was $187M in 1998, up 12% from 1997. Five major factors are responsible for the increased volume of folding carton product shipments by domestic boxmakers in 1999:

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17 http://www2.targetonline.com/ppo/monthly/0300/03000flutes.html
19 Flutes come in several standard shapes (and sizes) or flute profiles (A, B, C, D, E, F, etc).
20 This classification includes such products as clay-coated recycled boxboard (a key grade used for food, paper, and soap product packaging), white patent coated newsback, manila lines newsback, and fourdrinier bleached kraft board (a premium grade used for cosmetic product packaging).
1) real GDP growth for U.S. economy (2.7%), 2) increase in real disposable income (2.7%), 3) growth in total U.S. industrial production (1.7%), 4) growth in purchases of non-durable goods (1.6%), and 5) increase in U.S. exports of folding cartons and related paperboard box materials (0.5% on a volume basis).\(^\text{15}\) Sales traditionally have been very seasonal.

Although estimates vary, industry sources estimate that there were about 300 companies operating 495 folding carton plants in the U.S. in 1998, essentially the same number as in 1997. In addition, there are about 145 smaller or captive facilities that produce only minimal output for specific packaging applications.\(^\text{15}\) The top producers are listed below:\(^\text{22}\)

**Figure 2**

**Major U.S. Folding Carton Manufacturers**

<table>
<thead>
<tr>
<th>Company</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jefferson Smurfit</td>
<td>15.2%</td>
</tr>
<tr>
<td>Fort James</td>
<td>14.1%</td>
</tr>
<tr>
<td>Rock-Tenn</td>
<td>8.3%</td>
</tr>
<tr>
<td>Shorewood</td>
<td>7.9%</td>
</tr>
<tr>
<td>International Paper</td>
<td>7.1%</td>
</tr>
</tbody>
</table>

Graphic Packaging Corp. formally completed its buy of the folding carton business of Fort James Corp. on August 2, 1999, becoming the largest US converter of folding cartons.\(^\text{23}\) Other major producers are Gulf States, Mead, Riverwood, Simkins Industries, Sonoco, Tenneco Packaging, and Westvaco. The packaging and container industry is currently in the process of considerable consolidation, primarily through mergers and acquisitions in order to extend market reach. The overall trend of combinations of operations is expected to continue.\(^\text{24}\)

\(^{22}\) [http://www.activemedia-guide.com/paper_forest.htm](http://www.activemedia-guide.com/paper_forest.htm)

\(^{23}\) Mark Spaulding, “Fort James Acquisition Flex-Pack Sale Sharpens GPC’s Focus on Cartons”, Converting Magazine, 17(9), pp. 10-14, September 1999.

Over the past decade, the folding carton sector has aggressively improved its overall productivity and expanded its range of products. In general, the industry's reputation is one of providing excellent technical and sales service, innovative packaging ideas, and flexibility in response to customer requests. As a result, the businesses in this sector have become increasingly competitive in an increasingly competitive packaging materials market, primarily from plastics and metals. In recent years, the sector has adopted enhancements to the technologies used for printing, pressing, folding, and diecutting. In particular, innovative technologies have been developed in response to the need for environmentally-preferable packaging, especially as an alternative to competing plastic and corrugated paper packaging products.

The food, bakery, and related products segments have been the traditional end-user market for folding cartons. Domestic producers, however, have expanded their customer bases in recent years to include some non-traditional end-user markets. These include cartons and boxes for software and computer-related products, alcoholic beverages, photographic equipment and supplies, and products for restaurant and fast-food businesses. In addition, as the sector's more mature markets have shown signs of fluctuating or stagnating sales, packagers have shifted to offering a wider range of more modern, upscale products to promote increased consumption from such end-user segments as pharmaceuticals, computers, software, soap, cosmetics, toiletries, and specialty foods.

It is forecast that product shipments of folding paperboard containers and boxes will increase about 1.6% annually over the next five years as the domestic economy is expected to grow at about 2.2% per year. As the U.S. economy strengthens, most of the sector's end-use markets are also expected to grow. In addition, exports of folding cartons are estimated to increase by about 6% annually throughout the next five-year period. Mexico and Canada will

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25 Diemaking equipment is used to produce dies that are specifically designed to cut and trim finished printed products to the exact design specifications.
27 http://www.corrugated.org/WhichContainer/index.htm
remain the principal export markets, but the sector will develop several new, non-traditional markets located primarily in Latin America, East Asia, and Eastern Europe.\textsuperscript{15}

1.2 CHANGES IN STRATEGIC POSITIONING

The current business strategy for many of the major paper and paperboard manufacturing and converting companies is the “Best Product” strategic option of Hax’s Delta Model.\textsuperscript{28} By focusing on their own firm and its competitors, the business aims to achieve sustainable competitive advantage through best product economics. Thus, companies at the business level seek to become the lowest-cost producer by being production oriented, expansion driven, asset and throughput centered, cost cutting, and internally focused. Pervading paper and related industries is a focus on production that has led to reducing unit costs by spreading fixed costs.

The goal of paper and paperboard manufacturers, in particular, has been to maximize the output of assets under almost any circumstances. As a result, vertical integration was a common strategy adopted by many of the leading companies to achieve competitive advantage, beginning with owning timberlands for reliable, low-cost supply of fiber and ending with converting and distribution to ensure a market for finished paper and paperboard production. The concentration on commodities continues with the current trend of consolidation through mergers and acquisitions. In the Appendix, the elements of the paper industry’s structure are analyzed using Porter’s\textsuperscript{29} Five-Forces Model to assess the industry’s overall attractiveness. Not surprisingly, the industry has overall low attractiveness as it continues to struggle to achieve acceptable returns due to excess capacity, low prices, and high capital investment for plant modernization and environmental compliance.

Consistent with the overall paper and paperboard industry structure, the majority of the packaging and container businesses have also followed a “Best Product” strategy of competitive positioning. Domestic producers of corrugated and solid fiber boxes focus on raw materials and


finished product inventories in an attempt to adjust operating rates to reflect current domestic and foreign demand patterns. This focus on product economics is illustrated, for example, by annual surveys conducted by the Technical Association of Pulp & Paper Industry (TAPPI) and the Fiber Box Association in which performance data are collected from many corrugators in order to evaluate how factors such as product mix, production rates, setup times, and crewing affect plant productivity. A similar focus on overall productivity characterizes the folding paperboard box sector. In order to remain competitive, many folding carton producers have striven to improve overall operating efficiencies to keep operating costs down. For example, the increased use of digital offset and flexography printing instead of the more traditional rotogravure process are promoted as a means to reduce printing costs and improve production turn-around times. The overriding value proposition has been to provide the lowest-cost, highest-volume of packaging and container products.

The “Best Product” strategy, however, has caused some business segments within the paper and packaging industry to miss significant opportunities that the Delta Model offers for strategic positioning. In the “Total Customer Solutions” option of competitive positioning, the business’ focus is concentrated on the integrated firm around the customer. The second, or “System Lock-In”, option is based on an integrated system focus that is centered on the firm and its complementors. The challenge for the packaging and container businesses is to move to a raison d’être that is based on customer economics, and for some companies, even a system economics strategy centered on the potential role of complementors. The necessary transformation will depend on the offering of value propositions that make for sustained competitive advantage. Increasingly challenged to view their businesses from a customer’s perspective, some paper and packaging businesses will be forced to shift and place less emphasis on making tonnage goals and more emphasis on improving the businesses of their customers.

31 A newer printing technique that uses digital files to put specialized inks onto surfaces being printed without the use of traditional printing plates.
32 A printing process that uses flexible plates commonly made of a photopolymer or a rubber material to deposit the ink on the surface to be printed.
33 A printing process that creates great detail by using intricately engraved metal cylinders to print an image.
A shift from product to customer focus is not without precedent within the broader paper industry. The tissue sector can be considered as just a very large niche market, one that is tied to converting in many instances. More importantly, however, the major tissue producers are very tightly coupled to the consumer. These businesses are found to consistently deliver higher margins on their products despite two frequently cited drawbacks in terms of sustainability. First, even big niche players are often considered too limiting in terms of growth. A second potential drawback is that there is a loss of operational focus among those players moving downstream into converting and merchanting in search of larger margins. Contrary to the views expressed by some in the paper industry, however, the best shareholder value proposition is not necessarily one that is by default relegated to the low range. Rather, the real option for some businesses seeking to generate higher margins over the long term is to enter market segments that enable the firm to provide products and/or services that add value to its customers as part of a “Total Customer Solutions” or “System Lock-In” competitive positioning.

This thesis applies the various dimensions of the Delta Model to the paper converting business of the Chesapeake Corporation, a major producer of specialty packaging and containers. The overall goal is to develop the key elements of a new business model for Chesapeake upon which a strategic agenda can be built. Thus, the central question is how will Chesapeake achieve a strategic positioning that enables sustained competitive advantage over the next decade. The Chesapeake Corporation was selected because the company has undergone an impressive strategic transformation from a natural resources-based, commodity paper and forest products company in the 1980’s to a focused supplier of specialty packaging products and services for selected markets by the end of the 1990’s. The three specific objectives of this study are to:

- Define the existing and desired strategic positioning
- Develop the mission statement / identify the necessary strategic transformation
- Develop a unique value proposition by customer segment

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35 See, for example, the Kimberly-Clark web site at http://www.kimberly-clark.com, and its global branding of Kleenex tissues.
As competition in the US packaging and container sector is expected to intensify even further, the business of Chesapeake must be positioned well beyond merely supplying packaging products and services to one that is capable of adapting to the changing needs of customers and complementors, and of making a profit by meeting those needs.
2.0 CHESAPEAKE CORPORATION

2.1 COMPANY BACKGROUND

Chesapeake is primarily a manufacturer of converted paper products. The existing strategic focus of the company’s business is on specialty packaging. When you buy Duracell batteries or Betty Crocker brownie mix, Chesapeake most likely made the packaging. In addition to consumer graphic packaging, the company is a leading supplier of corrugated shipping containers. For example, chances are good that Chesapeake manufactured the corrugated carton when you purchase a new GE dishwasher.

Founded in 1914 as a pulp and paper mill in West Point, VA, the company is a leading producer of litho-laminated packaging, folding cartons, customized corrugated packaging, point-of-purchase displays, leaflets, and labels. Headquartered in Richmond, VA, the company has over 50 offices and manufacturing plants in the United States, Canada, Mexico, and Europe employing approximately 6,000 people. For 1998, the company had sales of $950.4M, an increase of 10% over 1997, and an EBITDA of $148M. At the end of 1999, the company’s market capitalization was about $517.6M. A detailed financial analysis is given in Section 2.3.

What distinguishes Chesapeake from many other paper and paper product companies is a series of major strategic transformations undertaken during the 1980’s and 1990’s that were targeted to position the company in faster growing niche markets in place of an historic reliance on single, commodity-driven products. Chesapeake recognized that it was not large enough to become a dominant player in the commodity markets, and beginning in the mid-1980’s the company began its transition to a manufacturer of specialty products in three business segments:

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37 This section draws from materials on Chesapeake’s web site at http://www.cskcorp.com.
38 Sources used to prepare this section are: “Chesapeake Corp. – History & Debt”, Investext Industry and Market Intelligence, November 27, 1999; Stephen S. Johnson, “Packaging Profits”, Forbes, 155(1), pg. 178, January 2, 1995.
market pulp, paperboard, and tissue. A major step towards this new business focus was the acquisitions of Wisconsin Tissue Mills, Inc. and Plainwell Papers Co., Inc., both in 1985. Chesapeake also acquired Color Box, Inc. in 1984 and the Displayco Group in 1989 to further the development of innovative products for higher growth niche markets. In addition, Chesapeake owned 325,000 acres of timberland in Virginia, Delaware, and Maryland, and continued to operate three sawmills in Virginia and Maryland which manufactured pine and hardwood lumber.

The company’s paper products and tissue business segments benefited during the 1990’s from increased industry prices for market pulp, containerboard, and tissue. The paper products segment focused its operations on white top paperboard, kraft paperboard, kraft paper, corrugating medium, and bleached hardwood pulp. By rebuilding and changing the product mix at its West Point mill, Chesapeake followed a less capital-intensive strategy to increase capacity. As a result, the company was a market leader in mottled white paperboard, a fancier paperboard that sells at a significant premium to brown paperboard and is used in such products as department store gift boxes.

During the early 1990’s, Chesapeake’s tissue business segment was also targeted for growth, both through internal expansion and acquisitions. New tissue converting equipment was installed annually for several years and in 1995 the company acquired the assets of the Chicago Tissue Company, L.P. to further increase its tissue capacity. In late 1996, Chesapeake acquired the tissue converting assets of two Mexican companies, Jokel Desarrollos, S.A. de C.V. and Ambitec, S.A. de C.V. The company’s tissue products were sold through hundreds of national accounts covering industrial, commercial, food service, and retail businesses. The growth strategy for Chesapeake’s tissue segment was to aggressively promote existing products and develop new products, such as the Second Nature Plus line of napkins and towels that are 100% bleach-free and made of 100% recycled fiber.

The second phase of the company's strategic transformation began in 1992 when an in-depth reassessment of corporate strategy determined that packaging would be the fastest area of growth for the company. In 1994, Chesapeake acquired the Lawless Holding Corp., owner of the Lawless Container Corp. The addition of six plants and the 1995 modernization of one of Chesapeake's container plants greatly increased the company's manufacturing capacity in containers. Chesapeake's earnings showed a major rebound in 1994 ending a four-year period of severely squeezed profit margins for commodity products. 1994 also marked the first time that packaging became Chesapeake's largest business segment by sales. The company's packaging businesses supplied corrugated shipping containers, point-of-sale displays, specialty packaging, and consumer graphic packaging. The graphic packaging segment recorded the fastest growth; led principally by the company's Color Box subsidiary, the company gained the status of a leading national producer of lithographic corrugated packaging. To increase the growth of their packaging businesses, Chesapeake completed three acquisitions in 1996: 1) Display Division of Dyment Limited, with operations in Erlanger, KY and Toronto, Canada; 2) Saillliard S.A.'s point-of-sale display and packaging businesses, the company's first investment in an operating company in Europe; and 3) Triad Packaging Co., Inc., a manufacturer of corrugated containers.

The next and single largest step in the transformation of Chesapeake aimed at moving the company out of cyclical commodity businesses was the sale of the West Point kraft paper mill to St. Laurent Paperboard (U.S.) Inc. in May 1997. No longer would papermaking be Chesapeake's primary business. Instead, the company would focus on less capital-intensive segments, such as packaging and tissue converting. With packaging the company's top priority for growth, Chesapeake acquired the Rock City Box Co. and the Capitol Packaging Corporation in 1998.

Chesapeake aggressively pursued divestitures and acquisitions in 1999 to firmly secure its decade-long strategic repositioning of the company's business. In March, the company acquired the Field Group Plc., a leading European specialty packaging company headquartered in the United Kingdom. In August, Chesapeake sold its building products business to St. Laurent Forest Products Corp., followed in September by the sale of the majority of its timberlands (278,000 acres) to Hancock Timber Resource Group. In October, Chesapeake contributed
substantially all of the assets of its Wisconsin Tissue business to a commercial tissue joint venture with Georgia-Pacific. It retains a 5% minority interest in the joint venture. This marked the last major divestiture of the company’s highly capital-intensive paper business. In October, the company completed the acquisition of Consumer Promotions International (CPI), a leading global designer and manufacturer of permanent point-of-purchase displays, to complement and enhance its existing display business that is primarily in temporary displays.

Several actions initiated by Chesapeake in 1999 were completed in the beginning of 2000. In September, Chesapeake and Georgia-Pacific announced plans to form a graphic packaging joint venture to combine each firm’s litho-laminated graphic packaging businesses. The operating loss of Chesapeake’s Color-Box litho-laminated business was continuing to widen, despite recent strong volume gains, due primarily to under-utilization of the capacity that was added in 1996. Access to this excess capacity was advantageous for Georgia-Pacific because its litho-laminated packaging business was already operating at capacity. Since announcing in November its offer to acquire Shorewood Packaging Corporation, a leading North American specialty packaging company, the company was in heavy litigation with Shorewood’s directors, who strongly resisted the tender offer. This stalemate ended in February 2000 when International Paper announced its intention to acquire Shorewood at a significantly higher price than that offered by Chesapeake. In December, Chesapeake made a cash tender offer for Boxmore International, a leading European specialty packaging company headquartered in Northern Ireland.

Year 2000 started with the Field Group’s announced plan to acquire SCA’s Scottish folding carton business. This move is designed to strengthen the company’s market position in the premium drink packaging market. In search of another North American specialty packaging business, Chesapeake announced plans on March 9, 2000 to acquire Green Printing Company, Inc., a privately-owned specialty packaging producer and printer located in Lexington, North Carolina. This acquisition was completed on March 14. The addition of Green Printing is envisioned to lead to a North American platform for a carton-based specialty packaging business, similar to Chesapeake’s European operations.
2.2 BUSINESS DESCRIPTION

Chesapeake is a specialty packaging and merchandising services company. It has undergone an impressive strategic transformation from a natural resources-based, commodity paper and forest products company in the 1980’s to a focused supplier of specialty packaging products and services for selected markets. As a result, Chesapeake is no longer a hybrid paper company with multiple businesses, but a global specialty packaging pure play as its business focus. Expanding in specialty packaging was advantageous for Chesapeake for three reasons. First, the segment was growing more rapidly than other segments in the paper and paper products business. Second, since specialty packaging is less subject to economic swings, it would be possible for the company to establish a more consistent earnings and growth pattern. More reliable earnings and a higher price earnings ratio for its stock would also allow Chesapeake to raise capital from external sources more effectively. By focusing on a less capital-intensive business, the capital dollars available to Chesapeake would be more effective in generating growth and profits. This third advantage would allow the company to compete more successfully with giant-sized companies that have papermaking as their primary business.

- Merchandising and Specialty Packaging

Chesapeake is the largest North American producer of temporary and permanent point-of-purchase displays. The company’s products and services are targeted to meet the packaging and display needs of multinational consumer product companies by providing a full range of display packaging solutions. Chesapeake offers a full range of services from graphic and structural design to manufacturing, assembling, packing, and distributing of displays and specialty packaging products. Approximately 25% of its customers currently utilize the full range of services offered from design through to packing.

The company also conducts specialty packaging and display operations in France. Products include the design and manufacture of point-of-purchase displays, rigid boxes, luxury folding cartons, and vacuum formed packaging. Chesapeake is the largest manufacturer of temporary displays in France with more than 50% of the production in its French facilities being temporary displays.
Chesapeake is the market leader among North American manufacturers of litho-laminated packaging. The new Chesapeake/Georgia-Pacific joint venture is expected to generate synergies for both top-line and margin improvement.

In addition, Chesapeake supplies high-resolution flexographic packaging, vacuum-formed packaging, and transparent packaging.

- European Specialty Packaging

As the leading European supplier of folding cartons, leaflets, and labels, Chesapeake’s Field Group Plc subsidiary is recognized for its design and manufacture of high quality printed folding cartons, self-adhesive labels, and leaflets for the pharmaceutical and healthcare industry. The Field Group also provides merchandising services to position brands worldwide for major consumer product companies in the tobacco, drinks, and confectionery markets. Its facilities produce the full range of packaging materials, including, for example, the box, the label, the blister pack for individual pills, and the leaflet that is included in the box for pharmaceutical consumer products.

Boxmore is a manufacturer, distributor, and seller of specialty folding-carton and packaging products. Among its packaging products are self-adhesive labels, leaflets, foils, and plastic containers. Boxmore, like the Field Group, is focused on serving the packaging needs of the pharmaceutical industry. In late 1999, the company acquired three pharmaceutical label and packaging operations from Rexam. Since there is very little overlap between the customers that Field and Boxmore serve, the acquisition is expected to add more leading global companies to Chesapeake’s client portfolio.

- Corrugated Packaging

Chesapeake is a leading supplier of customized corrugated containers for specific U.S. markets. In addition to corrugated shipping containers, the company supplies containers made from a variety of materials, such as corrugated-foam combination packaging and corrugated-wood combination packaging.
• Land Development

The divestiture of the building products business and a majority of the company’s timberlands still leaves Chesapeake with a secondary business in land development. This business has been substantially scaled down since there are far fewer company-owned timberlands that can be marketed for greater value as developed property. Land development is conducted through bulk land sales, residential development, and commercial real estate. Chesapeake’s land development subsidiaries, Delmarva and Stonehouse, are currently developing approximately 13,000 acres of land, the majority of which is former company-owned timberlands, in Virginia, Maryland, and Delaware. These development projects include residential housing and a master planned community with a variety of commercial, residential, and recreational uses. Chesapeake has identified its remaining 35,000 acres of timberland for use through similar value-added development projects. The company is expected to continue to develop these properties and sell them in smaller lots or larger blocks as opportunities arise over the next 5-10 years. Until the tracts are sold, the company will continue to harvest the lands. These land holdings include higher value properties located near the I-95 corridor in and around Richmond and Williamsburg, VA and Washington, D.C., where lots range from $50,000/acre for waterfront properties to $2,000/acre for developed land.

2.3 FINANCIAL PERFORMANCE\textsuperscript{42,43}

Chesapeake ended 1999 with revenues of $1.162B, up 22.3% from the previous year. This increase is due to “new” sales of $312.9M in the European Specialty Packaging segment. Revenues from on-going operations performed less well. Merchandising and Specialty Packaging showed a modest increase of 3.0% in sales to $486.6M, but the tissue segment posted a significant decrease of 26.2% in revenues from 1998. Land Development revenues also decreased, but by a smaller percentage (4.2%) to $42.9M.

\textsuperscript{42} Merrill Lynch Global Fundamental Equity Research Department Report, January 25, 2000.
\textsuperscript{43} Stephen E. Keane, “CSK Outlook Uncertain Due to Outcome of Tender Offers Now Underway”, Baird Equity Research Department Research Note, January 26, 2000.
### Figure 3

**Chesapeake Corp. 1998 and 1999 Net Sales**

<table>
<thead>
<tr>
<th>Year - Sales</th>
<th>1999</th>
<th>1998</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>$1,162</td>
<td>$950.4</td>
<td>22.3%</td>
</tr>
<tr>
<td>Merchandising &amp; Specialty Packaging</td>
<td>486.6</td>
<td>472.3</td>
<td>3.0%</td>
</tr>
<tr>
<td>European Specialty Packaging</td>
<td>312.9</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Tissue</td>
<td>319.6</td>
<td>433.3</td>
<td>-26.2%</td>
</tr>
<tr>
<td>Land Development</td>
<td>42.9</td>
<td>44.8</td>
<td>-4.2%</td>
</tr>
</tbody>
</table>

Operating income increased 1.6% over 1998 to $87.9M. However, adjusted for the tissue business that was divested in a joint venture with Georgia Pacific in the third quarter, the operating income was up 31%. The drop in operating income in the Merchandising and Specialty packaging segment was the result of lower margins in the corrugated container and graphic packaging business, which were in turn driven by higher raw material costs such as purchased containerboard. The company has raised container prices to offset raw material price increases, but the impact of the price increase has lagged the increase in containerboard costs. Net income dropped from $42.8M in 1998 to $38.0M in 1999.

### Figure 4

**Chesapeake Corp. 1998 and 1999 Operating Profits**

<table>
<thead>
<tr>
<th>Year – Operating Profits</th>
<th>1999</th>
<th>1998</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Income</td>
<td>$87.9</td>
<td>$86.5</td>
<td>1.6%</td>
</tr>
<tr>
<td>Merchandising &amp; Specialty Packaging</td>
<td>11.9</td>
<td>13.3</td>
<td>-10.5%</td>
</tr>
<tr>
<td>European Specialty Packaging</td>
<td>26.6</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Tissue</td>
<td>51.1</td>
<td>69.6</td>
<td>-26.6%</td>
</tr>
<tr>
<td>Land Development</td>
<td>16.4</td>
<td>16.3</td>
<td>0.6%</td>
</tr>
<tr>
<td>Corporate</td>
<td>(18.1)</td>
<td>(12.7)</td>
<td>42.5%</td>
</tr>
</tbody>
</table>
Figure 5
Chesapeake Corp. 1998 and 1999 Margins

<table>
<thead>
<tr>
<th>Year – Margins</th>
<th>1999</th>
<th>1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchandising &amp; Specialty Packaging</td>
<td>2.4%</td>
<td>2.8%</td>
</tr>
<tr>
<td>European Specialty Packaging</td>
<td>8.5%</td>
<td>N/A</td>
</tr>
<tr>
<td>Tissue</td>
<td>16.0%</td>
<td>16.1%</td>
</tr>
<tr>
<td>Land Development</td>
<td>38.2%</td>
<td>36.4%</td>
</tr>
</tbody>
</table>

It is worthwhile to note the dramatic decline in operating earnings and margins in the specialty packaging segment from 1995 to 1998. While sales increased from $319.4M in 1995 to $472.3M in 1998, the segment’s EBIT dropped from $30.4M in 1995 to $5.4M in 1997. The EBIT recovered to $13.3M in 1998. The specialty packaging margin also fell, dropping to 1.3% in 1997 from 9.5% in 1995 before recovering to 2.8% in 1998. The breakdown of the margin data is also insightful. For 1998, it is estimated that the point-of-purchase display business was modestly profitable with a margin of about 2%, the corrugated container business generated a margin in the high single digits, and the color box business was essentially at the break-even level. The observed earnings and margin pressure are the result of overly aggressive expansion of the graphic packaging (color box) and point-of-purchase display businesses, with both operations burdened by the costs and inefficiencies of operating facilities well below capacity.

Entering 2000, Chesapeake’s graphics packaging joint venture with Georgia-Pacific is expected to result in $3-4M of pretax profit as margins are expected to increase by three full points during the year. The reason for this is that Georgia-Pacific’s business is currently profitable and is operating at full capacity. In addition, CPI is expected to add approximately $50M in annual revenues. Modest margin improvement is expected in the European Specialty Packaging segment due to rising raw material costs. However, sales are expected to show steady growth as end markets such as tobacco and luxury items continue the recent trend of improved demand as the effects of the Asian crisis alleviate. In addition, the acquisition of Boxmore is
expected to be accretive to earnings within the first year. Chesapeake estimates that it will achieve $8-10M in annual synergies through the better utilization of both Chesapeake and Boxmore packaging facilities and through overhead and SG&A reductions. An additional $8M in annual revenues is expected from the acquisition of SCA’s Scottish folding carton business.

**Figure 6**

**Chesapeake Corp. Balance Sheet and Cash Flow Summary for 1999 and 2000 (Estimated)**

<table>
<thead>
<tr>
<th>Balance Sheet &amp; Cash Flow</th>
<th>1999</th>
<th>2000e</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Debt</td>
<td>7</td>
<td>313</td>
</tr>
<tr>
<td>Total Capitalization</td>
<td>559</td>
<td>850</td>
</tr>
<tr>
<td>Debt/Total Capital</td>
<td>1.2%</td>
<td>35.2%</td>
</tr>
<tr>
<td>Cash Provided By Operations</td>
<td>109</td>
<td>136</td>
</tr>
<tr>
<td>Cash Flow Per Share</td>
<td>$5.34</td>
<td>$7.66</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>2.4x</td>
<td>1.2x</td>
</tr>
<tr>
<td>ROE</td>
<td>7.6%</td>
<td>7.1%</td>
</tr>
<tr>
<td>ROA</td>
<td>4.9%</td>
<td>3.9%</td>
</tr>
<tr>
<td>ROCE</td>
<td>9.5%</td>
<td>7.5%</td>
</tr>
</tbody>
</table>

In summary, Chesapeake appears to be well positioned for revenue growth from high-growth target markets and expanded global capabilities. To date, the recent acquisitions of the Field Group, CPI, and Boxmore have exceeded expectations and led to a significant strengthening of the firm’s specialty packaging capabilities. These acquisitions also offer important synergistic opportunities with Chesapeake’s existing point-of-purchase display and merchandising services business for continued year-over-year margin improvement.
3.0 STRATEGIC POSITIONING OF THE BUSINESS

3.1 EXISTING STRATEGIC POSITIONING

Today, the overarching mission of Chesapeake’s specialty packaging and merchandising services business is to be a leading “marketing focused supplier of specialty products for selected markets”.

In the framework of the Delta Model, the strategic position can be characterized as moving from “Best Product” to “Total Customer Solutions”. In other words, the company’s business is positioned to seek customized or bundled solutions for enhancing the performance of their customers by increasing their customers’ market share. Chesapeake is seeking to achieve this by providing customers, on a global basis, with high quality, unique primary product packaging as well as point-of-sale merchandising services. Chesapeake’s strategic position is centered on differentiation from product design through to customer service.

A recent example of an innovative packaging solution is the Field Group’s folded leaflet in carton (FLIC) system that combines a printed folding carton with a consumer leaflet. With FLIC, the leaflet is attached to the carton and becomes visible when the carton is opened. Since the leaflet stays attached throughout the carton’s life, the FLIC enables pharmaceutical and food companies to include detailed instructions on consumption or care in large leaflet sizes that would ordinarily slow down customer turn-around by decreasing packaging line performance. The FLIC also eliminates the need for leaflet feeders. In addition to designing the product, the company developed and manufactured the machinery that attaches the leaflet to the carton during the carton manufacturing process.

Another example is the Duracell displays supplied by Chesapeake to promote battery sales for the Christmas holiday season through point-of-purchase displays in strategic positions at 2,500 Wal-Mart stores. For what turned out to be the largest order in the history of the company, the firm’s Chesapeake Display & Packaging (CD&P) subsidiary used its capabilities

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45 http://www.cskcorp.com/Field/99_field/solution.htm
in design, manufacturing, and logistics to produce, assemble, and ship thousands of Duracell displays to every Wal-Mart store in the U.S. From start to finish, the entire process took only four months. Even more noteworthy is how CD&P’s project management capabilities were used to meet Duracell’s request for minimal product handling and ease of movement by store personnel. CD&P responded by specially designing the display to be on wheels. This meant that the displays could be stocked with battery packages before being shipped and, upon delivery, that Wal-Mart personnel simply had to roll the pre-packed display into position.

Chesapeake has committed to creating and maintaining partnerships with consumer product companies by providing end-to-end services and capabilities for their point-of-purchase promotions. The company has created a bundle of services that they term one-source, turnkey solutions that benefit their customers by providing one of the most customized complement of supply chain technologies in the display and packaging business. Dedicated Chesapeake customer project management teams coordinate each step of brand promotions for retail stores, including worldwide product launches. The one-source solution in merchandising services includes concept development, structural design, graphic design, in-house manufacturing, inventory management, and product distribution. Instead of having to manage several different suppliers, a consumer products company gains important benefits, including project control, shorter lead times, cost controls, risk reduction, in-house manufacturing, quality controls, inventory flexibility, and speed to market. Recognizing that not all products require the same solution at retail, the company provides three types of displays to make their customers’ products distinctive from the competition: temporary displays for high-impact promotions, semi-permanent displays to extend brand presence, and permanent displays to increase retail customer involvement.

The existing strategic position has a sound rationale and benefits for Chesapeake, but it does not go far enough towards attaining sustained competitive advantage. Three deficiencies are paramount. First, the competitive positioning scope fails to garner the full economic value of capturing the brand owner. It also omits two key players, namely, the retailer and the consumer.

Second, while Chesapeake aims to provide one-stop merchandising services, the value chains of the multinational consumer companies and Chesapeake, not to mention retailers, are essentially independent activities. Third, the existing business model is limiting in terms of new value propositions that the company can offer its customers.

3.2 DESIRED STRATEGIC POSITIONING

For sustained competitive advantage, Chesapeake must be solidly positioned to provide “Total Customer Solutions”, with the goal of moving towards “System Lock-In”. This desired strategic positioning is next defined and elaborated in four dimensions of the Delta Model: focus, relevant benchmarking, scope, and synergies.48

3.2.1 FOCUS

The business must think in all directions – back to its raw material suppliers, downstream to the multinational consumer products company as the immediate customer, and, even more importantly, further downstream to the retailer as the channel customer and then to the consumer as the end-user. Chesapeake, its suppliers, and its three customer segments form the integrated firm for which Chesapeake has to offer value propositions centered on customer economics. The integrated system broadens the focus to include the integrated firm and its complementors. In this case, the complementors are the brand owners – the branded product and the package are what ultimately constitute the durable or non-durable good that is bought by a consumer. In the integrated system focus, Chesapeake needs to offer unique value propositions to optimize the economics of the entire system.

Chesapeake has the potential to achieve remarkable growth by assembling a distinctive bundle of capabilities: great merchandising skills, a set of privileged assets, and a web of complementary relationships.48 Chesapeake can make its mark with integrated merchandising services that are designed to help consumer product companies and retailers manage the rush of new product introductions in selected end-user markets. Chesapeake’s merchandising skills will

lie not in developing new merchandising services per se, but in brand and retail concept renewal.\textsuperscript{49} This is the complicated mix of products, brand images, store formats, and retail operations that make retailing a brand unique.

Renewal entails recognizing and responding faster to changes in consumer needs. In addition to understanding how the consumer shops (e.g., which categories) and what brand means to consumers, Chesapeake will have to factor in impulse buying that is a pervasive aspect of consumers’ behaviors and a focal point for much marketing activity.\textsuperscript{50} In-depth information about consumers is the critical link to converting their needs into brand and retail-specific merchandising solutions.

Chesapeake’s differentiation will be predicated on three types of collateral assets: 1) a production and packaging infrastructure, 2) access to key retail networks, 3) a reputation or "corporate brand" for services and products for leading consumer product companies, and 4) detailed information of all kinds relevant to maximizing sales, including consumers’ buying habits and needs.

Central to the desired strategic focus is a web of complementary relationships. Chesapeake will seek to partner with: brand owners desiring to convey unique images, packaged good companies desiring to market consumer products, retailers desiring to make sales, and consumers desiring for quality of life improvements - all through packaging and promotional displays in one form or another. It is in the interests of all these partners to increase each other’s market shares and profitability. When successful, Chesapeake will have created strong barriers to competition through customer lock-in and competitor lock-out.

Despite an impressive strategic transformation, the business of Chesapeake remains heavily focused on product economics – the producing and selling of specialty packaging and point-of-purchase displays. Although the net profit margin for the company was 21.58% in

1998, its stock valuation has been largely dormant in recent years, while the markets in general have soared. 1998 financial data of the firm, the paper and paper products industry, and the market are listed in the following figures and testify to the shareholders' predicament.\textsuperscript{51}

\textbf{Figure 7}

\textit{Comparison of Chesapeake, Industry, and Market Financial Data for 1998}

<table>
<thead>
<tr>
<th>Profitability Ratios</th>
<th>Company</th>
<th>Industry</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Profit Margin</td>
<td>29.25%</td>
<td>27.83%</td>
<td>46.87%</td>
</tr>
<tr>
<td>Pre-Tax Profit Margin</td>
<td>26.22%</td>
<td>6.33%</td>
<td>8.47%</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>21.58%</td>
<td>4.32%</td>
<td>5.66%</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>60.9%</td>
<td>9.1%</td>
<td>12.5%</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>16.8%</td>
<td>2.9%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Return on Invested Capital</td>
<td>23.8%</td>
<td>4.5%</td>
<td>6.4%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Valuation Ratios</th>
<th>Company</th>
<th>Industry</th>
<th>Market</th>
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</thead>
<tbody>
<tr>
<td>Price/Sales Ratio</td>
<td>0.36</td>
<td>0.86</td>
<td>2.06</td>
</tr>
<tr>
<td>Price/Earnings Ratio</td>
<td>1.93</td>
<td>20.25</td>
<td>38.83</td>
</tr>
<tr>
<td>Price/Book Ratio</td>
<td>1.01</td>
<td>1.83</td>
<td>4.53</td>
</tr>
<tr>
<td>Price/Cash Flow Ratio</td>
<td>2.47</td>
<td>7.99</td>
<td>18.50</td>
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<table>
<thead>
<tr>
<th>Financial Ratios</th>
<th>Company</th>
<th>Industry</th>
<th>Market</th>
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</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>1.47</td>
<td>1.66</td>
<td>1.31</td>
</tr>
<tr>
<td>Quick Ratio</td>
<td>0.9</td>
<td>1.0</td>
<td>0.8</td>
</tr>
<tr>
<td>Leverage Ratio</td>
<td>3.62</td>
<td>3.17</td>
<td>5.62</td>
</tr>
<tr>
<td>Total Debt/Equity</td>
<td>1.57</td>
<td>1.13</td>
<td>1.41</td>
</tr>
<tr>
<td>Interest Coverage</td>
<td>5.1</td>
<td>2.7</td>
<td>2.3</td>
</tr>
</tbody>
</table>


\textsuperscript{51} \url{http://www.hoovers.com/premium/comp_data/7/0,2151,10327.00.html}
<table>
<thead>
<tr>
<th>Growth Rates</th>
<th>Company</th>
<th>Industry</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>12-Month Revenue Growth</td>
<td>22.3%</td>
<td>3.5%</td>
<td>4.3%</td>
</tr>
<tr>
<td>12-Month Net Income Growth</td>
<td>637.6%</td>
<td>13.2%</td>
<td>9.0%</td>
</tr>
<tr>
<td>36-Month Revenue Growth</td>
<td>(0.6%)</td>
<td>4.8%</td>
<td>7.8%</td>
</tr>
<tr>
<td>36-Month Net Income Growth</td>
<td>81.4%</td>
<td>16.4%</td>
<td>7.5%</td>
</tr>
</tbody>
</table>

This problem is not unique to Chesapeake, but common throughout the manufacturing sector. Only about one in eight of the 1,000 largest manufacturers has outperformed the S&P 500 since 1988, and fully one-third have seen the value of their stocks decline. The path to success is to create a business model that captures profits downstream, in other words, at the customer’s (and their customer’s) end of an integrated value chain. Chesapeake needs to move even further beyond its core manufacturing capabilities and tap into the valuable economic activity throughout its integrated system value chain.

3.2.2 RELEVANT BENCHMARKING

The first step towards a new value chain is to assess the overall attractiveness of Chesapeake’s downstream market opportunities. Wise and Baumgartner⁵² suggest three metrics:

1. Ratio of installed base to new product sales
2. Life cycle economic activity as a multiple of product cost
3. Difference between downstream margin and product margin

The specialty packaging and point-of-purchase display market has an installed base - to - new unit ratio of about unity since consumer and consumer-related products that come packaged are essentially expendable goods and there is little accumulation of past purchases. Although this would suggest that a downstream move is relatively unimportant because the firm should focus on traditional manufacturing strategies, the contrary position is strongly indicated by the other

two metrics. First, the costs associated with packaging or display “ownership” and “usage” over the product’s life cycle are relatively large compared to the product’s cost. For example, a consumer goods company incurs substantial expenditures in packaging, logistics and distribution, warehousing, marketing, and retailing that are a fraction of the cost of purchasing packaging or display materials. Second, the profitability of downstream activities (approximately 15%) relative to Chesapeake’s product margin (approximately 5%) is relatively high, an estimated 10 percentage points. Thus, there exists a significant downstream opportunity for Chesapeake.

It is also necessary to assess the competitive position of Chesapeake’s business in order to evaluate the importance of forming strong customer relationships. Three metrics are suggested by Wise and Baumgartner:\(^{52}\):

1. Magnitude of product-based differentiation
2. Market share of top five customers
3. Share of total profit earned from top 20% of customers

Chesapeake’s ability to differentiate products that are essentially commodities is increasingly more difficult as the leading packaging manufacturers maintain relatively comparable technology and performance capabilities. The market share of the company’s top five customers\(^ {53}\) is estimated at 30%, suggesting a moderate-to-high level of consolidation in the end-user markets served by Chesapeake’s customers. These metrics suggest that it is essential to establish strong relationships with key customers. Since Chesapeake has aimed to build in diversification by catering to as many customers as possible, as opposed to serving several key accounts, the share of total profit earned by the firm from its top 20% of customers is broadly estimated to be about 33%.\(^ {54}\) The primary conclusion, therefore, is that Chesapeake needs to move downstream in the integrated value chain since this is what provides the only viable escape from a profit squeeze in

\(^{52}\) Chesapeake’s largest customer is Procter & Gamble. Other top customers (in no particular order) are Pharmacia & Upjohn, Warner Lambert, Gateway, Johnson & Johnson, BAT, United Distiller, Estee Lauder, and Cadbury. This information is courtesy of Gregg S. Lucas of Wachovia Securities.

\(^{54}\) Gregg S. Lucas, Wachovia Securities.
the core manufacturing business when the price of finished products lags behind the increase in raw material costs.

The last step is to evaluate the structure of the distribution channels in the system value chain in order to understand the real scope of downstream opportunities centered around the complementors. Three metrics provide useful insights into the power of the distribution channel:

1. Distribution and selling expenses as a percentage of product price
2. Degree of channel concentration: market share of top five distributors
3. Degree of channel innovation or multiplication

From a Chesapeake-only perspective, it would appear that channel issues are not as critical for two reasons. First, the distribution and selling expenses represent a very small percentage of a packaging or display product’s price compared to raw material costs. Second, Chesapeake sells its products directly to consumer goods companies. This would suggest that the traditional focus on manufacturing strategies be retained. In this case, however, the more appropriate view is that of the integrated system. Within the packaged goods industry, the large, consolidated retailers control the distribution channels. As a result, the products of any one consumer goods company represent a small fraction of the retailer’s mix of goods, leaving the company with little influence over the retailer’s (i.e., their customer’s) purchasing decisions. Whereas Wise and Baumgartner suggest that the only option in these cases may be to bypass the distributor using some new channels, the premise of this study is to seek a complete network and a system value chain that allow retailers to discover new value propositions for their customers. This benefit is in addition to the significant value propositions made possible for Chesapeake and consumer product companies by an integrated system focus.

The scope of Chesapeake’s downstream opportunity is summarized in the following figure that is adopted from Wise and Baumgartner:

34
### Figure 8

**Chesapeake’s Downstream Opportunity**

<table>
<thead>
<tr>
<th>Attractiveness of Downstream Business</th>
<th>Importance of Customer Relationships</th>
<th>Power of Distribution Channel</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ratio of installed base to new product sales</td>
<td>Life cycle economic activity as a multiple of product cost</td>
<td>Difference between downstream margin and product margin</td>
</tr>
<tr>
<td>Magnitude of product-based differentiation</td>
<td>Market share of top five customers</td>
<td>Share of total profit earned from top 20% of customers</td>
</tr>
<tr>
<td>Distribution and selling expenses as a percentage of product price</td>
<td>Degree of channel concentration market share of top five distributors</td>
<td>Degree of channel innovation or multiplication</td>
</tr>
</tbody>
</table>

- **Downstream moves are unattractive or irrelevant.**
- **Downstream moves are more attractive or important.**

- **Stable or monolithic**
- **Dynamic or multiplying**

3.2.3 **SCOPE**

In looking beyond its traditional packaging products and more recent offering of merchandising services, it is necessary to understand the major challenges facing multinational consumer product companies and general retailers.

For consumer goods companies that market branded products, there are constant pressures to continually counteract generic and private label products. With pricing pressure

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not abating for retailers, their emphasis on private brands is expected to continue.\textsuperscript{56} This is especially a top issue for the over-the-counter drugs produced by pharmaceutical companies.\textsuperscript{57} A second major challenge for consumer packaged goods companies is to continually introduce new products to fuel top-line growth.\textsuperscript{58} This runs the gamut from discovering the next blockbuster drug to developing the next high-tech gizmo. Since over the next five years, packaged goods companies plan to introduce about 21\% fewer new products than they did in 1998, the products that they do bring to market will have to generate significantly more volume than new products did in the past.\textsuperscript{59} With fewer in-store retail employees available for merchandising, packaged goods companies are having to overcome poor retail execution, such as out-of-stocks and nonexistent displays, that mightly influence a consumer’s purchasing decision. A related challenge for consumer goods companies is measuring their return on promotions at the store level. Approximately 78\% of consumer goods companies do not have any means of distinguishing poorly performing promotions from more profitable ones so that they might shift their resources accordingly.\textsuperscript{59}

Retailing includes all business activities that involve the sale of goods and services to the consumer for personal, family, or household use. It is typically a high volume, low margin business that poses several key challenges to general retailers. Although total retail sales and retail sales as a percent of disposable personal income increased steadily throughout the 1990’s, a primary challenge is to lure consumers into stores now that they are spending less time on shopping and to keep them coming back to shop.\textsuperscript{56} Since convenience is an important consideration for these so-called “precision shoppers”, retailers are challenged to have a full stock of merchandise, speedy checkout, and good service. In the near-term, the general retailing environment will remain intensely competitive, challenging managers to increase productivity and reduce expenses. This has two major implications. First, retailers will focus on carrying unique merchandise in seeking to differentiate their businesses from the competition that offers a

\textsuperscript{57} Christopher Moran, “Pharmaceuticals & Medical Equipment Industry”, http://www.hoovers.com/industry/snapshot/0,2204,32,00.html
\textsuperscript{58} Joy Aiken, “Electronics & Miscellaneous Technology”, http://www.hoovers.com/sector/analysis/0,2178,12,00.html
virtually identical product mix. Second, managers will strive to extract the best sales volume possible out of the least amount of inventory. Since pricing pressures will likely worsen as e-tailing captures a larger share of sales, inventory management will be a major challenge.\(^{60}\) Having the right merchandise in the right place at the right time is essential to successful retailing.

To be successful and achieve sustained competitive advantage, Chesapeake must respond with an integrated solutions business model that directly combines products and services into seamless bundled offerings that can be easily customized to address the needs of the complete firm and customer network. This new business model is a complete merchandising management system. The critical underlying concept in this model is to exploit the synergies that arise from offering both brand and in-store merchandising products and services on one functional axis, and production management and display management as another unifying functional theme. These relationships are illustrated in the following figure.

\(^{60}\) Linnea Anderson, “Retail & Wholesale Industry”, http://www.hoovers.com/industry/snapshot/0,2204,37,00.html
Chesapeake is already well positioned to conduct brand merchandising. This activity is centered on the services needed to create and deliver packaging and point-of-purchase (POP) display materials for branded products. It includes the complete array of product type (i.e., corrugated containers, specialty packaging, folding cartons, displays, labels, etc.) that can be deployed by consumer goods companies. More importantly, however, along with these products, Chesapeake needs to provide services that meet the requirements of consumer goods companies for packaging and displays that are either specially tailored to specific retail channels or communicate a consistent brand image across all relevant distribution channels. By purchasing such integrated packaging-plus-POP products and services, consumer goods companies should anticipate and realize increased market share, reduced cycle time, and enhanced quality levels.
The in-store merchandising element seeks to tailor primarily POP displays and related materials for retailing to specific channel customers. Addressing these end-user requirements runs the gamut from convenience (e.g., in-store layout optimization) to selection choice (e.g., assortment planning) to shopping experience (e.g., in-store operations). By using Chesapeake’s integrated packaging-plus-POP services, retailers should anticipate and realize more effective sourcing and branding through nationwide account management.

Chesapeake is already well positioned to carry out some downstream activities because of its knowledge of its products and end-user markets. In shifting its strategic perspective, however, the company will also need to build integrated customer relationships that bond together Chesapeake’s business with its direct (i.e., consumer goods companies) and extended customers (i.e., retail distribution channels and consumers). This is critical, since one of the most efficacious means of securing customer lock-in is customer allegiance. By creating value propositions that drive customer loyalty, Chesapeake can aim to become the preferred supplier of specialty packaging and POP displays throughout the life cycle of the “bundled solution” for total merchandising service. The goal is to secure the strongest relationships with the most profitable customers.

Close, more committed partnerships with many retailers, and mass merchandisers in particular, are not common. Retailers are powerful both because they are the gatekeepers of the consumers, but also because they control supply and demand of space. Despite the doubling of retail space in the past 15 years, for each area of retail space given out there are about a dozen brands and/or companies waiting in line. It is not uncommon for about 50% of POP material to not make it out of the back room.

One aspect that retailers cannot control, however, is the packaging of a branded product. Therefore, by offering products and services that are based on a complete merchandising management system, Chesapeake can create the partnerships needed to bring together its

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business, as a merchandise service provider, with that of the consumer product company, as well as with that of the retailer who is struggling to keep shoppers out of competitors’ stores. Retailers are increasingly looking to brand marketers for knowledge of how to market better in-store to make greater profit centers. This can mean creating more scale and more theater, but it can also mean determining consumer preferences. Thus, sustained competitive advantage for Chesapeake will be to provide value-added products and services to both consumer product companies and retailers through partnerships that ultimately keep merchandise moving off of pallets. Chesapeake is well positioned to serve this role because its capabilities can extend beyond production to specialized design and display management. Every retailer has its own identity and value proposition that packaging-plus-POP should enhance; this can mean incorporating graphics that emphasize merchandise quality for the Target chain, whereas designing displays with a price-oriented bent is more appropriate for Wal-Mart stores. The challenge for Chesapeake is to offer integrated packaging-plus-POP that meets retail objectives as well as brand objectives.

3.2.4 SYNERGIES

In a drive towards global presence, leading consumer product companies are consolidating worldwide. This trend is accompanied by strategic sourcing, an increasing preference by multinational firms to purchase supplies and services through a consolidated, global vendor base. The existing merchandising and specialty packaging business is highly fragmented, however, and offers few suppliers of integrated value chains.

While many suppliers in general offer to work more closely with their customers, the natural tendency of customers is to chose their supplier based on “best” price – unless they desire and are willing to pay for new value-added services that enhance their own performance. In order to identify such synergies for the business of Chesapeake, it is necessary to view the system value chain from the perspective of all customer segments.

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Chesapeake's existing value chain is basically a traditional manufacturer's view that is relatively compact. It generally consists of raw materials logistics, manufacturing, distribution, warehousing, marketing and sales, and technical support services. However, from the perspective of the multinational consumer product company and retailer, as well as the consumer, the downstream chain is much more complex. For example, the supply chain of a typical packaged consumer goods company comprises R&D, manufacturing, packaging, distribution, warehousing, marketing, and retailing. In retailing, the value chain involves site selection, assortment planning, manufacturing and sourcing, logistics and distribution, marketing and branding, and in-store operations.\(^{65}\) How these demand-supply chains are linked is important to identifying what Holmstrom et al.\(^{66}\) refer to as the optimal penetration point (OPP) and value-offering point (VOP). The second step is to manipulate the integrated system value chain to identify new value propositions throughout the network that benefit all customers.

The new system value chain centered around the customers of Chesapeake's business is shown in the following figure:

Figure 10

Integrated Value Chain

Consider, for example, the case of retail-specific promotions. The consumer goods company must typically choose between ordering packaging and promotion materials in relatively large lots, and thus holding unnecessary inventory, or paying the higher cost associated with procuring many small orders. By offering to plan and manage the in-store merchandising system from pre-packaging through to post-packaging operations, Chesapeake can reduce the purchasing and materials-handling costs of the packaged consumer goods company as well as streamline overall operations. This “pack to order” OPP is the place in the supply chain where consumer goods are turned into finished products and are allocated from a packaging plant in response to orders received from retailers. In the future, it is envisioned that the OPP will move to “make to order” for on-demand manufacturing that meets the specifications of individual customers.

The VOP is the place in the chain where the consumer goods company fulfills the demand in the retailer's demand chain. By again offering to plan, Chesapeake moves the VOP back to merchandising. By collectively seeking to analyze the consumer demand in the end-user markets served by the consumer goods company and retailer, the optimal targeting strategy can be identified. This activity is also expected to improve the delivery performance of the Chesapeake-consumer goods company link in the system value chain.

Integrated merchandising management is the heart of the new value proposition because it enables the total network to measure and assess the effectiveness of the customized “bundled” solution. It enables the experimentation and feedback needed to adaptively meet changing requirements at all levels of the supply-demand chain. The synergy between brand and in-store merchandising is realized when an effective total packaging+display solution is executed that results in: “seamlessness” for consumers, more profitable use of retail space by retailers, larger market shares for consumer goods manufacturers, and, for Chesapeake, high in demand services that the firm can charge a premium price and increase its profitability.
4.0 MISSION STATEMENT

The new mission of Chesapeake is to be the global leader in integrated merchandising products and management services. In the next ten years, the business will be dedicated to providing world class integrated merchandising management and retailing consulting services. With this new mission, Chesapeake can lead the converted paper products industry with merchandising management services that are unique in the industry because they integrate both supply- and demand-side merchandising strategies of the firm, customers, consumers, and complementors.

In order to identify the requisite transformation, it is necessary to analyze the existing and future business scope from four dimensions: product, market, geographic, and unique competencies.\(^{67}\) Underscoring and linking the changes within each scope is the recognition that long-term relationships with customers are critical to building demand for Chesapeake’s value-added products and services and eventually capturing preferred-vendor status. In this respect, Chesapeake is re-modeling itself as a new breed of producer and merchandiser within the paper converting industry. The challenge for the business is to break out of the “low-margin box”.

4.1 PRODUCT/SERVICE SCOPE

4.1.1 EXISTING PRODUCT/SERVICE SCOPE

Chesapeake’s merchandising and specialty packaging business consists of a wide array of products and services supplied by three wholly owned subsidiaries: Chesapeake Display & Packaging Co., Chesapeake Packaging Co., and Field Group plc.

For 1999, total sales were about $1.0B, with the newly acquired European packaging segment posting the largest percentage of sales.\(^{68}\)


\(^{68}\) Chesapeake Analysts Presentation, January 2000.
Net sales for the merchandising and specialty packaging segment were up 3% in 1999 from the previous year due mainly to volume increases in corrugated containers and displays. However, the earnings for this segment were down 13% from 1998 due primarily to higher raw material costs.69

The existing product and service scope is characterized as follows:70

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70 Following the priority assessment scale of Hax and Majlu: -- is being divested or exited from; - will be assigned a low level of importance, E will continue to receive the current level of resources; + is assigned a high level of importance and additional resources needed to achieve a better competitive position; ++ is assigned the highest level of importance and the resources needed to achieve as outstanding a competitive position as possible.
### Figure 12
**Existing Product/Service Scope**

<table>
<thead>
<tr>
<th>Existing Product/Service Scope</th>
<th>--</th>
<th>-</th>
<th>E</th>
<th>+</th>
<th>++</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Temporary &amp; permanent point-of-purchase displays</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• Merchandising services</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>• Litho-laminated corrugated packaging</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>• High-resolution flexographic packaging</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Corrugated shipping containers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• Corrugated/other material combination packaging</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• Folding cartons</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>• Leaflets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• Labels</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Litho-laminated packaging</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>• Rigid set-up boxes</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>• Vacuum-formed packaging</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>• Transparent packaging</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

In terms of the overall competitive positioning of the business, the leading products are folding cartons, corrugated containers, and displays. Currently, only about 25% of Chesapeake’s customers make use of its turn-key merchandising services.

Chesapeake Display & Packaging (CD&P) designs and manufactures temporary and permanent point-of-purchase (POP) displays in the United States, Canada, England, France, and China. Point-of-purchase displays are a major marketing tool used in grocery stores, convenience stores, video stores, pharmacies, and other retail locations to advertise and showcase a specific product or a set of products to consumers. Point-of-purchase displays are free-standing and highlight or advertise a specific product or set of products for customers. They are typically temporary, composed primarily of linerboard and corrugated medium with high
graphics printability, and used to support a specific product rollout or advertising campaign. Chesapeake also supplies permanent point-of-purchase displays that are constructed out of wood, plastics, and/or metal. Critical performance features for displays are design creativity, strength, print quality, and appearance. With facilities at 16 locations, Chesapeake aims to add value by providing a full-range of merchandising services (i.e., one-stop shopping), including market research, graphic and structural design, assembly, co-packing, and overall logistics support.

Under its joint venture with Georgia Pacific, Chesapeake’s three plants located in California, Indiana, and Mississippi design and manufacture litho-laminated graphic packaging (i.e., small flute corrugated packaging) for consumer product companies. This small flute corrugated packaging is made from high quality lithographic sheets that are placed over microflute corrugated boxes. Consumer product companies use this lightweight graphic packaging to pack, store, stack, and display retail products. Mass merchandisers prefer this packaging because of its superior graphic appearance and stacking strength.

The recent acquisition of Green Printing adds high-end, lithographic printed folding cartons, specialty packaging, sales and promotional materials, and technical publications to the existing product scope. Green Printing’s capabilities also enable the business to provide its customers with state-of-the-art pre-press and design operations, leaflet and bindery support as well as fulfillment and assembly services.

Chesapeake Packaging Co. manufactures corrugated shipping containers in 10 plants in the United States. Since the products are driven by customer needs, the plants produce a wide range of boxes using linerboard and recycled corrugated medium ranging from J flute to H flute. The containers supplied by the company aim to prevent damage to packaged products during shipment through high quality, durable protective features. The company’s products include custom-designed features, such as corrugated and foam combination packaging and corrugated and wood combination packaging. Each plant typically provides a unique component. For example, the Binghamton, NY plant mostly produces boxes with high registration flexo-graphic requirements and the Denver, CO plant produces a patented handhold for Gateway computer boxes.
Field Group is a European specialty packaging company with headquarters in the United Kingdom. The company’s principal business is the design and manufacture of folding cartons, leaflets, and labels. With the acquisition of Boxmore International Plc, a leading European packaging company headquartered in Northern Ireland, and SCA Packaging, a Scottish folding carton business, Field Group is well positioned as the leading supplier of folding cartons in the UK. In addition to plants in England, Ireland, and Scotland, Field Group has facilities located in Belgium, France, the Netherlands, and Spain.

4.1.2 FUTURE PRODUCT/SERVICE SCOPE

The new “integrated merchandising management system” model necessitates a new, redefined service-led scope. It will be high quality and problem solving services that largely sell Chesapeake products to major brand owners and customers. It is envisioned that Chesapeake’s unique product and service offering will consist of the following comprehensive and complementary business activities for creating the customized solutions required by key customers in selected markets:
### Figure 13
**Future Product/Service Scope**

<table>
<thead>
<tr>
<th>Future Product/Service Scope</th>
<th>Key Offerings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrated Merchandising Services</td>
<td>• Brand Merchandising&lt;br&gt;• In-store Merchandising&lt;br&gt;• Merchandising Information System&lt;br&gt;• Logistics / Distribution&lt;br&gt;• Inventory / Purchasing Management&lt;br&gt;• Packaging Waste Management Services&lt;br&gt;• International Service Management</td>
</tr>
<tr>
<td>Production Management</td>
<td>• Production Operations Management / Packaging Production Runs / Maintenance Services&lt;br&gt;• Package Engineering&lt;br&gt;• Contract Packaging / Order Fulfillment&lt;br&gt;• Testing / Certification</td>
</tr>
<tr>
<td>Display Management</td>
<td>• Category Management / Assortment Planning&lt;br&gt;• Design / Manufacture / Assembly&lt;br&gt;• Prototyping&lt;br&gt;• Pre-packs</td>
</tr>
<tr>
<td>Consulting &amp; Design Services</td>
<td>• Retail Branding / Marketing&lt;br&gt;• Cross-Merchandising</td>
</tr>
</tbody>
</table>

This product/service scope within the firm’s new business model is designed to enable the strategic transformation needed to create strong customer allegiance, capture a large share of customer’s high-margin merchandising spending, and earn recurring service revenues.

- **Integrated Merchandising Services**

  Integrated merchandising services are at the heart of the new business of Chesapeake, providing customized solutions that meet the unique needs of its customers. Integrated
merchandising services integrate all the functions necessary to support product rollout, new product launches, and retail-specific promotions. The integration of merchandising management services with Chesapeake’s specialty packaging is key. This is because it gives customers value-added incentives to employ the firm for manufacturing and sourcing by providing them with the tracking and measurement of their retailed brands in terms of selling performance factors. Information-sharing relationships with manufacturers and retailers will be critical in setting out to build the firm’s reputation as a leading retail service merchandiser of category-specific consumer brands.

- Brand Merchandising

Chesapeake’s brand merchandising will focus on creating a strong brand image by blending the brand messages, the product, and the packaging. All three elements must reinforce each other to enhance the end result. For example, in the pharmaceutical market, some firms seek to either implicitly or explicitly distinguish all aspects of the product as providing the highest quality available and thus endearing the brand to customers, mainly physicians and patients. Another example, in the cosmetics sector, is Olay’s Daily Renewal Body Wash. To address merchandising changes for retailers and alleviate customer confusion between two products, a bold, sleek packaging with updated graphics was developed for Daily Renewal that also aims to revamp and enliven Olay’s image.

Value-added merchandising will be driven by Chesapeake’s ability to adapt to changing market sectors. The utilization of new and adapted technological innovations will allow the development of lighter-weight, more colorful graphics packaging products that are visually appealing, yet do not sacrifice the folding carton’s dimensional stability and structural integrity. Other techniques such as cold embossing and foil stamping, including custom holography foil stamping, offer brand owners high impact shelf visibility and enhanced brand image. The successfulness derived from these various processes and conditions, however, will ultimately depend on superior packaging design. Creating classic designs that produce enduring quality

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and appeal, and transcend the practicality of packaging, will drive Chesapeake’s brand merchandising.

A key element of brand merchandising will be mock-ups. By creating a few samples of a carton or label, Chesapeake can work with the brand manager to mock up a new or redesigned package to see what it will look like before committing to a final design. Such samples can also be shown to key retailers and consumers, giving them a real life look at how a new or revised product or extended product line will appear. In addition to assessing product visibility, samples allow exploration of shelf impact and nesting opportunities. The intent is to produce package/label variations for branded, in-house consumer testing where production-quality packaging and printing are very important. This will also mean a quick turnaround on sample redesign and production. For pharmaceutical and other companies that use shrink bands, mock-ups will be important for testing graphics in a quick, economical way prior to full production. Lastly, they can also be used in print ad campaigns and catalogs when the real package is not yet available.

In the quest for tamper-resistant packaging, many consumer products companies and packaging manufacturers have lost sight of the need for consumers to easily view products. For example, in some market sectors, limited-edition products are viable sales options for which Chesapeake can design and produce short-runs of packaging that permits the product to “leap out”, yet remain protected from tampering.

Sturdy, brightly colored corrugated boxes for direct mailings are another new product category for Chesapeake to leverage its corporate packaging competencies. This is a natural extension for Chesapeake since multinational consumer companies frequently opt for a direct mail approach to introduce a new product or promote a brand extension, and at the same time combine it with a free trial of the product. This brand merchandising will involve the design and manufacture of corrugated boxes that break through the usual mailbox clutter and also reinforce a brand’s premium positioning. The box/product packaging could also be designed to

73 Mike Beirne, “Touching the Untouchables”, Brandweek, 40(13), R18, March 29, 1999.
include postage paid cards for recipients to recommend friends to receive the trial product, thereby creating for the brand owner a demographic database of likely customers. Such product introduction and direct response promotion programs will also serve to enhance the reputation of Chesapeake’s consulting services.

- **In-store Merchandising**

  In-store merchandising activities will focus on creating a strong retail image by tailoring a brand’s packaging, point-of-purchase material, and product information services to amplify the business of the retail channel.

  Successful in-store merchandising will need to fill the gap at retail that exists between retailers lacking the resources to meet all of their needs for merchandising support and third-party merchandisers hired by consumer goods manufacturers to address their brand needs. In 1996, in-store merchandising services were estimated at about $7.4B, with third-party merchandising firms accounting for about $1.1B.\(^74\) Much of the growth in the retail merchandising industry is in the supermarket, drug, and mass merchant channels; consumer electronics is another rapid end-user growth area.\(^75\) In a recent survey of retail executives from various trade channels, 75% had worked with an in-store merchandising company during the past year, but only 53% of the retailers reported that they encouraged their suppliers to use these services.\(^76\) Not surprisingly, the current environment frequently instills conflicts and the resulting grudging reluctance by both parties to pay for in-store merchandising services can jeopardize the success of the product on the shelf.

  The implications of impulse selling and other POP activities for the business of Chesapeake are several-fold. First and foremost, Chesapeake’s POP must be highly informative – it must tell the customer what the product is and why the customer should buy it from this retailer. It also must strengthen brand perceptions and attitudes, and differentiate the brand from

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its competitors. Depending on the promotion, Chesapeake will seek to tailor its POP to reach new customers, retain customers, up-sell existing customers, or educate in-store sales staff. For each objective, there will need to be a means of evaluating the POP’s effectiveness at meeting that objective.

Chesapeake’s two major service activities will be new product introductions and product presentation, areas that typically fall in the merchandising gap. This will require linking the brand equity of a line, as expressed in product and packaging ideas, with merchandising presentations that reflect the demographic profile and merchandising needs of the retailer in order to sustain consumer interest and, thus, profits.\textsuperscript{77} Other activities include implementing POP and ensuring in-stocks on promotion products. In terms of service execution, Chesapeake will need to rely on its intimate knowledge of the retailer to insure knowledgeable performance of tasks, attention to timeliness in performance, and full store coverage.

Transparent at retail is the detail work that goes into acquiring information that leads to the development of appropriate point-of-purchase. It is this data collection that will drive Chesapeake’s value-added retail merchandising services in the short-term. This includes designing and executing category management programs and efficient consumer response initiatives as well as maximizing shelf space by recommending optimal product mixes. Chesapeake’s ability to adapt to changing customer segments will be the long-term driver of its value-added merchandising.

Although point-of-purchase has long been a part of manufacturers’ marketing plans, its importance and prevalence within the marketing mix appears to be increasing among major brands. This is based on evidence provided by anecdotal reports from companies of increased spending on POP activities and by the creation of new job positions within companies to specifically handle POP and channel marketing issues.\textsuperscript{63} According to the Point-of-Purchase Advertising Institute’s (POPAI) most recent industry study, sales of POP displays, signage, and in-store media to marketers and retailers in 1996 reached $12.7B.\textsuperscript{78} A 1995 study of consumer

\textsuperscript{77} Barbara Thau, “Target’s Bakeware Strategy: Johnson Unveils Makeover”, HFN, 73(39), pg. 1, October 4, 1999.
buying habits by the POPAI testifies to the importance of POP in marketing. The data show that 70% of all buying decisions are estimated to take place at the point of sale, and that two-thirds of consumers who buy an item that is being promoted using POP are influenced by the display or sign in making their decision.\textsuperscript{62} As packaging increasingly addresses quality of life issues and retail stores become trusted information agents (see Section 4.2.2), POP information will become more important than ever.

The function of retail merchandising to deliver more information to the consumer has important implications for Chesapeake's future service offerings that will utilize new retail technologies. One such new activity will be the operation and servicing of in-store product information and frequent shopper kiosks. In a recent survey by Indiana University's Center for Education and Retailing (IU) and the KPMG, consumers were very positive about kiosks.\textsuperscript{79} Information/ordering kiosks received favorable ratings because they were perceived as making shopping faster and easier by helping consumers locate products as well as learn about the product in which they were interested. Consumers also liked frequent shopper kiosks because they highlighted promotion items and eliminated the need to clip and carry coupons. By operating web-enabled kiosks that can be free-standing, shelf systems, or wall-mounted displays,\textsuperscript{80} Chesapeake will be able to develop and implement integrated marketing programs for manufacturers and retailers that communicate with consumers not only in the retail store, but also at home and work. In this way, the information void, created by sales personnel that are unavailable or uneducated about the product, is filled. By using kiosks, Chesapeake will enable firms such as pharmaceutical, healthcare, and technology product manufacturers to provide more detailed information and usage instructions for special, rapidly changing, or complex products. In addition, Chesapeake will aim to utilize this type of POP to differentiate among similar products in a manufacturer's product line and between competing products.

A second new retail technology offering of the business will be electronic signage services. The IU-KPMG survey found that consumers were very receptive to electronic point-of-

\textsuperscript{79} Raymond R. Burke, "Retail Technology and the Customer Interface", Point of Purchase Magazine; http://www.popmag.com/archives/0999/sept99stor7.html
sale (POS) shelf labels and signage because they provide accurate price information on the shelf that allows them to make faster product decisions and avoid errors and manual price checks at checkout. Chesapeake’s services will include working with manufacturers and retailers to dynamically change promotions in response to changes in product inventory, consumer demand, and competitive conditions.

The impact of these new retail technologies on Chesapeake’s service execution is significant. The reason for this arises from technologies’ interactivity and direct interface with customers. What this means for the firm is the adoption of new approaches to developing many types of promotional materials. Rather than creating one campaign that appeals to the mass market, information will be tailored to the unique needs, preferences, and shopping habits of customer segments. An even more important value-added proposition for Chesapeake will be quantification of promotional program impact since information can be updated in near-real time and directly linked to consumer transactions.

With a growing number of clients, Chesapeake will be in the unique position to promote cross-merchandising of products. Joint promotions based on product affinities, seasonality, and other factors have been found to significantly boost the sales of both companies’ products. Just about every packaged product is part of a potential consumer solution, and Chesapeake is positioned to leverage the opportunities by bundling products or services and creating destination centers within stores. The POP designed by Chesapeake will play a critical role because it has to convey what customers need to know about the offer and it has to clearly state the value to the consumer.\(^8^1\) In addition, displays will have to be as easy as possible to install and set-up. At another level, Chesapeake may provide retailers with pre-printed channel tags and pressure-sensitive lettering to assemble price points and messages on pre-printed signs in a professional-looking manner.

\(^8^0\) Anonymous, “Use of Interactive Displays Gains Interest”, Point of Purchase Magazine; http://www.popmag.com/archives/0299/feb99stor2.html
\(^8^1\) http://www.popmag.com/archives/0699/jun99stor2.html
Recycled packaging and packaging waste reduction are a major concern of end-users, as well as product and package manufacturers and retailers. The trend is to reduce the amount of material in logistical and other packaging in response to pressure to facilitate recycling of some material. With each passing year, Chesapeake will aim to use less and less new material per package as more material is reused and recycled. Thereby, Chesapeake will be able to shape the decisions of consumer product companies and retailers based on its recycling or reusable container programs and servicing of waste disposal programs. Since logistical packaging disposal expenses are increasingly being factored into the cost for delivering goods, it makes good system economics sense for Chesapeake and its customers and complementors to pursue competitive waste reduction strategies.

- **Merchandising Information System**

One of the most critical issues for brand manufacturers and retailers to address is “how effective is the promotion – what is the incremental sales increase of the program?” With its arsenal of in-store-merchandisers, Chesapeake can offer data collection methods for tracking and measuring the selling performance of packaged consumer goods that are linked to its POP. For manufacturers, the focus will be on the stores, promotion types, and lifestyle appeals that will increase business from their brands’ loyal customers as well as consumers who buy competing products. Similarly, retailers will be able to identify the store-format, merchandising (e.g., shelf placement), and promotion strategies, and other decisions, that will most effectively increase business within existing stores and proposed expansion sites. Both manufacturers and retailers will be able to base decisions on store-level, consumer information using Chesapeake’s on-line merchandising information system. The value-added derived from access to retail information escalates as the focus shifts from initial operational issues (e.g., out-of-stocks) to strategic and marketing issues (e.g., consumer trends).

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New uses of technology will be realized to capture consumer information, build loyalty, and identify the top 20% of users who account for 80% of sales. Interactive displays offer the potential to assess POP's effectiveness for clients in terms other than increase in sales. With increasingly high-tech displays, it is becoming easier to determine, for example, exactly how many people use the display and for how long. While the main attraction of high-tech POP displays is its newness – the client has something that its competitors do not yet have – there are additional advantages for evaluating effectiveness. In the cosmetics sector, for example, it can be important for Chesapeake and the manufacturer to know how well different cosmetics were grouped to encourage cross-selling.

The data collected by Chesapeake would be used to establish key performance measures that are tracked and updated for the customer. A database containing this information would be a powerful benchmarking tool for the consulting & design group in making performance-enhancing recommendations to existing and new costumers.

- International Merchandising Service Management

As US-based consumer companies globalize their operations, Chesapeake will aim to provide pan-European POP services, and eventually international POP services, in addition to specialty packaging management. Currently, POP is considered as a cottage industry in many European countries and there is not yet a network of suppliers that can work together on behalf of clients. The results of a recent study by the French government’s statistics department indicate that pan-European POP activities must be flexible enough to take into account cultural differences.\(^4\) Across most product sectors, retailer and consumer buying habits still differ widely from country to country. To fill these gaps, Chesapeake will have to carry out effective regional studies if a consistent brand message is to be conveyed internationally. It will be important for the firm to determine how well a client’s product is perceived by consumers and retailers in specific countries. This is a key indication of how much space stores are likely to allocate to POP material. When the objective of brand owners is to sell cross-border promotions into individual retail accounts, Chesapeake displays will have to be flexible enough to appeal to

local retailers who know their customers. At a more practical level, in addition to altering the language in which the displays are written, Chesapeake will need to consider issues ranging from climatic variations that can cause colors to fade in shop windows in hot countries to strict promotions regulations in some countries.

Although intensive research may be necessary for design execution, the fundamentals of Chesapeake’s POP management services do not change simply because a campaign becomes international. Account-specific marketing and partnering with retailers is fundamental to the business. Thus, partnering with local marketing organizations to execute any cross-border POP strategy will be vital if the menu of display items is to appeal to the targeted cross-section of consumers. For high-end electronics and technology markets targeted by Chesapeake, it will make sense to broaden any marketing strategy beyond purely domestic boundaries.

- **Production Management**

The two primary production management services offered by Chesapeake will be production operations management and packaging engineering.

For key accounts, Chesapeake will seek to assume some of the manufacturer’s production activities and join with it to develop new approaches to packaging. Beyond providing design and engineering support, Chesapeake will look to manage the production lines of its clients and to work with them to develop a range of innovative packaging concepts. R&D teams that include members from both companies will create these concepts. Working in-plant at the manufacturer’s facility will be particularly important in designing packaging for sensitive technology and electronics products as well as resolving material handling issues.

Packaging engineering services at Chesapeake will cover every step of the package development and production process to provide customers with a single packaging solution for shipping consumer products, protecting them in transit, and selling the product on the shelf. The focus on branded products and promotional items will call for corrugated containers and folding cartons with special structural and graphics designs that properly house the product while at the
same time enhance its marketing and facilitate ease-of-use by the consumer. Chesapeake’s goal will be to achieve the best combination of visual and physical properties.

The results of a recent survey of box users by the Corrugated Packaging Council indicate that the industry as a whole is rated uniformly high in the “leadership domains” of product importance and performance quality.\textsuperscript{85} For Chesapeake, this perception translates into continued new value-added corrugated products. In particular, buyers will be looking for even stronger, lighter weight boxes. Future corrugated shipping containers will need to provide enhanced protection, but with less packaging material, and use more recycled material. In addition, lower interior strength packaging will be needed in order to lower shipping costs, a major expense for brand manufacturers.\textsuperscript{86}

While strength will continue to be the most important fundamental characteristic, there is already a growing shift of emphasis to box aesthetics, and with it, the need for high quality imprintable container materials. Chesapeake will replace older types of corrugated packaging with packages that sport high-end graphics. A major focus of some of the firm’s corrugated products will be on consumer brands targeted to retailers dependant on off-the-shelf marketing to advertise the quality of the product inside the box.

A major share of production will be of new micro-flute corrugated. With the ability to serve as both a shipping container and a POP display, micro-flute will be at the center of Chesapeake’s package designs that incorporate marketing, protection, and shelf display attributes in a single medium. The use of micro-flute in the technology and high-end cosmetics markets, in particular, is expected to increase because the quality of graphics and protection which micro-flute offers cannot be obtained by other packaging materials.

Containers that offer die-cut inserts, molded and die-cut foam cushioning, thermoformed base trays and lids, and other customized packaging materials will be particularly important for

\textsuperscript{86} David Lutton, “Packaging Changes –Their Impact”, Modern Materials Handling, 53(5), pg. 37, May 1998; see also article by Clyde E. Witt.
the technology, electronics, and appliance market segments targeted by Chesapeake. For example, new high tech packaging foam has been found to set very firmly around individual contours to securely protect sensitive and fragile items during shipping.\textsuperscript{87}

For its folding carton business, Chesapeake will draw heavily on highly differentiated packaging products focused on specific end-use markets. Many of these products will derive from the Field Group’s technical and market leadership in carton design and packaging machinery performance, particularly in pharmaceutical and healthcare packaging. For example, miniflute corrugated containers enable direct printing without the need for printing labels for lamination. In addition, there will be a major push to take advantage of the EU’s requirement to shift pharmaceutical packaging to include leaflets by 2001. The folding carton business will also expand to include new applications requiring recyclable barrier coatings. This is motivated by the drive to source-reduce, recycle, and use post-consumer recycled content. In addition, the design and manufacture of transparent packaging and plastic-folded cartons will be pursued because these are value-added products and services for customers.

Chesapeake’s production operations will be streamlined for the short-runs characteristic of new product launches and promotional campaigns in the consumer goods industry. For example, an order size of 5,000 units is typical of many pharmaceutical companies worldwide.\textsuperscript{88} In addition, the printing process for folding cartons and corrugated containers will move to direct-to-plate technology because this process is faster and less expensive for very short runs.\textsuperscript{89}

To better serve diverse customer needs in the future, Chesapeake will need to consider entry into the paper as well as plastic flexible packaging market. Plastic, paper, and foil are the three most common types of material used in flexible packaging due to the combined use of these substrates in laminates. The demand for flexible packaging is forecast to increase from

$15.3B in value in 1999 to $18.6B in 2003.\textsuperscript{90} The addition of flexible packaging to the product offering extends the possibilities for customized solutions.

- **Display Management**

  The strategic thrust of Chesapeake’s display management services is to assume some of the assortment planning and inventory management activities conducted by the retailer and to work jointly together to develop unique new point-of-purchase strategies.

  Poor retail execution is a problem for both packaged goods companies and retailers. In a recent survey of 24 leading US packaged goods manufacturers, more than half found that conditions in retail outlets failed to meet expectations at least half of the time.\textsuperscript{99} The survey noted that one senior sales executive reported that in the past two years, he had not once been in a store where the retail conditions corresponded to plan. The most frequently cited lapses were out-of-stock situations, delayed resets, badly built or nonexistent displays, and poor compliance with planograms. By offering to carry out category and inventory management, Chesapeake can plan product assortments and different types of promotions to improve out-of-stocks, and build and execute in-store displays.

  A primary focus of Chesapeake’s display management services will be the design, assembly, and pre-packing of temporary, semi-permanent, and permanent point-of-purchase displays. In the process, however, of providing these services, the Chesapeake name and ‘brand” need to become synonymous with display innovation, in terms of both persuasive appeal and information content, and retail execution, in terms of retail coverage.

  Ever more innovative displays will be needed to break through retail clutter. Depending on the specific objective (i.e., establish brand differentiation, build brand recognition, reach new customers, retain current customer segments, up-sell existing customers, or introduce new product), several new display technologies offer Chesapeake new opportunities for display innovation. These technologies range from electronic ink to animation to interactive elements.

\textsuperscript{90} Anonymous, “Private Flex-Pack Makers Changing With the Times”, Converting Magazine, 17(10), pg. 10, October 1999.
For example, Inmedia is a new technology that enables signs to change and has the feature that the electronic ink can be printed on virtually any surface, including paper, Mylar, cloth, or plastics.\textsuperscript{91} Three-dimensional animation is offered by Wicked Widgets’ “lenticular display” that appears to move as the customer walks past. Compared to displays using normal printing processes that have enough room to display only one message, the “lenticular display” enables two or more messages to be conveyed in the same space.\textsuperscript{92} Chesapeake will also seek to provide interactive POP displays for one-on-one marketing to reinforce the message that retailers care about their customers.

Chesapeake will also use conventional display technologies. In particular, the trend to employ more temporary displays in retail stores will be reflected by Chesapeake’s product offerings. In addition to offering basic temporary displays that are highly functional, Chesapeake will supply more elaborate temporary displays utilizing multiple materials, multiple printing methods, lug-ons to create multi-dimensional headers and wrap-around headers. More elaborate, embellished displays, account-specific programs, and increased placement have resulted in significantly more selling power of temporary POP in recent years.\textsuperscript{93} For Chesapeake, temporary displays will also be more interactive, featuring LCD displays, flipcharts, rotating wheels, flashing lights, lenticular graphics, or sound chips.

Chesapeake will seek to expand the temporary display category by combining elements of temporary and permanent displays into a single display. For example, in the 4Q99, CD&P combined with CPI to produce a large order for Proctor & Gamble’s Olay line of skin care products. The display utilized permanent components in a temporary display. Future joint point-of-purchase display products will build on this multi-million dollar project.

The POP display must inform as well as persuade. With mega stores packed from floor to ceiling with a dozen options in every product category, Chesapeake will have to create


informative, readily accessible POP materials that do not confuse the consumer. This is particularly important in the technology sector with shorter product life cycles and more sophisticated products. For example, larger POP displays can be used to show annotated photographs that explain the different parts of the product as well as visually demonstrate how the product is actually used. In other cases, Chesapeake can leverage its leaflet and technical publication capabilities to provide in-depth information, including tear-off fliers. Another product offering will be to integrate coupons and free samples into POP displays. For example, electronic couponing systems and other nontraditional ways of dispensing coupons for redemption in the store can be incorporated into the design of POP displays. At the same time, there is the old maxim of “keep it simple”, suggesting that for some purposes, Chesapeake’s graphical design capabilities can be used to provide displays that communicate simply, but are highly aesthetically and graphically pleasing.

Creating POP prototypes will be a major product offering. This involves developing different prototypes for testing in stores to determine which displays are the most effective. Since footprints vary from store to store, designs will have to be flexible. In addition to working with retailers’ guidelines, Chesapeake will have to maintain the brand to make it stand out.

A major component of Chesapeake’s display management services will be pre-packs. These merchandising tools are expected to grow in popularity as retailers face the problems of day-to-day staffing and actually running their stores, and are looking for display programs that require as little effort and personnel as possible. In this category, Chesapeake will aim to supply pre-packs that are stronger and bigger, yet remain attractive enough with more visible and colorful graphics. In addition, pre-packs shipped with several hundreds of pounds of product will have to be manufactured using materials that withstand the rigors of shipping and consumer shopping.

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93 Gail Walker, “Temporary Displays are Long-Term Trends”, Point of Purchase Magazine; http://www.popmag.com/archives/0499/apr99stor2.html
• **Consulting & Design Services**

With increasing experience and a growing domestic and global portfolio, Chesapeake will be able to leverage its best practice techniques to offer valued partnerships through a strategic consulting approach that provides broad benefits to customers. Comprehensive evaluations and recommendations can range from assortment planning to lay-out optimization to re-set planning. One potential target is complete department store design solutions for luxury goods, pharmaceuticals and healthcare, and branded merchandise. The goal of this group is to provide clients with expert support for critical merchandising decisions and to help plan for change. This includes forecasting sales, determining product mix, and addressing distribution issues. In addition, brand differentiation is imperative with the vast number of competing brands and products, and Chesapeake can offer ideas on how to differentiate based on first-hand experience with its targeted end-user markets.

### 4.1.3 CHALLENGES

The future product and service scope will be dramatically different from the existing scope. These changes create several major challenges that focus on how the business will bundle and execute a complete array of merchandising, production, and display management services that are customized. Specifically, Chesapeake will need to:

- Develop new brand packaging and retail POP concepts for changing market demands
- Deliver design innovations in packaging and POP – new structural features and high visual impact
- Customize new retail technologies for brand owners, consumer goods companies, retailers, and consumers
- Establish and maintain a high quality work force and geographic coverage for merchandising services
- Acquire specialization in information systems management
- Establish and manage regional/local merchandising and promotion teams for international initiatives
• Keep pace with technological improvements – advances in printing technology and increases in productivity in the areas of manufacturing, design, and process control (e.g., printing and packaging line speed)
• Manage production capacity for short runs
• Establish processes to manage top retail accounts

With a new product and service scope, Chesapeake’s challenges will culminate in how it delivers superior service and performance.

4.2 MARKET SCOPE

4.2.1 EXISTING MARKET SCOPE

Chesapeake provides its packaging and merchandising services for targeted consumer product companies. The major targeted end-use markets of these consumer product companies are pharmaceuticals and healthcare, multimedia and technology, and luxury goods and cosmetics. Thus, the existing market scope is based on customer segmentation, namely, the type of consumer product industry targeted. In addition, the customer segmentation varies with the type of product or service.

targeted. Specifically, it provides products and services to many Fortune 500 companies in the computer, financial, and textile market sectors.

The three major market segments served by Chesapeake Packaging Co. are technology, electronics and appliances, and food. These segments are selected primarily to focus on local market requirements. Although the box plants do not serve national accounts, they do serve large companies for their local shipping requirements. Major customers of Chesapeake’s corrugated container business include General Electric, DuPont, IBM, Royal Alliance, and Gateway.41

Field Group is the leading producer of pharmaceutical packaging in Europe, and the leading specialty packaging supplier in the UK. It is known for its “printed system” supply of cartons, labels, and leaflets for the pharmaceutical and healthcare market. In addition, Field has strong competitive positions in Europe in branded product markets, including tobacco, alcoholic drinks, and confectionery, as well as food and household packaging. Field Group’s major customers are Pharmacia & Upjohn, Astra-Zeneca, American Home Products, Schering Plough, Smith Kline Beecham, Johnson & Johnson, BAT, Diagio, Cadbury, Mars, Nestle’s, and Sanofi.95 The pharmaceutical and healthcare sectors are expected to remain strong, while the luxury products and export tobacco sectors will continue to recover, although probably at a slow rate in the near-term. The Field Group will also focus on the technology sector where healthy sales growth is expected. The acquisition of Boxmore significantly broadens the pharmaceutical and healthcare market segment. In addition, Boxmore serves the cosmetics, food and beverage, agrochemical, and other industrial sectors. Key Boxmore customers are Merck, Hoechst, Glaxo Wellcome, 3M Health Care, Pharmacia & Upjohn, Coca Cola, Zeneca, and Novartis.96

The following chart shows Chesapeake’s sector revenues for 1999 and major customers by market segment.97 The company’s total revenues were approximately $1.0 billion.

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95 Chesapeake Presentation to Analysts, December 1999.  
96 Chesapeake Presentation to Analysts, January 2000.  
97 Chesapeake Presentation to Analysts, February 2000.
<table>
<thead>
<tr>
<th>Market Segment</th>
<th>% of Revenues</th>
<th>Major Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pharmaceutical – Personal Care</td>
<td>22%</td>
<td>American Home Products</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Astra-Zeneca</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Colgate-Palmolive</td>
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<td></td>
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<td>Gillette</td>
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<td></td>
<td></td>
<td>Glaxo Wellcome</td>
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<td></td>
<td></td>
<td>Hoechst</td>
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<tr>
<td></td>
<td></td>
<td>Johnson &amp; Johnson</td>
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<tr>
<td></td>
<td></td>
<td>Merck</td>
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<tr>
<td></td>
<td></td>
<td>Novartis</td>
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<tr>
<td></td>
<td></td>
<td>Pharmacia &amp; Upjohn</td>
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<tr>
<td></td>
<td></td>
<td>Procter &amp; Gamble</td>
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<td></td>
<td></td>
<td>Sanofi</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Shering-Plough</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Warner-Lambert</td>
</tr>
<tr>
<td>Cosmetics – Luxury – Spirits</td>
<td>21%</td>
<td>Cartier</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Estee Lauder</td>
</tr>
<tr>
<td></td>
<td></td>
<td>L'Oreal</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Lancome</td>
</tr>
<tr>
<td>Food – Beverage</td>
<td>12%</td>
<td>Coca Cola</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Diageo</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Hershey Foods</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Nestle's</td>
</tr>
<tr>
<td>Tobacco</td>
<td>12%</td>
<td>BAT</td>
</tr>
<tr>
<td>Candy</td>
<td>10%</td>
<td>Cadbury</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mars</td>
</tr>
<tr>
<td>Recreation</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>Home – Garden</td>
<td>5%</td>
<td>General Electric</td>
</tr>
<tr>
<td>Other</td>
<td>5%</td>
<td>Dupont</td>
</tr>
<tr>
<td>Technology – Multimedia</td>
<td>4%</td>
<td>Duracell</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Gateway</td>
</tr>
<tr>
<td></td>
<td></td>
<td>IBM</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Paramount</td>
</tr>
<tr>
<td>Paper – Packaging</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>Clothing</td>
<td>1%</td>
<td></td>
</tr>
</tbody>
</table>
4.2.2 FUTURE MARKET SCOPE

The future market scope will consist of four interdependent segments: customer, channel, consumer, and complementor.

- Customer Market Scope

Chesapeake’s revenue growth will come from high-growth target markets. Demographic and other market research conducted by Chesapeake indicate that the most significant growth potential will be in three of the market segments currently targeted by the firm:

Figure 15
Projected Size and Growth Rate of End-User Markets

<table>
<thead>
<tr>
<th>Market Segment</th>
<th>End-User Market Size in 1999 (in billions)</th>
<th>Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pharmaceutical &amp; Healthcare</td>
<td>115</td>
<td>6-8%</td>
</tr>
<tr>
<td>Technology</td>
<td>575</td>
<td>10-12%</td>
</tr>
<tr>
<td>Luxury Goods</td>
<td>180</td>
<td>8-10%</td>
</tr>
</tbody>
</table>

Thus, Chesapeake’s end-use markets will be extremely diverse. What they have in common, however, is that they are the right customer segments to target for four important reasons: each segment has an abundance of new product introductions and launches requiring in-store merchandising; each necessarily requires high service levels for the design of packaging; each has stringent quality controls; and each has the characteristic that the packaging is a small component of the overall cost of the product. These attributes strongly favor the selection of products and services offered by the firm’s integrated merchandising management system. A recent survey of folding carton converters indicates that CDs, computer games, and
nutraceuticals (foods that claim to cure or prevent diseases) offer strong potential market growth.\textsuperscript{98}

The attractiveness of the three targeted market segments is qualitatively shown on the following figure that plots growth rate as a function of degree of sophistication. Chesapeake’s new integrated merchandising business model is well suited to the role of specialty converter of customized, bundled products and services.

\textbf{Figure 16}

\textit{Attractiveness of Targeted Market Segments}

\textsuperscript{98} http://www2.targetonline.com/ppc/monthly/0300/0300soifold.html
The pharmaceutical and healthcare, technology and luxury packaged goods industries are highly competitive and innovative. As a result, they tend to be very aggressive in their advertising and promotional schemes, in part due to the growing popularity of private-labels that threaten branded products’ long-established relationships with customers. Private-label products are capturing much of the consumption growth in the consumer packaged goods industry. To attract more new customers to these segments, Chesapeake will have to shape and make use of new and innovative advertising campaigns through new product and service offerings. This will include a number of different display units, carton designs, and creative advertising and packaging products and services depending upon customer requirements. In addition, Chesapeake will be looking to shorten “time-to-shelf”.

The pharmaceutical, cosmetics, and personal products industries have traditionally been a small segment, about 6.5%, of corrugated end-users. However, this has been dramatically changing due to the introduction of micro-flute corrugated board, and improved substrates and printing processes. As a result, there are significant competitive advantages of corrugated containers that Chesapeake will aim to enhance by creating new and innovative uses of corrugated in retailing through point-of-purchase and floor displays as well as primary packaging.

The pharmaceutical packaging market is attractive for several reasons. Global demand is growing for pharmaceutical and healthcare products due to population growth, aging of population, new medical technology, and new regulations. The use of over-the-counter and prescription pharmaceuticals is continually on the rise. A key factor favoring the growth of folding cartons in pharmaceutical packaging is the increasing number of drugs that are switching from prescription to over-the-counter sales. For Chesapeake this means that when a drug first appears on the shelf, it needs a well-designed folding carton with sophisticated graphics to distinguish it from its more-established competitors. The increasing globalization of producers combined with the rationalization of suppliers also supports a good strategic fit with

99 http://www.aiccbox.org/mm_Oct.asp
Chesapeake's integrated systems solutions strategy. Lastly, there exist cross-selling opportunities.

Product packaging is evolving in the pharmaceutical sector with folding cartons dominating the secondary packaging. In recent years, this end-user market has expanded to show above-average carton usage. A major reason for this growth has been the combination of eye-catching graphics and comprehensive information contained in the packaging. Chesapeake's service and product offering to this end-user market will, however, be strongly affected by significant competition from expanded-content labels, stand-alone tubes, and sophisticated labeling. First, the advent of expanded-content label and more-sophisticated inserts means that a label or leaflet can hold all the same information that a carton does, and more. Second, the introduction of wide closures to tubes has enabled toothpastes and other products to be displayed on shelves without cartons. Third, prescription drugs do not need eye-catching graphics and may not require the marketing presence of a carton. Therefore, to remain competitive with these developments and other forms of packaging, Chesapeake will have to create new and innovative ways to create shelf presence through packaging that offers stunning graphics, innovative designs, detailed information, and quality printing. Sophisticated cartons will take into account concerns such as consumer protection, colors, schematics, and sharp layouts.

Ethical drug packaging also presents business opportunities for Chesapeake. In order to send ethical drugs to pharmacies or retailers, drug companies will need to purchase larger cartons that contain quantities of 12 or 24. This is now viable due to improvements in attaching literature directly to individual drug products. Folding cartons are also an option for packaging ampules, vials, pre-filled syringes, pens, and other liquid drug-delivery systems. Partitioned cartons are particularly well suited for liquid-drug delivery systems because the fluted partitions hold products in place inside the rigid paperboard structure. In the U.S., only about 10% of these applications use folding cartons, while blister packaging commands a 90% market share. However, competition from blisters is not insurmountable as seen in the European market where folding cartons are the dominant form of packaging with a 60% market share. One reason for this turnaround is the strong concern in Europe for disposal costs and disposal volume; since cartons are made of one material, they are easy to dispose of and recycle.
A second key reason that the pharmaceutical segment is a good strategic fit with the new business model of Chesapeake is the stringent requirements of packaging components, including GMP (Good Manufacturing Practice) and CGMP (Current Good Manufacturing Practice) guidelines and FDA regulations. In addition to conducting high-speed production runs with accurate results, Chesapeake will need to perform intense review and inspection of all packaging machines to insure strict adherence to standard operating procedures. In addition, the new “Drug Facts” labeling regulation for all nonprescription drugs increases the requirements and demand for package, label, and leaflet combinations such as the FLIC pioneered by the Field Group for dispensing detailed instructions on consumption. The new standardized format for labels will show a drug’s ingredients, dose, and warnings. While many OTC drugs with the new labeling will begin appearing on the shelves within the next two years, all OTC drugs will be required to adopt the new labeling within the next six years.

In the United States, regulatory requirements frequently overshadow environmental concerns, yet there are options for Chesapeake to attract environmentally conscious shoppers with environmental claims printed on their packages. In a study conducted by Environmental Research Associates, half of those surveyed would change the brand of a product that they regularly buy if they learned that the product, its packaging, or its manufacturer harms the environment. Many drug companies do not allow recycled paper products partly because the FDA would require new stability tests and revalidation for packaging other than that meeting the standard packaging requirement. Therefore, Chesapeake will need to advocate for the use of recycled materials during the packaging design phase of a new product before the FDA approval process. This creates not only customer solutions, but also significantly closer relationships between Chesapeake and the pharmaceutical company because three levels of the pharmaceutical organization are involved: marketing and sales, finance, and manufacturing.

The increasing operation of generic pharmaceutical manufacturers to resemble branded companies has potentially large implications for Chesapeake. In 1999, the Office of Generic

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101 The FDA regulates manufacturing and food labeling. The FTC regulates the packaging and labeling of all consumer products.

Drugs received 296 submissions and approved 186 applications. During the next ten years, the “Golden Age” of generic pharmaceuticals, $48B worth of brand drugs will lose patent protection. However, the generics share of total prescriptions has been about 42% over the past ten years. Thus, many generic companies are developing high-margin branded products and strictly prioritizing their product portfolio mix that will require customized packaging and promotion solutions to compete with established branded products on other than a price basis.

The multimedia and technology packaging market heavily depends on strong brand awareness and retail presence, factors that favor Chesapeake’s integrated merchandising product scope. In addition, there are increasing needs for innovative product protection that Chesapeake’s capabilities in flexo, litho-, and folding carton manufacture can lead the industry. As with the pharmaceutical and healthcare sector, there is demand for multiple services through a single supplier as well as global sourcing that are inextricable portions of the strategic make up of Chesapeake’s new business model.

- Channel Market Scope

There is a plethora of retail shopping choices for the consumer depending on the type of general merchandise. There are hardline merchandise that includes electronics, small appliances, and impulse merchandise. Hardline consumables include health and beauty aids, over-the-counter medicines, and cosmetics. These nondurable goods are primarily sold by department stores (e.g., J.C. Penney, Federated Department Stores, and May Department Stores) and mass merchandise retailers (i.e., discounters).

In addition, there are national drug store chains and so-called “category killers” that sell consumer packaged goods in the pharmaceutical, technology, and luxury goods markets. The nation’s largest drug store chains are Walgreens (the sales leader), CVS (second in sales), Rite Aid, and Eckerd. These four major drug retailers now hold either the first or second share in

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104 These specialty superstores dominate a particular merchandise category, and typically offer a larger assortment of products at lower prices than traditional retailers.
all but two of the top drugstore markets.\textsuperscript{105} In the consumer electronics sector, the major specialty retailers are Best Buy, Circuit City, CompUSA, and Tandy.\textsuperscript{106} Although 88\% of all retail companies employ fewer than twenty workers and 95\% operate just one store, it is the large chains such as Wal-Mart and Sears that garner the most sales.\textsuperscript{56}

Relentless competition and consolidation through internal expansion and acquisition has created mega-retailers. As a result, the majority of retail selling power is concentrated in a few major chains that do not hesitate to gain power in their relationships with manufacturers. The following data are an indication of the strength of mass retailers:\textsuperscript{107}

\begin{figure}
\centering
\begin{tabular}{|c|c|}
\hline
Product Category & \% of Revenue Derived from US Mass Retailers \\
\hline
Consumer electronics & 37\% \\
Non-prescription drugs & 23\% \\
Jewelry and watches & 9\% \\
Prescription drugs & 5\% \\
\hline
\end{tabular}
\caption{Revenues Derived from U.S. Mass Retailers}
\end{figure}

Their increased buying power has led to more demands on manufacturers for volume discounts, cooperative advertising, and merchandise pricing and ticketing prior to shipment.

Discounters are the fastest growing chains in retailing. They are high volume, fast turnover outlets that sell a variety of merchandise at low prices. One of the tradeoffs for low prices is minimal service. The top three discount chains based on 1999 sales are Wal-Mart,

\textsuperscript{105} http://www.hoovers.com/sector/analysis/0,2178,26,00.html
Kmart, and Target. Wal-Mart stores, for example, generally contain forty departments offering a wide variety of merchandise. The breakdown of Wal-Mart’s merchandise as a percentage of sales is as follows:

![Figure 18](image)

<table>
<thead>
<tr>
<th>Type of Merchandise</th>
<th>% of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Soft goods/domestic</td>
<td>25%</td>
</tr>
<tr>
<td>Hard goods</td>
<td>25%</td>
</tr>
<tr>
<td>Stationary and candy</td>
<td>11%</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>10%</td>
</tr>
<tr>
<td>Records and electronics</td>
<td>9%</td>
</tr>
<tr>
<td>Sporting goods and toys</td>
<td>8%</td>
</tr>
<tr>
<td>Health and beauty aids</td>
<td>8%</td>
</tr>
<tr>
<td>Shoes</td>
<td>2%</td>
</tr>
<tr>
<td>Jewelry</td>
<td>2%</td>
</tr>
</tbody>
</table>

Discount stores, like department stores, aim their price points to target various economic levels. Target, for example, is considered an upscale discounter. Although it stocks typical discount goods, the stores’ ambiance (e.g., wider aisles) and product assortment (more trendy merchandise) are more upscale than that of some discounters. As opposed to Kmart and Wal-Mart who tend to pull in customers with median household incomes of $25,000 and below, Target’s customers are more affluent with median household incomes of $43,000.

Consumer electronics retailers are expected to benefit in the next several years from an accelerated sales pace due to new technologies such as DirecTV, wireless communications, digital video disk (DVD) players, and digital camcorders. Personal computer sales should also

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be strong.\textsuperscript{106} Specialty consumer electronics stores will likely receive more attention from Chesapeake in the future as these stores increasingly focus on higher-margin new products and services, while discounters, such as Wal-Mart, are expected to gain share in basic commodity merchandise.

The majority of soft and hard goods sold at retail are now sold in “big box” stores such as Wal-Mart and Circuit City. Over the past decade, retail stores have grown in size, up to 200,000 square feet in some cases, to provide one-stop shopping for their time-pressured customers. This has led to the creation of roles for salespeople and print media suppliers that are different from those when retailing was dominated by department stores and specialty stores. In particular, there is a much smaller emphasis on service and a greater emphasis on the use of media such as freestanding inserts, direct mail, and coupon promotions. Since the margin markups are tighter for big box stores, there is a strong push to reduce labor costs and the cost of marketing communication materials.

The continued growth of large “warehouse-styled” retail outlets will also provide new marketing and sales opportunities for Chesapeake’s packaging and merchandising services. Despite increased competition, corrugated packaging materials will play a two-fold dominant role directed at the retail marketplace: first, as a shipping medium that is protective, environmentally friendly, and recyclable and, second, as an innovative, eye-appealing, consumer-oriented point-of-purchase display. The development of new mini-flutes (E-, F-, and N-flutes) has already opened up many end-user segments previously unattainable for domestic corrugators, and it will be up to Chesapeake to develop new products for retail stores and outlets that are even more popular as displays in and of themselves.

The general trend in all retail environments is to become more distinctive in design as companies seek to differentiate themselves from the competition.\textsuperscript{106} This has a significant impact on Chesapeake because retailers will place a much greater emphasis on the creation of enticing product displays and signs. In addition, stores will be striving to incorporate new retail technologies to help customers find what they are looking for more easily. At a higher level, Chesapeake’s business will see the impact of a greater emphasis on merchandising management
and associations with high quality, brand products and images. In addition to increased demand for merchandising services, tighter shelf space and more fierce new-product competition should bode well for the high print quality of folding cartons and a pro-environmental image via recycled content that makes paperboard packaging the preferred point-of-purchase salesmen.108

- Consumer Market Scope

The way we live, work, shop, and socialize strongly influence how packaging will have to develop to satisfy the consumer of the future and their needs. There are several emerging trends that affect customer segmentation.109 Consumers are changing and packaging will also have to change to follow the trends.

There is an increasing number of single person households due to late marriage, increasing divorce, and a growing number of women outliving their husbands. This suggests a growing preference for smaller quantities of many consumer goods as well as for formats that are convenient. Thus, there will be the need for retailers to provide smaller pack sizes. One impact of this trend will be to increase overall consumption of packaging materials.

A second trend is the emergence of the color TV/MTV generation as the segment with a huge share of purchasing power. This group is composed primarily of two career households with children in day care. Their lifestyles are characterized by time pressures and a sense of urgency. The lack of time is a major issue. In addition to looking for convenience, this segment is simultaneously placing increased demands and increased reliance on trusted brands and favorite retailers. As a result, Chesapeake will have to respond to the demand for good functionality by providing new innovative packaging formats.

A third major trend is the increasing proportion of people over the age of 65. Due to improved healthcare, many elderly people are quite active as well as financially secure and economically active. Packaging needs for this sector are concerned with the loss of sight and

physical dexterity. Elderly people often have difficulty in reading small print, yet legislation requires more and more information to be printed on packaging. This suggests the need for larger print inserts and leaflets. "Micro dots" have been suggested as a possible solution for the future. These printed sections of packaging would contain the requisite information that would be scanned into a home computer for reading. The issue of openability and ease of use will also have to be addressed by Chesapeake and consumer product companies. Further consequences of the aging of the population include growth in pharmaceutical packaging. Lastly, those 65 and older who are financially secure may also create a high demand for premium product lines and luxury goods, either for their own use or as gifts to children or other relatives.

Growth in the number of working women is a third major trend. More than half of the American work force is female, and there are many time-pressed working mothers. As a result, convenience has become an important part of a pleasurable shopping experience. What has become known as "precision shopping" refers to how consumers want to go into the store, get what they need, and get out. It will be incumbent upon retailers to provide a full stock of merchandise and to increase the use of convenience formats. These trends, in turn, will increase demands for high levels of packaging functionality with innovations. As retailers aim to capture a share of the convenience market, there will be opportunities to develop appropriate packaging at the retail store level.

Another major trend is mass customization. Namely, micro-marketing is used to segment consumers into smaller and smaller groups. As a result, products are tailored very closely to the specific needs of these groups. Increasingly common are retailer category management initiatives that center on understanding and responding to consumer needs. Mass customization makes high demands on packaging, and this plays directly to the new strengths of Chesapeake. Instead of one or two variants of a product there may be seven or eight, and multiple designs and smaller quantities of each variant will be required. Thus, there is a tremendous potential for Chesapeake to innovate and provide added-value products and services. This can lead to a virtuous circle as consumers become increasingly sophisticated and respond to highly targeted

products that give them a wider range of choice. The increasing sophistication among consumers will have to be met by more packaging innovation.

Good packaging to the consumer goes beyond issues of graphics and structural design that are paramount for brand owners and retailers. Instead, as discussed above, it increasingly correlates with packages that enhance the quality of life. A recent consumer survey conducted by Doyle found that in many consumer, business, and medical product categories, "seamlessness" is the emerging criterion for packaging.\(^{110}\) Whereas many packages today are awkward and hard to use, seamless packages can be used and discarded effortlessly from start to finish.

The implications of Doyle's study\(^{110}\) for Chesapeake's integrated merchandising services are incisive because they bring full circle the value proposition of a system economics model. Specifically,

- packaging will be more efficient and less hassle to decrease the demands on consumers' time and attention
- packaging will be well-functioning to enable consumers to reach a desired goal faster or with less work
- packaging will have the following characteristics depending on end-use market:

### Figure 19
**Key Package Characteristics for Pharmaceutical, Technology, and Luxury Goods Markets**

<table>
<thead>
<tr>
<th>Package Characteristic</th>
<th>Pharmaceutical Market</th>
<th>Technology Market</th>
<th>Luxury Goods Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portability</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Product protection</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Product visibility</td>
<td></td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Hand-purse &amp; pocket friendliness</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Flexibility</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Versatility</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Easy-fit storability</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Easy readability</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Eco-sensitivity</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Easy opening</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Easy access to product</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Clear dating</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Such packages will foster three important outcomes for Chesapeake to tap:

- consumers willing to make brand choices based on packaging
- consumers frequently, although not always, willing to pay more for packaging improvements
- consumers tending to equate a perceived-as-perfect, go-anywhere package with a perceived-as-perfect product

Thus, the selling power of Chesapeake packaging will depend increasingly on packaging function and package quality. Furthermore, there is the largely untapped potential to influence product usage by consumers through packaging function. This not only benefits consumers and
retailers, but also Chesapeake if it is successful in developing “branded” packages that appear on the market with their own identities, such as Zip-Pak™, VersaTray™, and MicroRite™. For example, in focus groups evaluating MicroRite™ packaging for frozen pies, some participants actually volunteered to pay a premium for the pies because they perceived that the product gave them the ability to be a perfect host/hostess to unexpected guests by serving a ready-to-eat pie in just 18 minutes.

As Doyle\textsuperscript{110} cites, there are many categories of products that consumers believe the packaging should be improved. The corollary to this is that packaging improvements can influence product sales. In her survey, Doyle\textsuperscript{110} found that 68% and 36% of consumers will make a drug and cosmetics purchasing decision, respectively, based on packaging improvement. There are two packaging concepts that Chesapeake will need to consider. The first is for packages that can be harmlessly composted or put in the garbage disposal. This concept drew a 72% response for purchase decision impact in Doyle’s\textsuperscript{110} survey, suggesting a need to move beyond recycling and reuse to minimizing and simplifying trash. The second concept is for packages that fit just about anywhere. This will require closer attention to consumers’ needs and lifestyles.

Many of these same demands for changes in packaging carry over to the shopping experience.\textsuperscript{111} Two prevailing themes are to accommodate all types of shoppers (e.g., women, men, children, and the elderly) and to make shopping more convenient. Many shoppers want to get in and out of a store without delays caused by interaction with store employees, but they still want to make an informed purchase. Thus, there is a trend towards more user- and information-friendly stores.

- Complementor Market Scope

For brand owners, image is what matters most. This is especially true in the pharmaceutical, electronics, luxury good, and cosmetics end-user markets. The quintessential function of a brand owner is to create distinctions that satisfy the needs of consumers and drive

\footnotesize{\textsuperscript{111} Julie Dalton, “Through the Eyes of the Shopper”, Point of Purchase Magazine; http://www.popmag.com/archives/0999/sept99stor5.html}
customers to retailers. For example, a successful brand serves to reduce perceived risk by providing an assurance of quality or to reduce psychological risk by conveying status or prestige. For sellers, brands facilitate product identification and loyalty that can lead to repeat purchases that the seller relies on for financial performance.

Branding by corporations can be done at three levels. Corporations can choose to 1) brand the corporation itself, 2) keep brand identities of the firm’s divisions or other organizational units uppermost in branding efforts, or 3) create branded product identities. For Chesapeake to realize integrated merchandising synergies, it must take advantage of brands that can serve as powerful tools for introducing new products. Companies such as Procter & Gamble believe a product or service can be branded even within lines of a business (or families of products) and therefore a different brand array can emerge from all the varying market preferences. As a result, for example, Procter & Gamble has multiple brands of cosmetics. By creating well-known product brand identities, it is possible for firms to sustain brand sales and profits over very long time horizons. If existing products carry familiar brands, then customers are more willing to try a new product if it carries the same familiar brand. Brand owners market consumer packaged goods by using brand extension and product flanking strategies to increase their sales volume and enhance market share. These strategies are usually used to increase shelf space and to prevent other competitors from establishing a presence with a competing product. Brand owners will often offer new and improved products and product line extensions to enhance their market position.

The biggest single problem with firms seeking product branding is too much brand proliferation. In their quest for increased market share, firms often market too many brands, some of which become marginal. For example, about 25% of Procter & Gamble’s 2,300 separate brands account for less than 2% of their total sales.

114 http://www.activemedia-guide.com/consumer_nondurables.htm
Since the 1980’s, corporate monolithic branders such as Wal-Mart have entered into product branding via private labels that end up competing with their mainstream national branded suppliers. Since both the private label and national brand hold some equity for the consumer, the customer is faced with an increasing number of choices and decisions. This branding battle continues on several fronts, including drug stores, warehouse clubs, department stores, and specialty chains.

Private brands continue to capture more shelf space as well as acceptance among consumers. In part due to better packaging and merchandising, private label brands became a $43.3B annual industry in 1998. This is causing national brand suppliers to feel margins that are even more tightly squeezed by retailers. As a result, consumers are often confused about price, size, and quality, making comparison shopping more difficult. The end result is that consumers make compromise decisions based on convenience rather than preference decisions based on choice. Consumers today are more likely to be more loyal to a particular store and switch brands when necessary, rather than shop at several different stores in order to satisfy brand preferences.

4.2.3 CHALLENGES

The fundamental challenge from changes in market scope is for Chesapeake to gain end-use specialization in customer, channel, consumer, and complementor segments. This will be essential for developing the strongest possible relationships with targeted consumer packaged goods companies and targeted retailers.

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4.3 GEOGRAPHIC SCOPE

4.3.1 EXISTING GEOGRAPHIC SCOPE

Chesapeake operates plants and facilities in over 40 locations in North America, Europe, and Asia. Two segments, the U.S. and Europe, largely dominate the existing geographic scope of the business. European sales are principally from the operations of the Field Group, with approximately 85% coming from within the UK and the remainder from continental Europe.

Figure 20
Existing Geographic Scope

<table>
<thead>
<tr>
<th>Existing Geographic Scope</th>
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<tbody>
<tr>
<td>United States</td>
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<td>Canada</td>
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<td>Ireland</td>
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<td>China</td>
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4.3.2 FUTURE GEOGRAPHIC SCOPE

During the next decade, the leading paper-consuming markets (excluding the U.S.) are expected to be in the Asian, Latin American, and European regions. These forecasts are contingent upon improving economic conditions and performance as well as reduced market-access barriers in key foreign markets. The latter will depend on both NAFTA and WTO GATT agreements. The major paperboard-consuming economies in Asia are Japan, Korea, Thailand, Malaysia, Indonesia, the Philippines, Hong Kong, and Taiwan. Key Latin American markets for Chesapeake in the future are anticipated to be Mexico and Brazil. In addition to the UK and
German markets in Western Europe, some portions of Eastern Europe show promise for substantial growth of paper-consuming markets.\textsuperscript{117}

As many consumer product companies are turning into truly global players, Chesapeake will have to deliver integrated merchandising services on a global basis as well. Delivering global presence will require expanded global capabilities because the specificity of demand will have to be matched by scale. Through strategic acquisitions and alliances, Chesapeake will aim to build a global network that offers customized solutions and consistent, high quality specialty packaging and point-of-purchase merchandising.

Intent on following its clients into new markets, Chesapeake will have to establish networks of companies in order to tap regional markets. Field’s pan-European network for supplying cartons, leaflets, and labels throughout Europe is expected to serve as a platform for growth in temporary and permanent displays and merchandising services in that continent. Boxmore’s packaging business is expected to expand the company’s European packaging platform by providing broader geographic coverage of targeted markets, particularly in the pharmaceutical and healthcare sectors.

Acquisitions, joint ventures, and other partnerships with Asian and Latin American firms will gradually be needed in order to broaden Chesapeake’s global presence beyond the U.S. and Europe. Several of the customers that Chesapeake supplies with packaging are increasingly relying to a greater extent on export markets, particularly to Asia. Lastly, despite recent problems, a number of factors are expected to underpin Latin American and Asian prosperity, including economic advances, rising population levels, improved literacy, and higher living standards.\textsuperscript{118} With prosperity comes greater consumption of packaged products – good news for Chesapeake.


### Figure 21

**Future Geographic Scope**

<table>
<thead>
<tr>
<th>Future Geographic Scope</th>
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<tbody>
<tr>
<td><strong>Broader European Coverage</strong></td>
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<td>- France</td>
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<td>- Eastern Europe</td>
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<tr>
<td><strong>Asia Coverage in Target Markets</strong></td>
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<td><strong>Latin America Coverage in Target Markets</strong></td>
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<td>- Argentina</td>
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**4.3.3 CHALLENGES**

The major challenges associated with changes in the geographic scope are summarized as follows:

- Identify region/country targets
- Develop entry strategies for targeted markets by region/country
- Develop local merchandising programs and infrastructure
- Establish management teams with broad international skills in foreign markets
4.4 UNIQUE COMPETENCIES

4.4.1 EXISTING CORE COMPETENCIES

A primary core competency of Chesapeake is its production know-how. From the standpoint of resources, the firm operates a network of 16 facilities, including three dedicated to graphic packaging, that use various converting equipment to manufacture, design, and package containers and displays for distribution, also performed by Chesapeake. Particularly important for the firm’s future business are its capabilities to provide both short and long production runs. In addition, Chesapeake is one of a small number of firms with the capabilities to use a variety of materials to build both temporary and permanent displays. The company also operates a nationally recognized technical laboratory that designs and tests the durability of container prototypes. In 1998, the firm’s expenditures for property, plant, and equipment totaled $73.3M. In terms of skills, the firm has an extensive skill base that includes employees with expertise in mechanical design, digital art board, graphic design, die making, and product testing. To improve operations, Chesapeake is installing new enterprise resource planning (ERP) software.\textsuperscript{44}

A second core competency is design creativity that has led to award winning innovation. In March 2000, the firm won an impressive sixteen Outstanding Merchandise Achievement (OMA) awards, the POP advertising industry’s most prestigious award.\textsuperscript{119} The awards were given for temporary, semi-permanent, and permanent displays in a variety of categories, including cosmetics, hair and skin care, and toy-sport accessories. The Field Group, in particular, has a worldwide reputation for quality and innovation. It is acknowledged to lead the industry in carton designs that are linked to packaging machinery performance and technical leadership in web processing. The subsidiary recently won three awards for carton printing at the European Flexographic Trade Association (EFTA) Flexographic Printing Awards.\textsuperscript{120} The award winning cartons were printed using a U.V. flexographic carton press that is among the most advanced in the world.

\textsuperscript{119} http://www.shareholder.com/csk/news/20000412-15255.htm
\textsuperscript{120} http://www.shareholder.com/csk/news/20000417-15356.htm
4.4.2 FUTURE CORE COMPETENCIES

The integrated and customized nature of Chesapeake’s future business will set the agenda of future core competencies. The overarching goal of these new unique competencies is to achieve a cross-functional capacity for executing the new product and service scope.

Two highly important new core competencies will be retailing and branding expertise. In addition to deepening its existing merchandising capabilities, the firm will have to acquire detailed knowledge of end-use markets as well as consultative skills. These are essential for executing the new merchandising business model. Another area of core competency will be
production management. The firm will need to have the requisite capabilities to provide economic short runs as Chesapeake builds and executes its make-to-order value chain. Even with a lead position in a targeted market segment, short-runs will dominate the manufacturing process. For example, if an average order was one million boxes a year ago, the same order in the future will be one million boxes but in four or five variants depending on the product and targeted retail channels and consumer segments. Promotional packaging and products directed to niche markets require packaging runs that are short, by definition.

In order for Chesapeake to be recognized for delivering high quality products and services that improve their customer’s profitability, the firm will need manufacturing and managerial systems and infrastructure required to support national, and eventually international, consumer product launches. As Chesapeake grows through internal growth and accretive acquisitions, there will be a high premium placed on developing and leveraging inter-firm networks to interact with other companies thereby accelerating the amount of knowledge that is transferred. These so-called relational capabilities for deepening cooperative relationships will be a critical dimension of how Chesapeake seeks to establish long-term customer relationships.121

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### Figure 23
**New Unique Competencies**

<table>
<thead>
<tr>
<th>Future Unique Competencies</th>
<th>--</th>
<th>-</th>
<th>E</th>
<th>+</th>
<th>++</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Managerial Infrastructure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- National / global project management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Acquisition integration</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• Technology</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Link technology developments to product applications</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Information systems / management expertise</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• Marketing / Merchandising Services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Retailing and branding expertise</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Long-term customer relationship building</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Cross-marketing capabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• Manufacturing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Capacity optimization</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Reliable local sourcing / strict quality control</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>• Distribution</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Inventory management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>- Extensive global logistics network/services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

### 4.4.3 CHALLENGES

Several challenges arise from changes in Chesapeake’s core competencies:

- Develop merchandising expertise in targeted market segments and channels
- Implement integrated production systems
- Develop joint packaging strategies with customers
- Develop joint promotion strategies with customers
5.0 VALUE PROPOSITION

5.1 VALUE PROPOSITION BY CUSTOMER SEGMENT

The majority of Chesapeake’s present relationships with consumer goods companies can be characterized as mainly transactional, with some consultative features. For the manufacturer buying specialty packaging and containers, value is intrinsic to the product alone, one that is viewed as a commodity. For these customers, a favorable cost and efficient procurement are the overriding sourcing considerations.

In the future, Chesapeake’s customer relationships will be controlled by joint product and service innovation with customers. In these relationships, customers perceive additional value is derived downstream from how Chesapeake’s packaging and POP products and services are used. In other words, added value is attached to the way in which Chesapeake helps meet the client’s needs. For these relationships to succeed, however, Chesapeake must have an intimate grasp of not only the business of the consumer goods company, but of how the brand owner and retailer view and execute product retailing. Thus, Chesapeake can create value in two primary ways: first, it can help customers understand their merchandising problems and offer opportunities from new or different perspectives; and second, it can provide customized merchandising solutions.

The maximum value-added proposition arises from capitalizing on Chesapeake’s core competencies and corporate assets. The former emphasizes production and marketing expertise. These attributes are particularly important in the high product turnover markets targeted by Chesapeake due to technological innovations and competitive pressures. In this environment, the firm’s dominant corporate asset will be the information its has about its customers and complementors. The products and services offered under the firm’s integrated merchandising management system are designed such that client’s will want to make full use of Chesapeake’s expertise and knowledge.
Realization of the value proposition is premised on the new integrated value chain. A critical element of the value chain is that it enables Chesapeake to leverage its existing production and logistics competencies to assume some of the consumer good company's manufacturing and distribution activities and join with the company to develop radically new approaches to brand packaging and marketing. Such a strategic value relationship entails two processes: first, the management of consumer good production lines by Chesapeake and second, the development of a range of innovative packaging concepts created by R&D teams that include members from Chesapeake and the consumer goods company. For Chesapeake, this will create high switching costs for its customers. For consumer goods companies, this will offer risk sharing of new branding concepts.

A second characteristic of the integrated value chain is that it allows Chesapeake to leverage its marketing and logistics competencies to assume some of the retailer's assortment planning, inventory management, and distribution activities and join with the retailer to develop innovative new display and retail technologies. The firm-retailer relationship involves management of in-store product presentation and promotions by Chesapeake, and joint development of unique merchandising concepts by both Chesapeake and the retailer. In this case, the switching costs for retailers are made higher, thereby creating some measure of customer lock-in for Chesapeake. In addition, the process offers risk management for retailers seeking to experiment with new retail technologies.

Value propositions derive from the integrated merchandising system that is built on an on-demand, make-to-order value chain. The overarching value proposition is information-based buying and selling decisions that functionalize the brand manufacturing and retailing activity. In the future, a consumer product will come down a production line, labels will be printed and applied, and the product will be packed in a customized carton that has been printed, die-cut, and assembled on a parallel production line and placed in the product production line at exactly the right time for packaging. Simultaneously, information leaflets will be produced and delivered to the packaging station for insertion into the carton. In some cases the cartons will be boxed and palletized, and in other cases these same products will be pre-packed into POP displays for distribution to retailers. Pervading the entire system network is a focus to integrate processes
(e.g. printing and packaging, order fulfillment) through services that meet customer demands. The value chain is made adaptive through in-store merchandising that adds store-level data that blurs buying and selling into a virtuous circle.

In this information-sustaining value chain, each customer segment seeks different types of value propositions:122

- Consumers value convenience – they are looking for the widest possible array of related products and/or services that can help them meet a need so that they can conserve a limited resource, namely, time.
- Retailers value participation – they are looking for services and support that can help them deliver brand sales so that they can conserve a limited resource, namely, customer service.
- Consumer goods companies value anticipation – they are looking for services that can help them market and promote new products and product improvements to meet future demand so that they can conserve a limited resource, namely, risk.
- Brand owners value perception – they are looking for services that can help them match product image with functional and aesthetic preferences so that they can conserve a limited resource, namely, unnecessary brand confusion.

The merit of the new business model is that it enables Chesapeake to offer new value propositions to each customer segment without either Chesapeake or the customer having to weigh the benefits of the product/service against its cost or risk. In-store merchandising as it currently exists is a prime example of a service that both manufacturers and retailers view as adding cost to the system instead of as a source of competitive advantage. If the consumer perceives improved purchasing convenience or other benefits, for example, from a particular product presentation, then this value-added will translate into improved profitability of both the retailer and the consumer goods company.

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5.1.1 CUSTOMER SEGMENTATION IN THE PHARMACEUTICAL AND HEALTHCARE MARKET

Within the pharmaceutical and healthcare market, Chesapeake will initially target its products and services for the prescription and OTC market in drug store chains. The value propositions offered by Chesapeake for each customer segment are summarized in the following figure:

**Figure 23**

**Value Propositions for Prescription and OTC Drug Store Markets**

<table>
<thead>
<tr>
<th>Value Proposition</th>
<th>Consumer Packaged Goods Company</th>
<th>Brand Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Adult Shoppers</td>
<td>Drug Store Chains</td>
</tr>
<tr>
<td>Assortment analysis within categories (e.g., analgesics) to meet customer needs without unnecessary retail confusion</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Permanent display units organized by ailment that offer educational health information</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Interactive in-line shelf displays to conduct diagnostic interviews with consumers</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>New product labeling and packaging to reflect newly approved indications for existing product formulations</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Compliance with growing government regulations, most notably, OTC Drug Facts labeling</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Packaging/promotions with clearer presentation of OTC drug attributes for making informed health management decisions before and after the initial purchase</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Easy-to-use/recyclable drug dispensing packaging and other dispensing/dosing tools</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>

To illustrate how Chesapeake can deliver the value proposition that each customer segment seeks, the firm’s positioning in a market sub-segment, pharmaceuticals and health care products for older adults, is discussed next.
- **Pharmaceuticals and Health Care Products for Older Adults**

As physiological changes and chronic conditions create new needs for adults 65 and older, seniors are shopping at their local drug stores across many categories. According to a recent survey by Roper Starch Worldwide, Inc., 96% of all adults age 70 and older visited a drug store in the past month. These high frequency shoppers are singularly responsible for fueling sales among pain relievers, laxatives, nutritional supplements, hemorrhoid treatments, incontinence products, vitamin and mineral supplements, antacids, oral care, and indigestion and upset stomach aids. In the prescription drug arena, consumers older than 70 also account for a significant portion of medications dispensed for arthritis, diabetes, heartburn, high cholesterol, osteoporosis, hypertension, and prostrate.

Older adults purchase the highest percentage of prescriptions of any age group, and drug stores want the business of these customers. Adults over 65 account for a high percentage of the $121.6B in prescription sales projected for 1999, more than half of which were expected to be dispensed in chain pharmacies. In 1998, drug chains continued to dominate the OTC business with 40% of the market.

Chesapeake’s overall value proposition for older adult consumers is to offer more health information and convenient drug and health care product dispensing through its packaging. Older adults want more health information than any senior generation has demanded before, due in part, to direct-to-consumer (DTC) advertising, in order to rationalize among the seeming myriad of new and old medicine choices. While meeting the new Drug Facts labeling guidelines, the firm will also seek to provide value-added packaging that has large enough print for seniors to be able to read and that contains minimal technical language that older adults may find particularly confusing. In addition, Chesapeake can use product promotions to offer health-oriented education materials targeted to older adults. Since it is likely that most older customers are taking multiple prescription medications for more than one ailment at any given time.

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Chesapeake can also provide an important value-added service by offering printed pharmaceutical leaflets that address consumers’ concerns about drug interactions.

Chesapeake can offer value-added convenience primarily with single-use prescription dosage packaging and easy-to-dispense pharmaceutical cartons. Another important value-added consumer proposition is packaging that is easier to use given the lower physical dexterity of older adults. The firm can also address noncompliance issues when multiple prescription medications often lead to unreliable administration of drugs by seniors. To help older adult consumers manage multiple as well as single drug regimens, Chesapeake can offer single-use dosage tagging and inserts that can be annotated for date and time of drug administration.

New retail initiatives are needed to satisfy the needs of older adults. Chesapeake’s value proposition for drug store retailers is management of products and services (e.g., in-store health fairs and seminars) offered by in-store wellness centers and targeted to older adults. For the resource strapped drug store retailer, Chesapeake will offer in-store personnel with expertise in marketing, merchandising, and pharmacy operations to support the convenience and information needs of older adults. In the process of providing these services, Chesapeake will acquire immensely useful first-hand information on actual product and package use. Even more important, Chesapeake will provide value-added services based on how it uses these data to build its own knowledge of the unique attitudes, behaviors, and physiology of senior consumers. The firm will also offer display management services that aim to minimize the amount of aisle clutter that can potentially trip older adult shoppers, and to provide overhead signs and on-shelf pricing information that are easier to read. These services will also set product presentations for shelves that are not too low for older adults to easily access. Although package printing of older adult-specific products will be improved, Chesapeake can offer additional value by rolling out customized magnifying devices that help older people read the print on packaging. The enhanced availability of printed informational material offered by Chesapeake will also free up some of the valuable time of pharmacists for more specialized, value-added assistance.

New OTC products are not only important to consumer goods companies but also to drug store retailers who rely on shoppers who typically seek new items at their stores in contrast to the
perceived convenience offered by discount stores. With actual product usage data acquired through in-store merchandising, Chesapeake can offer value-added services to health care product companies for new product development, product line extensions, and product improvements targeted at older adults. For example, the current move toward condition-specific positioning of health care products (e.g., sections of shelf dedicated to cold or pain reliever medications) can be extended to new sub-departments that offer condition plus demographic specificity all in one product. Chesapeake's value proposition to the consumer goods company is promotions dedicated to older adults and the assessment of promotion performance of targeted healthcare products. This can include promotions that underscore new special older adult formulations, for example, that are more easy to swallow, as well as easy to use packaging dispensers. With a large portfolio of clients, Chesapeake can provide additional value through in-store cross merchandising targeted to older adults. For instance, the older adult arthritis pain reliever section can cross merchandise selected foot care and skin care items. Just as older adults are looking for convenient single dose pharmaceutical products and packaging, they can also be offered packaging with smaller serving sizes of food and other perishable products.

For the brand owner, Chesapeake's central value proposition is point-of-purchase displays and other POP materials that explicitly call out the brand's benefit for improving the older adult's quality of life compared to a commodity product. Since elderly shoppers tend to look for recognizable national brands, Chesapeake will seek to intimately link the brand with concern for the healthcare of older adults. For example, one of the most common ailments of the elderly is arthritis and seniors are willing to trade-up if there is a perceived value-added.

5.1.2 CUSTOMER SEGMENTATION IN THE LUXURY GOODS MARKET

Chesapeake will target initially the luxury cosmetics, fragrance, and skin care market served by department stores with value-added products and services. The value propositions offered by the firm for each customer segment are summarized in the following figure:

---

### Figure 24
Value Propositions for Luxury Cosmetics, Fragrance, and Skin Care Markets Served by Department Stores

<table>
<thead>
<tr>
<th>Value Proposition</th>
<th>Consumer</th>
<th>Retailer</th>
<th>Consumer Packaged Goods Company</th>
<th>Brand Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Female Shoppers</td>
<td>Department Store Chains</td>
<td>Personal Care &amp; Cosmetics Companies</td>
<td>National Brands</td>
</tr>
<tr>
<td>Assortment analysis within categories (e.g., fragrances) to satisfy “hot” sales trends early and “seasonal” store level replenishment</td>
<td></td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Personalized promotions that offer product benefit and healthy lifestyle information (e.g., new scientific formulations designed to meet customer goals of sun protection or anti-aging)</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Interactive in-line shelf displays to conduct personal and aesthetics preference interviews with consumers</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unit-dose samplers that 1) duplicate appearance of full-sized retail product for easy recognition and are 2) incorporated into billboard-like foldover cards containing coupons</td>
<td></td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>“Gift with purchase” and other reward-oriented programs (e.g., combination products, such as specially designed applicators) that promote consistent branding at the store level and across distribution channels</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Packaging/promotions incorporating “try me” features while retaining product safety, and reflecting new product delivery systems (e.g., mini-pumps, silicone sheets)</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Convenient secondary packaging for travel sizes and purse sizes</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New packaging technologies (e.g., micro chips) capable of emitting tactile, visual, and olfactory messages</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Within the luxury market, the demand for fine fragrances is on the rise. This market sub-segment is next used to illustrate how Chesapeake can deliver the value proposition that each customer segment seeks.

- **Fine Fragrances for Upscale Lifestyles**

  The U.S. fragrance market, with an estimated market value of about $5.39B in 1998, is the largest in the world.\(^{128}\) Fragrance sales represented about 45% of prestige beauty dollar sales in U.S. department stores in 1999.\(^{129}\) Prestige women’s fragrances grew to a value of about $3.2M in 1998.\(^{130}\) This market includes baby boomers and women re-entering the work force who are choosing to pamper themselves, and Generation Y’ers looking to mimic their mother’s beauty regimens.

  The relationship between fragrance and its wearer is intensely personal. In this highly fashionable business, the only certainty is that there will be many different perfumes. Particularly for prestige fragrances, the accent is towards new and highly individual products in addition to the more established classic favorites. Thus, a paramount value proposition that Chesapeake can offer is more personalized promotions and displays and at the same time offering displays that convey scented products as something that is quite exclusive. For example, limited edition secondary packaging and labeling that is extremely distinctive can add substantial value when positioning certain prestige fragrances within a demographic or lifestyle category. The effect of product display on female shoppers’ responses toward a product can also add value. In this regard, a Chesapeake proposition can be combining a display either internally or externally with environmental fragrancing. An appropriately fragranced display can be used to create higher purchase intention through more pleasurable experiences.

  Sampling is very important in the fragrance market. This is even more important with the trend towards customer access to products with store-in-store boutiques. For the assisted selling venue, Chesapeake can offer added value through informational promotions and displays that

reflect product attributes among a collection of highly individualized fragrance products. Since women consumers tend to smell the different fragrances very rapidly, a specific value-added service that Chesapeake can provide is packaging that says “try me”. In addition, the firm can offer information management services that keep track of customers’ preferences in fragrances so staff can make suggestions to family or friends looking for gifts. The intent with this and other Chesapeake value propositions is to find new ways to incorporate fragrance into everyday living.

5.1.3 CUSTOMER SEGMENTATION IN THE TECHNOLOGY AND MULTIMEDIA MARKET

The consumer electronics market covers a very wide array of products, ranging from wireless phones to digital televisions to personal computers. Within this market, Chesapeake will initially focus on the new, higher-end products associated with home entertainment as consumers and specialty retailers ride an unprecedented wave of new product introductions and continued economic prosperity into the next decade. These consumers are largely “technocrats” and people looking for the latest hi-tech gadgetry. To serve this market segment, Chesapeake can offer several key value propositions to consumers seeking to be early adopters of new technological innovations. The firm’s value propositions for the home entertainment market served by specialty retailers are summarized in the following table:

---

### Figure 25

**Value Propositions for Home Entertainment Markets Served by Specialty Retail Chains**

<table>
<thead>
<tr>
<th>Value Proposition</th>
<th>Consumer Packaged Goods Company</th>
<th>Retailer</th>
<th>“Early Adopters”</th>
<th>Specialty Retail Chains</th>
<th>National Brands</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assortment analysis across categories to meet customer bundled product needs (e.g., in-home theater systems)</td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
</tr>
<tr>
<td>Product guides that educate retail sales associates in providing individual and bundled entertainment solutions for consumers</td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
</tr>
<tr>
<td>Permanent displays that reduce product compatibility confusion and product obsolescence fears</td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
</tr>
<tr>
<td>Promotions and product technical and feature information materials that explain benefits of the latest technology and suggest application of the product</td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
</tr>
<tr>
<td>Interactive in-line shelf displays to help consumers to 1) look up product information, 2) customize products, and 3) search inventory for nearest store merchandise pick-up</td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
</tr>
<tr>
<td>Promotion materials for in-store demonstrations</td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
</tr>
<tr>
<td>Convenient packaging inserts for making installation and set-up quick and easy</td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
<td><img src="true" alt="Yes" /></td>
</tr>
</tbody>
</table>

The DVD sub-market segment is a good example of how Chesapeake can realize its value-added propositions.

- *DVD Video and Audio Hardware for Home Entertainment*

  DVD has been a phenomenal success in the consumer electronics industry. With an installed base of more than five million players, DVD is enjoying the most successful new
product launch ever according to the Consumer Electronics Association.\textsuperscript{131} Even more important, there are numerous product improvements, added features, and new uses that will keep consumers coming back for the latest features and capabilities. Industry sources expect the installed base to double by 2001.\textsuperscript{131}

With this rush of new technology, Chesapeake will add value to consumers through displays that educate and inform in ways that show how new applications add entertainment value. For consumer electronics firms, Chesapeake promotion displays can add value through messages that emphasize the added utility that DVD brings to a bundled in-home theater system. For some DVD players, promotions will emphasize forward-compatibility with DTVs that consumers hope to own in the future. Cross-merchandising opportunities also exist for which Chesapeake can add value through informational displays, such as with HDTV and progressive scan DVD players. DVD audio software releases are expected to be on the market by this summer, and this offers opportunities for Chesapeake to add value through displays and promotional materials that help to push product acceptance given issues of competing formats.

6.0 CONCLUSIONS

The Chesapeake Corporation is at a crossroads. Its traditional product-centric business model, common to the paper industry in general, has led to unacceptably low returns for shareholders. What will separate Chesapeake from the rest of the packaging and container industry is the ability of its management to execute on delivering integrated merchandising management to consumer goods companies, retailers, consumers, and brand owners.

To distinguish itself as a value creator, Chesapeake will need to transcend conventional boundaries between the firm and its immediate customers and eventually extend new kinds of cross-functional relationships with their customers’ customer as well as with complementors. When every player can touch every other player in this system network, then the potential gains from an integrated value chain can be realized. The future business of Chesapeake will be sustained by the firm’s ability to make information flow quickly to all players in the system network who need it, and this will make the critical difference. The firm’s merchandising services are very important for this very reason because they seek in various ways to collect and distribute information about consumers.

If the key to higher profits for Chesapeake is to enable its immediate customer to serve its own customer in a superior way, then what value proposition does Chesapeake offer its immediate customer in order for that immediate customer to be successful in its own market? To answer this question, three key market segments for national brands were identified for Chesapeake to target first: the prescription and OTC market in drug stores; the luxury cosmetics, fragrance, and skin care market in department stores; and the home entertainment consumer electronics market in specialty retail stores. For each market segment, specific product and service elements were defined that create value for each customer segment. Each value proposition aims to build real partnerships and integrated processes by creating win-win situations.

Measuring the success of the “new Chesapeake” will require adopting two new criteria. The first important factor will be customer penetration that is of core customers. In other words,
what share of the customer’s total spending on downstream activity accrues to Chesapeake? The intensity of customer contact will be the second new success criterion. The breadth and depth of customer contacts will indicate how intense and thus how serious a relationship is. For example, what levels of each organization are involved in joint partnerships and what joint projects are undertaken to develop new products and applications together?

The outlook for Chesapeake to attract, satisfy, and retain the customer is filled with exciting new opportunities. There are tremendous possibilities for sustained competitive advantage that are not based on product differentiation, but rather on total customer solutions and even system lock-in through integrated value chains.
7.0 APPENDIX: PAPER INDUSTRY STRUCTURE ANALYSIS

Porter’s\textsuperscript{29} Five-Forces Model is very applicable to understanding a best product industry and is used to assess the elements of the paper industry’s structure that contribute to the industry’s overall attractiveness.

7.1 BARRIERS TO ENTRY

Paper is one of the most capital-intensive industries in manufacturing. A new mill can cost up to $400M while it can take between two and four years on average to add new capacity to existing mills.\textsuperscript{132} This includes compliance with environmental regulations, mill construction, and optimization of the manufacturing process. Large facilities dominate the industry, with the fastest mills producing over 1,000 miles of paper a day and employing typically 100-500 people.\textsuperscript{6,132} New capacity in particular employs very high capacity machines to increase throughput and volume. In the U.S., the tendency is to dedicate a large, fast paper machine to a single commodity grade, and to run specialty grades involving many production changes on smaller machines. Converting facilities tend to be smaller, more labor intensive, and more numerous, although the majority of the value of shipments of converted products is accounted for by large integrated facilities.\textsuperscript{6}

The increasing concentration of the industry and the resulting growth in the size of paper companies through acquisitions and mergers is an attempt by paper companies to gain economies of scale to better compete on cost. An illustrative example is International Paper Co., the world’s largest paper company. Following the acquisition of Union Camp Corp. in May 1999, International Paper operates 40 pulp, paper, and packaging mills, 93 converting and packaging plants, 35 wood products facilities, 12 specialty panel and laminated products plants, and 11 specialty chemical plants in the US, Europe, Asia, Latin America, and Canada.\textsuperscript{133} Although companies such as Chesapeake Corp. have switched from single, commodity-driven products to “less” capital-intensive segments, new entrants will still face companies with large economies of scale, particularly as the industry is expected to consolidate further (Chesapeake invested $600M

\textsuperscript{132} Clifton Linton, Investor’s Business Daily, August 16, 1999.
over eight years for machinery, equipment, and technology to enter the faster-growing, specialty niche paper market). Thus, the scale economy of major companies and the capital intensity of the manufacturing process serve as high barriers to new entrants.

The basic process used to make paper is very mature, and paper machines have a long life, lasting between 40 and 60 years. To improve production, new process technology and control systems are being developed and are generally widely available to paper companies. Recent examples are advances in high-speed coating, multi-coating, and coating formulations for fine paper manufacturing. In addition, many companies invest in R&D to develop proprietary production technologies. With essentially ample access to the latest technology, the major issue facing US paper companies is increasing capital spending for technological upgrades of existing facilities. In order to achieve the high operating efficiencies and product quality attained by many global competitors, existing US mills will need significant technology upgrades.

Paper manufacturing is highly complex and specialized. Even in small mills, there are thousands of process variables that require monitoring and control. Experience with the technology gives companies a major competitive advantage over new entrants.

The industry is strongly dependent on the availability of water, energy, and pulp. Pulp is the most important raw material in paper products. Approximately two-thirds of pulp production is integrated on-site with paper manufacturing. In these facilities, virgin wood fiber from timber, or recycled fiber (also known as wastepaper) from recovered paper and paperboard products, are the major ingredients for pulp production. The sourcing of recovered fiber increased significantly in the 1990's when environmental and other regulatory policies eliminated substantial areas of timberland from harvesting. The remaining one-third is a commodity on the world market, where the price of pulp follows the supply and demand balance. The pulp and recycled paper markets are normally open. Other raw materials are widely available paper chemicals used to produce pulp and additives used in papermaking.

134 Includes printing, writing, and cover papers, as distinguished from wrapping papers and paper not generally used for printing purposes.
The barriers to entry in the paper industry are overall high because of the high costs of production, safety, and environmental equipment as well as the high capital investment needed to modernize and expand plant capacity. Large economies of scale for companies producing commodity grades are critical. While other factors such as access to latest technology and raw materials are ample, the high importance of economies of scale and capital requirements tend the industry to highly attractive.

**Figure 26**

**Barriers to Entry**

<table>
<thead>
<tr>
<th>BARRIERS TO ENTRY</th>
<th>CURRENT</th>
<th>FUTURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economies of scale</td>
<td>Small</td>
<td>Large</td>
</tr>
<tr>
<td>Product differentiation</td>
<td>Little</td>
<td>Big</td>
</tr>
<tr>
<td>Brand identification</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Switching cost</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Access to distribution channels</td>
<td>Ample</td>
<td>Restricted</td>
</tr>
<tr>
<td>Capital requirements</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Access to latest technology</td>
<td>Ample</td>
<td>Restricted</td>
</tr>
<tr>
<td>Access to raw material</td>
<td>Ample</td>
<td>Restricted</td>
</tr>
<tr>
<td>Government protection</td>
<td>Nonexistent</td>
<td>High</td>
</tr>
<tr>
<td>Experience effect</td>
<td>Unimportant</td>
<td>Very important</td>
</tr>
</tbody>
</table>
7.2 BARRIERS TO EXIT

There are high barriers to exiting the paper business. Paper is a high fixed cost industry due to the high level of asset specialization and maintenance needed for pulp and paper processing. The manufacture of paper consists of three principle steps of pulp making, pulp processing, and paper/paperboard production. The following figure shows how each step employs highly specialized, large scale equipment: wood debarking and chipping machine; chemical and mechanical pulping machine; pulp screening, bleaching, and washing machines; paper making machine for adding additives, pressing, drying, and rolling paper. The value of residual assets if exiting the business is low. Proposed mill closures create headlines and are met with significant resistance, particularly in so-called one-mill towns. In addition, there can be large environmental clean-up costs.

Figure 27
Papermaking Process
From the perspective of barriers of exit, the paper and paperboard industry is highly unattractive largely due to large fixed assets not transferable to other manufacturing sectors.

**Figure 28**

**Barriers to Entry**

<table>
<thead>
<tr>
<th>BARRIERS TO EXIT</th>
<th>HIGHLY UNATTRACTIVE</th>
<th>MILDLY UNATTRACTIVE</th>
<th>NEUTRAL</th>
<th>MILDLY ATTRACTIVE</th>
<th>HIGHLY ATTRACTIVE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset specialization</td>
<td>High</td>
<td>Low</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>One-time cost of exit</td>
<td>High</td>
<td>Low</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strategic interrelationship</td>
<td>High</td>
<td>Low</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emotional barriers</td>
<td>High</td>
<td>Low</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government and social restrictions</td>
<td>High</td>
<td>Low</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 7.3 RIVALRY AMONG COMPETITORS

The current structure of the US paper industry is not attractive. Compared to most other major industries, particularly capital intensive ones such as car manufacturing, aluminum, mining, oil, and gas, it stands out as one of the least concentrated in its ownership structure. There are about 100 leading paper manufacturers of pulp, paper, and paperboard, and many more converters.\(^{135}\) As a result, the overall level of market concentration is low and rivalry is very intense. The following figure lists the ten largest U.S. companies based on 1998 revenues. Across the industry overall there is no dominant market player. A company of the size of International Paper controls less than 10% of the worldwide paper market.\(^{136}\) Within a paper grade, however, there are several leading companies; for example, in the uncoated freesheet

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\(^{135}\) [http://paperonweb.com/ppmanf11.htm](http://paperonweb.com/ppmanf11.htm)

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grade, the top five companies hold about 50% of the market share and the top ten companies have about 77% market share.\textsuperscript{137} Although the major paper companies in particular manufacture and sell paper on a global scale, about 90% of their products are targeted for the US market that is very mature.\textsuperscript{3}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure29.png}
\caption{Largest U.S. Companies According to 1998 Revenues\textsuperscript{138}}
\end{figure}

<table>
<thead>
<tr>
<th>Company</th>
<th>Revenue ($M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Paper</td>
<td>19,500</td>
</tr>
<tr>
<td>Georgia-Pacific</td>
<td>13,223</td>
</tr>
<tr>
<td>Kimberly-Clark</td>
<td>12,298</td>
</tr>
<tr>
<td>Weyerhaeuser</td>
<td>10,766</td>
</tr>
<tr>
<td>Fort James</td>
<td>7,301</td>
</tr>
<tr>
<td>Boise Cascade</td>
<td>6,162</td>
</tr>
<tr>
<td>Champion International</td>
<td>5,653</td>
</tr>
<tr>
<td>Union Camp</td>
<td>4,503</td>
</tr>
<tr>
<td>Smurfit-Stone Container</td>
<td>3,794</td>
</tr>
<tr>
<td>Mead</td>
<td>3,772</td>
</tr>
</tbody>
</table>

The paper industry is consolidating. In 1998 alone, there were 14 mergers and acquisitions in the paper industry.\textsuperscript{2} Notable among the wave of consolidations is the merger between Fort Howard and James River in August 1997 to form Fort James to become the number one maker of tissue paper. In May 1999, International Paper grew even larger by acquiring Union Camp to become the largest producer of uncoated freesheet in the world with an expected

\textsuperscript{136} Joel Dresang, Milwaukee Journal Sentinel, July 5, 1999.
\textsuperscript{137} "Grade Profile, Uncoated Freesheet: Rising Imports Put Damper on Prices, Shipments as Demand Slows", Pulp \& Paper, April 1999.
\textsuperscript{138} Standard \& Poor’s Industry Surveys – Paper \& Forest Products, October 21, 1999.
20% market share. The US paper industry generally remains fragmented and further consolidation is likely.

The leading US companies have diversified paper and paperboard products. The mainstay of the industry has been commodity grades of ten major categories of papers and paperboards that are listed in the following figure:

**Figure 30**

**Types of Paper and Paperboard Products**

<table>
<thead>
<tr>
<th>Grade</th>
<th>Major Customer Segments</th>
<th>Largest US Producers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newsprint</td>
<td>Daily newspapers</td>
<td>Bowater</td>
</tr>
<tr>
<td>Uncoated groundwood</td>
<td>Telephone books, catalogs, advertising inserts, flyers, business forms, paperback books</td>
<td>Bowater</td>
</tr>
<tr>
<td>Coated groundwood</td>
<td>Commercial printing, magazines</td>
<td>Consolidated Papers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Champion International</td>
</tr>
<tr>
<td>Coated freesheet</td>
<td>Magazines, catalogs, commercial printing</td>
<td>S.D. Warren</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Consolidated Papers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Westvaco</td>
</tr>
<tr>
<td>Uncoated freesheet</td>
<td>Office/business printing, business forms/envelopes, publishing, commercial printing, and writing stationary</td>
<td>International Paper</td>
</tr>
<tr>
<td>Kraft paper</td>
<td>Grocery/retail bags, multiwall shipping sacks, wrapping papers</td>
<td>Longview Fiber</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Smurfit-Stone Container</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Gaylord Container</td>
</tr>
<tr>
<td>Tissue</td>
<td>Sanitary products (consumer, commercial/industrial)</td>
<td>Kimberly-Clark</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fort James</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Procter &amp; Gamble</td>
</tr>
<tr>
<td>Linerboard (kraft, recycled)</td>
<td>Corrugated boxes</td>
<td>Smurfit-Stone Container</td>
</tr>
<tr>
<td></td>
<td></td>
<td>International Paper</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Georgia-Pacific</td>
</tr>
<tr>
<td>Bleached paperboard</td>
<td>Folding cartons, milk cartons, disposable cups/plates</td>
<td>International Paper</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Westvaco</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Temple-Inland</td>
</tr>
<tr>
<td>Recycled paperboard</td>
<td>Folding cartons, corrugated containers, linerboard</td>
<td>Smurfit-Stone Container</td>
</tr>
</tbody>
</table>
Containerboard and print/writing grades represent approximately 37% and 28%, respectively, of U.S. paper and paperboard production. The printing and writing market consists of uncoated and coated papers. Both uncoated and coated papers include freesheet and groundwood grades. To stabilize earnings during business downturns, some paper companies have turned to manufacturing specialized paper products that meet a specific market segment need, unlike a commodity grade of paper. There are many different commodity and specialty grades, and a complex classification system exists to provide consistent pricing depending on the use and quality required. A consequence of the manufacture of highly varied products is the development of market imperfections that lead to fierce competition to dominate market segments and gain price leadership advantage.

Two recent and conflicting trends are the movement of paper manufacturers away from commodity paper grades such as newsprint to new, specialty variants of paper, and the movement of printers and publishers to demand fewer variations of paper grades, instead seeking more uniformity of choice across the major grades.

The urge to build capacity ahead of demand has generally meant that the new capacity starts up as the industry enters a downturn, giving rise to excess supply and declining prices. This trend appears to be slowing down, as paper companies recover from poor investment returns resulting from capacity expansions undertaken in the 1980’s and early 1990’s. This trend is also being tempered by management that believes that it is better to acquire capacity through mergers rather than to build it. According to the 39th annual survey of pulp, paper, and paperboard manufacturers’ capacity by the American Forest & Paper Association, the average annual increase is expected to be 0.9% in 1999-2001, the slowest growth on record.

The fierce competition among many competitors has made for intense rivalry that is evidenced by the substantial levels of excess capacity. As a result, the industry tends to highly unattractive for this element of the analysis.

140 Contains less than 10% mechanical pulp.
141 Contains at least 10% mechanical pulp.
7.4 POWER OF BUYERS

Paper distribution is becoming more fragmented, reflecting changes in business patterns. Paper products have traditionally been sold through company-owned merchant distributors, major independent paper distributors, and converters as well as directly to printers and publishers. The emergence of the small office/home office market, and the ensuing plethora of printers, copiers, and fax machines, has changed the traditional patterns of paper distribution to include office products distributors and catalogers, printing equipment manufacturers, price club and warehouse outlets, and retailers (e.g., computer stores). The slow, but persistent, emergence of distributed printing (printing of electronically transmitted material in remote sales offices,

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manufacturing plants, convention centers, hotel business centers, and quick print operations) is expected to further strengthen the power of buyers. A disadvantage of the new distribution channels for some printers is the lack of uniformity from purchase to purchase since the paper may be from different mills.

During the last decade, the major paper companies acquired independent paper merchants to control the channels of distribution. The remaining independent paper merchant organizations have also consolidated and are beginning to gain significant strength. Whereas many merchants previously handled a paper inventory of “redundant” paper lines from more or less the same mills, the drive for improved financial performance has led some merchants to pare their lines and represent fewer mills. In addition, substantial improvements in paper quality and consistency have eliminated the need for merchants to carry large numbers of similar papers. The result of these trends is that paper merchants are increasingly able to selectively choose a mill partner based on non-product services that the mill can provide a merchant. In some cases, these services can be passed by the merchant on to the end user.

The key role of distributors in the supply chain is further evidenced by a new trend to automated paper distribution centers. Through distributors, the paper industry realizes its all-important goal of speed to market. This is accomplished by “smart” warehouses that enable a longer and later window for orders, highly accurate order fulfillment, and real-time updates for inventory counts.

Overall, printers, publishers, and packagers are the major purchasers of a mill’s printing paper output. It is moderately easy for these buyers to switch same-grade products within the paper and paperboard industry. However, price leadership in some paper industry segments results in the setting of prices by a major manufacturer that are accepted by other companies. This is typical for uncoated printing and writing papers, newsprint, unbleached kraft papers, and linerboard. In addition, it is fairly common for buyers to change paper grades. For example,
catalogers frequently switch among coated groundwood, coated and uncoated freesheet, and supercalendered\textsuperscript{143} papers depending on supply and price.

The fast growing market for office papers is largely a consumer market that is highly fragmented with millions of end-users. What is important to these consumers is the availability and functionality of the paper products that they use. As a result, the choice of brand and distributor are important criteria in paper buying decisions. Price is a secondary factor. In addition, the consumption of office papers is relatively less cyclical in contrast to the market for commodity paper in reels.

Tissue products for the consumer market are sold through grocery, drug, and mass merchandise retailers. The commercial and industrial market for tissue products is sold through independent distributors and directly to national accounts (e.g., food service).

Paper products are everywhere, and as such, there are many sources of papers and paperboards to the end user. The bargaining power of buyers is insignificant, largely due to price leadership advantage in most product grades. Overall, the buying power of buyers tends the industry to mildly attractive.

\textsuperscript{143} High gloss and smoothness.
7.5 POWER OF SUPPLIERS

As discussed above, most of the pulp used to make (woodfree) paper grades comes from internal sources. For those companies that manufacture paper from market pulp, the market concentration of pulp suppliers is relatively low: the 10 major market pulp suppliers represent 40% of the world’s capacity.\textsuperscript{144} The pulp market is characterized by low customer loyalty and prices that are under constant pressure. Historically, the paper industry has used the price of pulp to drive paper prices. This method of price setting is increasingly being challenged as the

relative costs for distribution and marketing are increasing, compared to production costs. As a result, pulp is becoming less important overall to the paper and paperboard industry.

A major trend reshaping the paper industry is the move to single sourcing of raw materials, particularly specialty paper chemicals. These include process and performance additives such as coating and filler pigments, resins, and repellants. Many of the larger paper manufacturers have adopted a strategy of developing single-source supplier relationships to, firstly, obtain technical developments, product developments and service, and R&D leverage, and, secondly, to help manage costs. In contrast to specialty paper chemicals, commodity chemical purchases are based strictly on price, and papermakers are not moving towards one-source suppliers.

The result of this single-sourcing strategy is that paper suppliers are consolidating through mergers and acquisitions as well as forming alliances in order to provide broader product lines. Currently there are three main broad-based suppliers of paper chemicals. As a result, competition among smaller suppliers is very intense, prompting significant investment in R&D to develop the next breakthrough technologies. The contribution of suppliers to paper production is expected to increase as paper companies look for specialty chemicals (e.g., strengtheners) that will enable the manufacture of high quality paper products using recycled or lower-quality fibers, less water, and more fillers.

Paper industry economics is forcing the three major suppliers of paper machines to make increasingly larger efforts to attract the dwindling number of papermakers seeking to invest in new machines. Moreover, paper machine builders are expending far more resources to develop rebuild and upgrade solutions tailored to potential papermakers' requirements. The overriding factor is to improve paper quality rather than to increase production. It is becoming more common for old machines to be converted to new designs under an upgrade program developed in cooperation between the paper manufacturer and the machine supplier. For

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example, it is important to papermakers that machine operation is very stable and grade changes smooth for optimal runnability.

The last major category of suppliers is sources of power generation. Energy costs can account for as much as 30-40% of a mill’s variable cost.\textsuperscript{146} The deregulation of the natural gas and electric utility industries has allowed most papermaking facilities to negotiate lower rates with suppliers under their existing special contracts. The entry of power marketers and brokers, such as Enron, is already seeing new service offerings tailored to the paper industry, such as financially settled long-term fixed price contracts, energy pricing inversely tied to paper costs, and inventory financing.

The power of suppliers is diminishing as the industry tends to single sourcing and suppliers continue to consolidate. Specialized paper chemical suppliers could retain bargaining power as the paper companies seek to develop new papermaking processes in conjunction with new product development. Overall, however, the power of suppliers is low and the trend for the industry is to mildly unattractive.

7.6 AVAILABILITY OF SUBSTITUTES

Predictions of electronic substitution of paper-based media are generally regarded as excessive claims. In a recent analysis of the impact of electronic media on paper, the Boston Consulting Group (BCG) forecast anticipated paper consumption, and assessed the expected penetration of the Internet and other sources of electronic and digital distribution as well as people's reading habits and emotional attachment as indicators of switching probability. The results indicate that the worldwide consumption of paper will continue to increase and that

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growth in most sectors will offset losses resulting from the switch to electronic media. The largest impact is expected to be on newsprint with direct and indirect electronic substitution from online news services and advertising. Another sector more likely to be affected is catalogs due to the inherent searchability, interactivity, and timeliness associated with electronic catalogs. However, there has been a strong, positive impact on paper consumption from the introduction of new office technology. The BCG study\textsuperscript{147} found that the cut-size office paper segment will double from 1996 levels by 2003 benefiting largely from individual printing of electronic information in offices and homes.

The growth of the flexible packaging industry has paper products struggling to keep up. Plastic or shrink wrapping has increased its share of the packaging market with manufacturers benefiting from more simplified packaging procedures and customers not having to face problems of storing and then disposing of waste paper when plastic can be shriveled up into a compact ball for disposal. Although plastics can create tight packages important for some uses, paper manufacturers point to paper as the source of new sleeve and stand-up pouch packaging that is water, air, and grease resistant. Paper also offers important advantages to the food packaging industry because of its high porosity and varying moisture content that are important when considering food contact over time. Lastly, the reprographic quality of paper is generally considered to rival that of plastic.

Another area to watch is the transport packaging industry and choices of paper versus plastic containers. The corrugated box business is still the largest segment of this sector, but the amount of plastic used to manufacture shipping containers has steadily increased over the last ten years.\textsuperscript{16} Regardless of material, container manufacturers are striving for lighter weights since the weight of the packaged product can be a significant determinant of the cost of transportation. As with newsprint and other wastepaper, future transport packaging decisions may be based on disposal expenses and thus the recyclability and reusability of packaging containers.

Plastic and coated bags have impacted the market share of paper and multiwall bags. This trend has been significantly dampened by the industry-wide campaign of the 1990's to reshape the paper industry as more environmentally friendly through comprehensive programs of
waste management and recycling. After investing heavily in recycling capacity, the industry recovers about 45% of all U.S. wastepaper.\textsuperscript{132}

The lack of wholesale substitutes for paper and paperboard products makes this element mildly attractive.

\textbf{Figure 34}

\textit{Availability of Substitutes}

<table>
<thead>
<tr>
<th>Availability of close substitutes</th>
<th>Highly Unattractive</th>
<th>Mildly Unattractive</th>
<th>Neutral</th>
<th>Mildly Attractive</th>
<th>Highly Attractive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Future</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>User's switching costs</td>
<td>Low</td>
<td></td>
<td></td>
<td></td>
<td>High</td>
</tr>
<tr>
<td>Substitute producer's profitability and aggressiveness</td>
<td>High</td>
<td></td>
<td></td>
<td>Low</td>
<td></td>
</tr>
<tr>
<td>Substitute price/value</td>
<td>High</td>
<td></td>
<td></td>
<td>Low</td>
<td></td>
</tr>
</tbody>
</table>

7.7 GOVERNMENT ACTIONS

The US government has taken actions to reduce or eliminate some paper and paper tariffs clearing the way for expanding exports of paper and allied products. Exports are expected to account for about 9% of total sales in 1999 as foreign markets have become increasingly important to paper manufacturers with only slight increases in domestic sales in recent years.\textsuperscript{148} Under the North America Free Trade Agreement, Canada and Mexico have phased out trade
barriers on most U.S. primary pulp, paper and paperboard products. Within a few years, Canada and Mexico will have duty-free entry for corrugated boxes and most converted paper products. While some other countries have followed similar actions to pare import duties as part of the Uruguay Round of trade liberalization agreements, the industry continues to push hard for the elimination of trade barriers worldwide, especially in Asian and Latin American countries.

At the state level, many paper companies have successfully secured favorable government support in the form of tax incentives and reductions in utility costs. In some cases, companies have received special relief from workers’ compensation and unemployment insurance costs.

The industry is highly regulated by the Environmental Protection Agency (EPA). Pulping processes are the major source of environmental impacts. Papermaking processes excluding pulping have not been associated with significant environmental problems and are not addressed by the EPA’s ongoing regulatory and non-regulatory initiatives.

Papermaking is often described as a smelly, dirty business. The vast majority of pulp tonnage produced in the U.S. is manufactured by the kraft chemical pulping process that can release nuisance odors and particulates into the air. In addition, the bleaching processes used to whiten and brighten pulps for paper manufacture can produce wastewaters containing chlorinated compounds such as dioxins.

Since April 1998, with the passage of the Phase I of the Cluster Rule, new and existing facilities that manufacture bleached paper grade kraft, soda, and sulfite pulps must meet strict effluent limits for toxic pollutants in wastewater discharged during the bleaching process and in the final discharge from the mill; mills have three years to comply with the new regulations. These limits are based on conversion to elemental chlorine free (ECF) and totally chlorine free (TCF) bleached chemical pulp production. Phase I also includes final air regulations based on maximum achievable control technology (MACT). The American Paper & Forest Paper

Association (AF&PA) estimates that the cost of compliance will be approximately $3.0B with an increase in annual operating expenditures of about $300M. The industry can expect increasingly stringent environmental regulations as Phases II and III of the Cluster Rule are expected to follow in the next few years to specify water regulations for other pulp mill categories.

Environmental regulation of the industry is strict. Government trade policies are generally favorable, but limited in number of country signatories. Government actions tend the industry to highly unattractive.

**Figure 35**

*Government Actions*

<table>
<thead>
<tr>
<th>GOVERNMENT ACTIONS</th>
<th>CURRENT</th>
<th>FUTURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry protection</td>
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<td>Favorable</td>
</tr>
<tr>
<td>Industry regulation</td>
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<td>Favorable</td>
</tr>
<tr>
<td>Consistency of policies</td>
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<td>High</td>
</tr>
<tr>
<td>Capital movements among countries</td>
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<td>Unrestricted</td>
</tr>
<tr>
<td>Custom duties</td>
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<td>Unrestricted</td>
</tr>
<tr>
<td>Foreign exchange</td>
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<td>Unrestricted</td>
</tr>
<tr>
<td>Foreign ownership</td>
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<td>Unrestricted</td>
</tr>
<tr>
<td>Assistance provided to competitors</td>
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<td>None</td>
</tr>
</tbody>
</table>

7.8 CURRENT OVERALL ASSESSMENT

The paper and paperboard industry overall has low attractiveness. The industry continues to struggle to achieve acceptable returns due to excess capacity, low prices, and high capital investment for plant modernization and environmental compliance. While efficient companies have grown and become leading commodity producers, many other producers have stayed in business due largely to the long-term expectations of their investors. In particular, although the trends in the sector are a mix of positive and negative, attempts to curb capacity expansion and the benefits of industry consolidation point to a more positive outlook for the industry. The industry is focusing on consolidation, which translates into slower capacity growth. Consolidation should also lead to larger profit margins as SGA and R&D costs are spread over a larger fixed asset base and redundant operations are eliminated. The sharing of best practices can also increase productivity. However, investors are coming to expect higher and more consistent returns, and new business strategies will be needed for some paper and paperboard companies to make fundamental changes to improve performance and profitability.
### Figure 36
**Overall Assessment**

<table>
<thead>
<tr>
<th>Current</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGHLY UNATTRACTIVE</td>
<td>HIGHLY UNATTRACTIVE</td>
</tr>
<tr>
<td>MILDLY UNATTRACTIVE</td>
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<tr>
<td>NEUTRAL</td>
<td>NEUTRAL</td>
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<tr>
<td>MILDLY ATTRACTIVE</td>
<td>MILDLY ATTRACTIVE</td>
</tr>
<tr>
<td>HIGHLY ATTRACTIVE</td>
<td>HIGHLY ATTRACTIVE</td>
</tr>
</tbody>
</table>

**OVERALL ASSESSMENT**

<table>
<thead>
<tr>
<th></th>
<th>HIGHLY UNATTRACTIVE</th>
<th>MILDLY UNATTRACTIVE</th>
<th>NEUTRAL</th>
<th>MILDLY ATTRACTIVE</th>
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</thead>
<tbody>
<tr>
<td>Barriers to entry</td>
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<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Barriers to exit</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Rivalry among competitors</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Power of buyers</td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Power of suppliers</td>
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<td></td>
</tr>
<tr>
<td>Availability of substitutes</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government actions</td>
<td></td>
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</tbody>
</table>

### Figure 37
**Overall Industry Assessment**

<table>
<thead>
<tr>
<th>Current</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>LOW ATTRACTIVENESS</td>
<td>LOW ATTRACTIVENESS</td>
</tr>
<tr>
<td>MEDIUM ATTRACTIVENESS</td>
<td>MEDIUM ATTRACTIVENESS</td>
</tr>
<tr>
<td>HIGH ATTRACTIVENESS</td>
<td>HIGH ATTRACTIVENESS</td>
</tr>
</tbody>
</table>

**OVERALL INDUSTRY ASSESSMENT**

<table>
<thead>
<tr>
<th>Overall assessment</th>
<th>LOW ATTRACTIVENESS</th>
<th>MEDIUM ATTRACTIVENESS</th>
<th>HIGH ATTRACTIVENESS</th>
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</table>
7.9 FUTURE PROJECTIONS - OPPORTUNITIES AND THREATS

There are several external factors affecting the U.S. paper industry and the markets it serves. As a result, the industry is headed towards some significant changes in the types of papers needed and in the way consumers buy and consume paper products. This reflects in large part a shift away from low-cost producers of commodities to marketing-oriented businesses seeking to fulfill customer needs through the development of new value-added products. The expectation is that profit contributions from value-added products will go to companies that are embedded in the businesses of their customers.

There are three major drivers for change in the paper industry:26

- Changes in retailing
- Changes in consumer demographics
- Time pressures and a sense of urgency

First, the majority of soft and hard goods sold at retail are now sold in “big box” stores such as Wal-Mart and Circuit City. This has led to the creation of roles for salespeople and print media suppliers that are different when retailing was dominated by department stores and specialty stores. For example, there is a much greater emphasis on the use of media such as freestanding inserts, direct mail, and coupon promotions. Since the margin markups are tighter for big box stores, there is a strong push to reduce the cost of marketing communication materials.

The second driver is the emergence of the color TV/MTV generation as the segment with the majority of purchasing power. This group is composed primarily of two career households with children in day care. Their lifestyles are characterized by time pressures and a sense of urgency. This tends to lead them towards shorter attention spans, multi-tasking, and quick gratification. While they do not have time to read a general interest magazine, they are likely to make time for specialized magazines dealing with their specific areas of interest.
The result of these changes is evident in the decline in traditional magazines as an advertising medium. Instead, the use of specialized magazines is increasing. In addition, the significant growth in freestanding newspaper inserts is continuing, as is the growth in direct mail, coupon usage, and other non-magazine media.

The most prominent areas of change in the paper industry and the associated opportunities and threats are discussed next:

- Internet, E-Commerce, and On-Demand Printing

  The Internet and e-commerce do not signal the advent of the paperless office or other paperless environments. Unarguably, there has been a significant increase in the use of the Internet as an alternative medium for information and communication. More recently, the use of e-commerce and consumer purchasing on the net has greatly increased. At the same time, email has become nearly ubiquitous in the U.S. Interestingly, email has not taken share from the postal service, but from fax and long distance telephone.

  The result of the increased use of the Internet has been an increase in the need for on-demand printing. The most common action when reading a *.pdf file or an email attachment is to print the document. Furthermore, the person clicking the print icon is more likely to be from the color-motivated generation who is seeking not just color printing but high quality color printing. For these users, ink jet and color laser printers are becoming standard tools. Thus, there is growing demand for papers that will provide commercial, high-definition color print on-demand.

- Printing, Imaging, and Publishing

  The two most common methods of printing are offset and flexographic. Headset offset has become the dominant process for medium and long run printing. It is the dominant printing process for newspaper inserts, coupon books, catalogs, and direct mail pieces. The make-ready costs for both offset and flexographic printing have been significantly cut due to computer-to-plate technology. A third printing process, gravure, is not expected to grow
significantly in North America, and a number of major publishers that had been users of the process have switched to headset offset printing.

The quality of digital printing has increased dramatically over the last decade and is currently almost comparable with offset. A large fraction of material that is now printed by sheet fed offset is expected to be produced by digital printing in the near future. A major reason for this change is that the computer-to-plate and make-ready costs are eliminated. In addition, the majority of run lengths that are too low for web offset will be produced by digital printing.

The second common printing process, flexographic, has also been improved to produce significantly higher quality output accompanied by a reduction in costs. One of the main reasons for these results is the use of water-based, minimal-VOC inks. The opportunity for increased flexographic printing is in papers where ink gloss and snap are not important criteria. Although flexographic printing is particularly well suited to newspaper printing based on technology and efficiency factors, it is not likely to soon replace web offset due to the large expenditures required for conversion; web offset itself replaced letterpress for general newspaper printing during the past several decades at great capital expense.

- New Grades of Paper

Changes in market drivers and shifts in printing and imaging are creating a need for new grades of paper. For example, there is a growing need for economical headset offset papers that are lower in cost than blade-coated lightweight coated grades. These new grades need to have better performance characteristics than current high-end supercalendered (SCA+) grades on headset offset presses, but need to cost less than LWC. The critical factor for keeping these grades economical is to minimize the amount of bleached kraft pulp in the finish. A potential method for manufacturing these new grades may be to carry out pigment coating with a metering size press combined with hot soft nip calendering. This may be feasible with a relatively low cost rebuild of an existing newsprint machine.
A second need is for digital printing papers that provide high-definition, high-quality color reproduction at a reasonable cost. In the small office/home office (SOHO) market segment, there is a need for mid-range ink jet/toner bond papers that provide better quality than multi-purpose uncoated free sheet at a price that is significantly less than that of silica-coated specialty papers.

The differences between coated and uncoated papers are expected to become increasingly blurred. The new paper grades will reflect this shift and have several unique characteristics. In order to be economical, the new grades will be made with lower cost finishes. They will probably be surface-chemically treated via metering size press, and the surface chemical treatments are likely to contain new engineered kaolin and calcium carbonate pigments. Lastly, the new grades will likely be hot soft nip calendered.

- Channels of Distribution

The way paper products are sold and delivered is undergoing significant change. The consolidation in the number of independent paper merchants and acquisitions and mergers within the paper industry itself has led to a sharp decline in the traditional roles of the stocking merchant, such as carrying inventory and handling customer credit. With these changes and pressures to increase efficiency in paper sales organizations, paper companies are even less poorly positioned to actually listen to customers and potential customers about their specific needs.

The role of the traditional office supply retailer has also declined. The majority of office supplies are now sold in “big box” stores such as Staples and OfficeMax. This reflects the growth of these stores to provide services for larger offices in addition to the SOHO segment that they were originally intended to serve.

More recently, another growing channel of paper distribution is the imaging center, such as Kinko’s. These centers provide copying and print-on-demand services that have replaced to a large extent quick printers. They currently account for a significant share of cut-size grades for consumer consumption.
The new channels for delivery of paper to end-users has resulted in an increase in national account management by paper companies. The negative impact of this trend is a further distancing of paper companies seeking to identify new and emerging needs for new grades of paper.

- Specialty Products

  The production of pressure sensitive adhesive grades (i.e., “peel and stick” labels and packaging components) is continuing to grow faster than other paper products. These grades are used for primary and secondary labeling, banding, bar coding, and other packaging applications, such as airline luggage tags. Pressure sensitive adhesive products are manufactured by combining adhesive technology with direct thermal coating technology. Growth in specialty products offers paper companies opportunities for other technology combinations to produce customized and specialized products.

- Packaging

  With the trend to “big box” stores for retail sales, there are fewer salespeople and, therefore, a greater need for the package itself and point-of-purchase displays to serve the selling function. From the design and manufacturing perspective, this creates a continuing and growing need for high quality color graphics.

  The corrugated container industry supplies the majority of the packages on store shelves and is currently in the midst of major changes. First, the development of mini-flute and micro-flute are enabling the industry to grow into folding carton applications that until now have been dominated by the solid bleached sulfate (SBS) and recycled multi-ply paperboard grades. For example, N-flute corrugated can produce a 26-30 point combined board that will run in standard folding carton machinery. The result is a box that weighs 40% less than the same box construction made from recycled multi-ply board and has better stacking strength. The market for high graphic quality corrugated containers is growing at more than twice the rate of the overall corrugated business. These grades are made by coating white top, mottled white or brown kraft or recycled linerboard.
The lightweight linerboards needed for micro-flute corrugated do not lend themselves to manufacture in a linerboard mill and are actually produced in paper basis weights rather than linerboard basis weights. Linerboard production is increasingly affected by the increase in applications for litho-laminating in the packaging segment.

In general, there are emerging opportunities for producers of communication and publication papers in the packaging segment. For example, the required new grades may need to run well in direct/post print flexo without drying.

Another opportunity is presented by the need to incorporate functional properties, such as recyclable barrier coatings. The development of recyclable barrier coating materials is being driven by an overall concern about recyclability. These materials are used for applications such as roll wrappers and headers, ream wrappers, hydro-cooling boxes, and numerous other bag paper, folding carton, and corrugated container applications. The recyclable barrier coatings replace extrusion polyethylene coating and wax treatments for providing the required resistance to moisture vapor, water, blood, grease, oil, and other penetrants while at the same time not adversely affecting recyclability of the paper or board. In addition to environmental benefits, these coated materials can have significant economic impacts. For example, large commercial printers are currently using paper wrapped in conventional PE-laminated wrappers and have to pay for the transportation and delivery of the wrappers to landfills. If these printers were to switch to paper wrapped in recyclable wrappers, then the used wrappers can be sold as secondary fiber. Recyclable barrier coating technology and applications is further advanced in Europe than North America, but significant advances are being made in the US and Canada. This area of packaging and container products is likely a high growth segment.
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NAME: Jeon, Laila