FACING THE CHALLENGE: MEAD'S JERRY TATAR

MATTHEW J. COLEMAN

PERFORMANCE ETHIC AND VALUE-ADDED PORTFOLIO DRIVE COMPANY'S SUCCESS

Jerry Tatar is chairman, CEO and president of The Mead Corporation. He joined Mead in 1973 as an operations research analyst and later served as a corporate planner, director of marketing for the company's paperboard operations, general manager of strategy and new ventures for the Packaging Division, and as president of the Gilbert Paper Division. He was named vice president of marketing in 1985, president of the Fine Paper Division in 1986, and vice president-operating officer in 1994. He was appointed president and chief operating officer in 1996 before assuming his present position in November 1997.

Jerry has a BS degree in mathematics and economics from Carnegie-Mellon University and an MBA from the University of Pittsburgh.

In addition to chairing Mead's board, Jerry serves on the board of directors of Robbins & Myers and as a trustee for Sinclair Community College, the Dayton Public School Foundation, Hipple Research Center, and the Ohio Foundation of Independent Colleges.

TAPPI JOURNAL: In your opinion, what challenges face a North American paper producing company between now and the first five years of the new century?

Tatar: There's no shortage of factors affecting our industry. They include global competition, price pressures, industry consolidation and the expectations of the financial community. Most critically, as an industry we aren't earning as much as we need to cover the cost of capital. Consequently we aren't generating the kind of shareholder value sought by investors. While there are many causes, most can be traced to competitive dynamics globally. This has been a decade, generally speaking, of oversupply as we've encountered overcapacity in most segments of the industry. We used to deal with oversupply only on a domestic or regional basis, but today its clearly a global issue.

We have also seen business combinations within our customer base. This is a fragmented industry of suppliers. Historically, it was a fragmented industry of customers. The last 10 years have seen the introduction of a lot of new paper industry players overseas. During that time, the amalgamation of the customer base has intensified and that's created a competitive dimension adding to the problems of the industry.

TAPPI JOURNAL: How is it that we can get into a condition of such dramatic oversupply globally? Is the financial community really making wise investment choices? In other words, why would someone invest in overcapacity? What dynamics lead companies to invest in overcapacity?

Tatar: There are three forces involved. The first is leverage. You can borrow the money and cover the cost of debt, but not its cost of equity. Unfortunately it is possible to borrow a lot of money and then just make enough returns to cover your debt payments through the very high cash flows that mills can produce.

The second force is that everybody sees their own position as being significantly different — read that as significantly better — than their competitors. Therefore, they'll be able to out-compete everyone and be the low cost producer. They view themselves as saying, "I can be the superior player in this marketplace and I can do well versus the average competitor." It's a combination of those two things that has led to chronic overcapacity.

Then there is a third element — for many years we have been blessed with markets that have grown quite well, usually more than GDP. Most capital project requests are based on the premise that demand will eventually catch up with supply, with the supply then leveling off. Unfortunately, this is almost never the case.

TAPPI JOURNAL: Does the fragmentation of the producer side create the problem where the industry ends up with a number of simultaneous projects that, when completed, will virtually guarantee overcapacity? Why does it seem that so many companies decide independently that they want to borrow money to do projects to expand capacity in X grade? If there are 100 companies in the business as opposed to 10, does it make it more likely to get into this kind of surge capacity building?

Tatar: The conventional wisdom says that the overcapacity problem will be fixed as assets combine and consolidate on the supply side. However, I don't think that's necessarily true.For example, consolidation doesn't solve the three forces that I explained earlier. In a highly fragmented industry, not every company can afford to undertake multiple capital projects — you have to space them out. So I don't think consolidation is necessarily the solution to the problem. The solution has to be based on a very prudent and very disciplined approach to capital spending. In other words, the number of competitors is not the only determination of wisdom in the marketplace. A strong commitment to achieving the cost of capital is the key ingredient to solving the overcapacity problem — no matter how consolidated or fragmented the industry.

TAPPI JOURNAL: What specific challenges face Mead as it moves into the 21st century?

Tatar: Mead has to live within the environment I've described and deal with the challenges I've laid out. What is Mead doing to compete successfully? We have two basic tenets. First, our portfolio of businesses is a little different from the average company. We tend to be more value-added in our approach to our businesses. The second tenet is the performance ethic that we try to instill among our employees. Since 1992, we've focused on what we call our change drivers of customer satisfaction, productivity improvement and building a high performance organization. So, value-added and performance ethic are the basic tenets we've relied on to separate ourselves from the pack and compete successfully.

At any point in time, we're into different phases of this program. For instance, right now we have six initiatives that are in process. First, we are focusing our portfolio — we're divesting some non-strategic assets. Second, for the areas in which we have a very strong market position, we're trying to grow those businesses. As an example, we recently acquired a small paper mill to complement our specialty paper business. Third, we are taking each of our businesses and making them as effective as we can. One part of that has been the combination of our paper divisions — Chillicothe, OH; Escanaba, MI; and Rumford, ME; into one major paper division. Fourth, we are going to discipline ourselves as far as capital spending is concerned. We've had a number of major projects in progress that kept us spending at the rate of US$ 450 million a year for the last couple of years. We're going to cut that down to about US$ 300 million a year over the next couple of years.

Fifth, we're determined to become a bit leaner, so in the short-term we're looking at some ways — including the combination of those divisions — to reduce our salaried workforce by at least 5%. Finally, longer-term, we're going to leverage information technology through an enterprise resource planning system that will centralize some of the functions that we've previously performed on a centralized basis. This will allow us, over the next few years, to reduce our salaried group by about another 5%.

The bottom line to each of these six initiatives is that we have to continue to do things that improve our performance ethic — the things that deal with productivity and customer satisfactionand make sure were always in a position to grow our businesses when the opportunity strikes. It is much easier to take advantage of the opportunity if your balance sheet is in good shape as opposed to being financially stretched. That's why we maintain a strong balance sheet.

When we make acquisitions — and most of our growth is probably going to be through acquisitions as opposed to internal growth — we make sure that we make wise ones. We like to be aggressive shoppers or lookers, but very prudent buyers. Why? You want a good asset, yet you want to pay a reasonable price for it — although reasonable looks pretty high these days! And most importantly, you have to be able to do something with it. So that's the real test, acquiring something and then making something happen with it. We think we're getting better at our ability to integrate businesses into our portfolio. We have the long-term perspective of our three change drivers to put our strategy into practice.

TAPPI JOURNAL: This sort of follows that — strategically, where do you see Mead in relation to other North American paper companies in terms of growth potential, and where do you see it in terms of local companies?

Tatar: We're only going to grow in our strong suits. You can't win the game unless you have a good base to work with, so we've pretty much defined the areas in which we feel we have strong positions, both in the sense of market share but maybe more in the sense of skills and capabilities. For us, those are coated paper, different elements of specialty paper, the whole packaging arena and the boards used in packaging, and school and office products. These areas are the heart of Mead, and in each of them we normally have a reasonably strong position with capabilities that can be viewed as core skills within the company. The competition is certainly fierce and there is no place where you can run and hide from it. But we don't feel that were outmanned, outgunned, or outresourced in those particular areas.

The issue always is — how fast can you do it? We can't afford to make many mistakes so we have to make sure that our decisions are based on some good sound reasoning. Which takes us back to what I said before — acquire good assets at a reasonable price and do something with them.

While part of our business is regional or domestic, we also have businesses that are global in nature. Our packaging business is co-located with beverage producers around the world. Our specialty paper business is, in one sense, a global business because we export a large share of our products, but everything is made domestically. We also sell pulp around the world. On the other hand, we have some businesses that are purely domestic — such as our Containerboard Division — and to a great extent our Coated Board Division. We're not going to be global for global's sake, but we'll be global where it makes sense from a competitive aspect.

TAPPI JOURNAL: You answered the next question. The only clarification that I would make out of it would be, are you comfortable with a strategic mix at Mead as you've defined it — coated paper and specialty papers, packaging and paperboard, and school and office products?

Tatar: Two words seldom in my vocabulary are comfortable and patient. But regarding our portfolio, we have plenty on our plate, we're strong in the areas I've defined, there are alternatives for growth and we're fully exploring them to identify those to which we'll commit our resources. Acquisitions are difficult and growth is difficult, so that's where the comfort breaks down. I'm comfortable about our position in these businesses. I'm comfortable about our core skills in those businesses, but I can have sizable discomfort about finding the right opportunities to grow those businesses and making sure that an idea turns into good results. Patience is a strange virtue once you make an acquisition because you don't have millennia to make it happen. Once you've made the acquisition, or set up the growth project, you need the right sense of impatience in bringing it to fruition as quickly as possible.

TAPPI JOURNAL: In your opinion, are companies with forest assets better positioned to maintain their viability than ones without it?

Tatar: Holding forest assets is not necessarily a make-or-break criterion of success. Some companies without forestlands have been relatively successful, and some companies with forestlands have been successful. Mead's long-term analysis is that fiber will be a scarce resource and that access to fiber will be under continued scrutiny. Therefore, we need cost-effective access to it. Our basic view is that this is a regional issue. In some parts of the country, there is more of a problem with long-term fiber access. Other places, its less of a problem. On the whole, we're going to keep control of our destiny as far as fiber is concerned.

TAPPI JOURNAL: What is your vision in terms of Mead and what is obviously a very active Asian market? What are your thoughts concerning the ability of mills in the tropics to produce bleached hardwood Kraft pulp at a substantially lower rate than were able to currently in the United States? In addition, the Asian market represents a consumption factor that represents potential exports for our products in North America. Does Mead see this as a time to move in this market place?

Tatar: That is a complex set of questions so let me try to sort it out in a couple of steps.

First, I'm bullish about the long-term viability, success, and growth rates of Asian markets, which I see as truly underdeveloped. The products that we make in this industry are basic to the development of economies. As GDP grows, the demand for our products grows. Certainly that level of consumption will grow and I think there is going to be a lot of demand for products in Asia. Also, I believe that over time the growth rates are going to come back. The past decade has demonstrated that those economies are innovative and vibrant, so I expect that those markets are going to grow and prosper over time. I believe the current situation is of short-to-intermediate term duration and it's going to take a while to work out of that. Longer term, I believe we'll see an envelope of increasing demand.

From the supply side, people, companies and organizations have recognized the enormous potential for tropical wood production and new companies have proliferated in Asia. Some of the forest products companies that now exist weren't even around 10 years ago, but they've proven they can get the money, equipment and skills to effectively compete. That's part of that competitive dynamic I talked about earlier.

Once upon a time this industry was a regional business — we worried only about U.S. or North American competitors. Now you have your head in the sand if that's all you're worried about. The new players that have sprouted up are strong and have access to the best of resources, money and people. They're going to be competitive and they're going to try to control the destiny of Asian demand created as their economies grow. But having said that, I don't necessarily feel that we will be disadvantaged in areas where we go with our strength. We're very good at our packaging business and we know how to compete worldwide. We compete worldwide in our specialty paper business. We've been doing this for some time and we're capable of matching or besting the competition.

The situation is different when you move away from value-added products toward commodity grades and products. We don't have major overseas investments in those areas and don't compete head-to-head. You have to look at overseas markets on a business-by-business basis and determine where you have strengths and play to them.

Coleman: If you could acquire a paper company or pulp company anywhere in the world right now, where would it be — North America or somewhere else?

Tatar: Its difficult for us to find the logic and synergies of making large acquisitions outside of North America. We wouldn't rule one out, but its clear to us that the synergies available are much higher regionally than they would be going into a completely new geographical market. Overseas acquisitions generally wouldnt allow significant reductions in overhead or the mixing and matching of machines. However, within certain segments of our business, smaller non-U.S. acquisitions have made sense. For example, in recent years we have acquired a Spanish packaging business and a Canadian company, Hilroy, as part of our School and Office Products Division.

TAPPI JOURNAL: What distinguishes Mead from other pulp and paper companies? What is your differentiation?

Tatar: In addition to our portfolio of businesses and our performance ethic, we've also been trying to learn from companies outside of our industry. We have been benchmarking highly successful organizations, such as General Electric, Allied Signal, Hewlett Packard, and others. We've been working at this a little longer than some of our competitors and have had a greater chance to apply some of what we've learned.

Mead has the aggressive discipline of its performance ethic and a strong portfolio of businesses that we're growing strategically. If we do that right, we shouldn't experience the massive earnings cycles that affect some of our competitors. Our earnings cycles should be tempered somewhat because of our specialty paper, packaging, and school and office products businesses. These are typically not the product areas that have significant cycles. But we're also in pulp, coated paper, and containerboard, and those products definitely are subject to earnings cycles. In these areas, we've got to make sure we can match up against the best. If we do the right things, we'll be prepared financially to make acquisitions or fund growth projects at the right time.

TAPPI JOURNAL: On a more personal side, what has given you the most satisfaction in the industry?

Tatar: The most satisfying thing about this work is people. To give people the opportunity to grow professionally and personally and watch them succeed and prosper has been an unexpected bonus of my career.

TAPPI JOURNAL: What has been your greatest challenge or frustration being a part of this industry?

Tatar: There are two answers. First, the last decade has been very difficult and the chronic underperformance of the industry has been disappointing. Cyclicality is one thing–chronic underperformance is quite another. Certainly the last decade has been difficult in that regard. Second, the antagonism between our industry and environmental groups shouldn't exist. The industry is really working hard towards sound stewardship of its land and resources. We live in the communities in which we work and have a vested interest in making these communities environmentally sound. In the end, I believe that our interests and those of the environmentalists are very much alike.

TAPPI JOURNAL: What do you see as TAPPI's role in the industry, and how can we serve the industry better?

Tatar: Education, innovation, creativity, and professionalism. These are all words that come to mind when I think of TAPPI. It is an organization that's focused on the scientific and engineering sides of the business. This industry certainly can use the best thinking across the industry, additional innovation and creativity in the production of our products, and help in enhancing our environmental performance. TAPPI's role in making that happen is significant and can be more significant if we give the organization advice about what to stress. Better relationships in the public arena is one example. There are certain economic business secrets, but within the areas that are public, TAPPI has a tremendous opportunity to move the industry forward. Second, TAPPI is not just completely technical in its focus, but also has a business perspective. As this becomes more and more a part of the TAPPI organization — to make sure everybody understands the economic situation of the industry — TAPPI can help direct some of that innovation and creativity, not only towards technical breakthroughs, but toward economic breakthroughs. In fact, TAPPI has already undertaken a combination of these initiatives. TAPPI has more than earned its keep as a major association. **TJ**

Coleman is publisher of TAPPI JOURNAL.