VIEWS FROM THE TOP–CEOs OFFER GLOBAL PERSPECTIVES ON THE PULP AND PAPER INDUSTRY

SALLY LOVE

THOUGHTS FROM TAPPI 99

*EDITOR'S NOTE: ON MARCH 4, 1999, DURING TAPPI 99 IN Atlanta, GA, Love moderated a panel discussion with **A. D. "Pete" Correll**, Chairman of the Board, Chief Executive Officer and President of Georgia-Pacific Corporation, U.S.A.; **Carlos Augusto Lira Aguiar**, President and Chief Executive Officer of Aracruz Celulose, Brazil; and **Carl Björnberg**, president of Myllykoski Corporation, Finland. The following is a summary of the discussion.*

TAPPI 99 panelists, from left, Pete Correll, Carlos Aguiar, Carl Björnberg, and Sally Love.

Q: *What is your company doing to position itself as a global competitor?*

Correll: We're a different kind of company because we have a great big building products business and it's been historically a lot more profitable than the paper business. We like it and we want to grow it. We are also unique in that nobody in the world builds houses like we do in the United States. So, much of our business is not global. It's domestic because nobody else in the world builds 3000 sq.-ft. stick houses and thank God, we do here.

We believe that clearly some of our businesses are, and have historically been, global. About a billion dollars of our sales is in foreign markets. Our basic strategy is to manufacture here in the United States and sell abroad. An exception is our chemical business where we have proprietary technology. We have established operations in foreign countries and continue to do that because we know more about sticking wood together than anybody in the world and a lot of processes involve sticking wood together.

In terms of our paper businesses, our position is we're going to be a domestic producer. We have studied the world and our basic belief is there are no barriers to entry and just because you have money doesn't mean you're going to make a lot of money. And, if you make a lot of money in any particular pocket, pretty soon everybody invests and ruins it. So our basic belief is that we're going to use residual chips and stay home and grow here.

Björnberg: We have already seen the fact that in order to be active, in order to be a successful operator, we cannot stay only in Finland. We must be worldwide and we must be at least what we call an international company. Today our largest paper mills are in Germany. We also have mills in Switzerland, here in the United States, and in Finland of course. We have operations in Spain, England and Holland, and our aim is to be much more international in the next 10-20 years.

Aguiar: The Brazilian market is quite small compared with the United States or Europe, so we cannot be only in Brazil. We export 92% of our production. So then, since we started up in 1978, our view is to be global, like Finnish companies who have to export to survive.

This was quite good for Aracruz, because since the first day we have compared ourselves with foreigners—with the best companies. We've always benchmarked against Scandinavians, Canadians, and Americans and followed developments in those countries very closely. We are very different from other companies in Brazil. Others are more locally-oriented, so maybe they have delayed their development. But not Aracruz. We are always looking abroad and looking to compete with Scandinavians and North Americans.

Q: Do you think that companies owning their own forest assets, are in a better competitive position than companies that do not own forest assets?

Aguiar: For us it is very important. The main difference for companies in Brazil is the forest. We have a lot of know-how. We invest about US$ 6 million per year in research and the forest area. We have very fast-growing trees. We can harvest our trees in seven years for pulp operations. And now we are starting to harvest in about 12 to 14 years for lumber and saw-milling. So we believe that to have our own forest is a strategic advantage for us.

Björnberg: In Sweden, companies have owned very large forestlands. In Finland it has not been the tradition. Finnish forests are largely owned by private individuals and in our case, at least, we've never even tried to buy forestland. We think it's a bad investment. Our trees don't grow like Carlos' trees grow. With his, you stick them in the ground and in two weeks it's a pulp tree. It takes 100 years for us to do that. Thus, we have aimed our production in a different way. We're very much involved with recycling and with using carbonates as fillers, and clays, and the coating operations. We're actually trying to avoid using fiber as much as we can.

Correll: We believe that growing and selling trees is a different business. It doesn't have anything to do with making paper or making lumber, so we separated our timber assets. We own about 6 million acres and it's traded on the New York Stock Exchange as The Timber Company, which is a letter stock at Georgia-Pacific. We believe that the world values cash flows from timberlands differently than it values cash flows from manufacturing operations. The timberlands are more predictable, so we believe that the key to success in the forest products industry is cheap wood and the key to success in the tree growing business is expensive wood. By definition those are two different businesses and they ought to be treated differently. We also believe that one of the problems of our industry has been subsidizing poor facilities with wood at cost, off of company lands, which had no bearing on what the shareholder had bought.

Q: Some pulp and paper companies have begun to lose their research and development focus and some have even abandoned their R&D group. Do you consider R&D a necessary and viable part of your company and this industry?

Björnberg: I think it's a very important issue. We have invested a lot of effort and time in really trying to get our R&D program going. In the last couple of years we've been able also to create a totally new family of products which have come out of our R&D program. Finland and Sweden also have a joint central laboratory which is working for the industry just like what the Canadians and Americans have. I think that's a vital addition to R&D within the company. But the R&D within the company is very important and I think the winning companies will always spend a lot of money on R&D. We certainly will.

Correll: I think that we would have to admit that R&D in our industry has been a terrible failure. There are not many industries where the technology you used 30 years prior is not technically obsolete. Our industry is in desperate need of major technological breakthroughs. But these breakthroughs are too expensive for any company to fund. It is going to take cooperative research. Our position is that we ought to do a lot of product development, but that the research effort should be cooperatively funded by entities such as the Institute of Paper Science and Technology, North Carolina State, Georgia Tech or Auburn. But we also need more than that. I think with AF&PA's Agenda 20/20 that we've found some receptivity with the DOE that says, "this industry desperately needs major technological breakthroughs so we can kill some of these marginal facilities and get on with the kind of technology that an industry ought to have." So I think we ought to admit that our R&D doesn't work.

Aguiar: In Brazil's case, the forest is very important. When Aracruz started up our yeild in the forest there was about 25 cubic meters per hectar per year. Now we are getting about 45 m^3/ha per year. This is mainly due to the R&D in this area. Also, because eucalyptus is not in the main literature of the developed counties so we have to create for ourselves a lot of background for eucalyptus fiber. Back in the 1980s, eucalyptus was an inferior pulp and due to a lot of R&D in refining and mixing fibers, etc. we proved that this was a good fiber. And now, even here in the United States they use a lot of our fiber to make the best tissue papers. I agree with Pete that we have to have breakthroughs and they cannot be made by just one company. It has to be made by maybe a group of companies or by some institutes, also together with the suppliers. The suppliers in our industry are now very big. They also have to invest in how to decrease investments.

Q: Consolidation in our industry was fairly swift in 1998. Is consolidation going to benefit our industry?

Correll: Our issue as an industry is a behavior problem and so the question is, will consolidation change behavior? The answer is it should, but there is no evidence that it will. Our industry has consolidated very steadily over the past 20 years. In any grade category, the top five producers' share has dropped fairly significantly over the past 20 years. Conversely, in containerboard and the last cycle, 50% of the capacity was added by people who were not in the top 30 producers, which is an astounding statistic. I am hopeful that consolidation will help. But I think as long as there is, as Carlos said, almost an infinite supply of investors who are willing to ignore economic reality and pour money into investments in this industry, you have to have somewhat of a jaundiced view that the way to heaven is through consolidation. There has to be a behavior change.

Björnberg: I think consolidation will continue and it will bring world players into play. I don't know whether that's good or bad. That's just the way it's going to be. I don't think that someone with 11 newsprint mills runs a better company than someone that has one newsprint mill. I think the one who has the single mill will run the better operation. We've also seen in Europe what Pete Correll refers to a lot, these big amalgamations, which, for example in marketing, have shown incredibly poor skills. How is it possible that with a 10% oversupply prices drop by 40% like they did in the early 1990s. You never see that in the car industry or other normal industries. This is a crazy industry in the way of marketing. We are the worst marketers of the world, but that's something we have to live with.

Augiar: I think consolidation is needed. Right now in this bad market we see that a very small company can create a big problem in the marketplace, just by giving pricing discounts. Then everybody goes down. This has to be brought under control. Also, I think that bigger companies can have more power to develop and invest in technology. Then there is the question of behavior. We must change the behavior and manner of our decisions. The question of behavior is very important because even now you see companies after mergers, after acquisitions, who are very big, still talking about building greenfield mills.

Q :Pulp and paper companies are mothballing and shutting down facilities. This is a fairly new behavior for this industry or at least it's certainly an recently accelerated behavior. What is the catalyst for this?

Björnberg: In our case we've closed down mills over time. If you look at the Scandinavian organizations, there are very few old machines anymore. We don't have clinkers of 100 inches anywhere. We can't afford them because we're competing worldwide. There are no 100-inch machines running in Finland, except maybe for making note papers or something like. Northern Europe, and that includes largely also Germany, has gone through a very major shakedown in cutting out a lot of old machines in the last 10 years. I think it's going to continue—it has to continue. It's strange; bankers and paper mill owners die, but paper mills never seem to die.

Correll: Clearly the investment community has said to people with jobs like mine in this industry, "enough is enough." If we wanted to give to the Red Cross we would. We'd like to invest our money for a return, not a charitable contribution. I was with Libby Dole the other day and I said, "we have a lot in common, we both run nonprofit institutions. I just didn't mean for mine to be that way." Management teams are starting to accept realities that they always have dismissed, that "mills must die," that the incremental ton is not our most profitable ton, and most times it's our least profitable ton. We have come to realize that the behaviors of the past are not adequate in today's world. So companies are doing things differently and I will submit, will continue to things differently, until we make some more money. Then the big question is, do we revert to our old behaviors or do we stay with our new trends?

Q: How have you changed your operation regarding the implementation of capital in order to improve your ROI and ROE.

Correll: I don't think our industry's capital intensity is either good or bad, it just is. I don't think capital per dollar of sales is an indicator of anything. So, in terms of making people understand that capital has a cost, we are an EVA company. We found that managers understand income statements better than they do balance sheets and they understand profits and losses better than they do ratios. So charging our operations for the cost of capital tends to improve decision-making and it's helped a lot in our company. We've gone from spending about US$ 1.2 billion a year in capital for a five-year average down to spending US$ 750 million a year in capital based on the same businesses. It has had an impact on our ability to generate free cash and repurchase our shares in the open market.

Aguiar: In the current operation, EVA is very important. It is certainly a tool we use at Aracruz. But when evaluating new, big investments, I think reverse engineering is very important, also. We must all try hard to push down the investments. As engineers we like to have our safety factors in many things. I think there are some opportunities, if we work together with suppliers, to minimize investments in this business.

Björnberg: The capital intensity is just a cold fact in this industry. For a family company, we just have to operate with the capital we have. So from the beginning we are restrained which means, don't buy very expensive stuff, period. We normally don't want to build new machines. Right now we're building one because we're building it very cheap—very cheap. We've expanded basically through purchases of companies. We're not going to overpay, either. I think we are probably one of the leaner companies in the world and that's something we're going to hang on to. That's why we are more profitable than many of our competitors.

Q: My perception of the paper industry is that it is very slow to make good use of reapplication, standardization of production equipment and the use of new technology. It seems that the industry is missing an opportunity to reduce investment, yet still get what it needs.

Correll: I agree. This is one of the biggest frustrations you would have if you had my job. We did seven longwood woodyards at seven mills. So I, in my infinite wisdom, said, "I want them all identical" and everybody said, "don't you worry, boss, they are going to be identical. We're going to put a team together and you won't be able to know which mill you're in". I went to see them and if they're identical, they sure don't look identical to me. We have this culture in our industry—it's not just in Georgia-Pacific that the mill folks have these special needs that must be met and by the time you finish, things don't look the same. I think companies, especially big companies who do things multiple times are losing big opportunities by not standardizing.

Aguiar: I agree. In fact I have one good example. The last boiler we bought, we decided to buy a twin-boiler from one mill in the United States and we paid less engineering for that and we got it in under schedule. It was a record. We bought the boiler and we put it in operation in 17 months. So I think we have something to gain by doing this in this industry.

Björnberg: It's really a very difficult issue. You can start very small. Say you try to have the same press rolls extras with your neighboring mills. Everyone starts saying, "that's a wonderful idea." Within two weeks everything breaks down. It's an engineering mindset, I think, more than anything else. I don't know why. There are a lot of areas where we could save immense dollars by doing this, but it's not being done.

Q: Lets talk about your corporate safety philosophy and performance. Pete, I understand that under your leadership, Georgia-Pacific has moved from being an average safety performer to a safety leader. Did you purposely set out to become the industry's leader in safety or did it just kind of happen?

Corell: It was one of the few things I did on purpose and we've now become the safest company in the industry for the sixth straight year. I've been in this industry a long time and I've never been in a mill that was clean, that was safe, that the employees would look me in the eye and tell me what they were doing that was not also profitable. So I said, "I believe safety is a key measure of management competence and we're going to be safe." We conducted a big study right after I took over as president because we, like everybody, always said safety was first. But when we looked at the data, we were average. And we got our management team together and said, "this is simply unacceptable performance. If you're not prepared to be the best in safety, please leave." We take a lot of pride in it and we think it drives value. Our incident rate on safety was 2.5 last year, which is the best in the industry. It's safer to work at Georgia-Pacific than it is at the bank down the street and we're proud of that.

I give an award if you work 500,000 hours without a recordable incident. I've given away 20 of them during the past year. Two years ago we had none. I've become convinced that we don't have to have accidents. The 47,000 employees at Georgia-Pacific are capable of working the year with nobody getting hurt and that's my goal. I'd like to have a year when nobody gets hurt at Georgia-Pacific.

Björnberg: We have very different companies. We have, for example, the American organization, which is operating very much along the US philosophy. In Finland we have a safety system which I think is not as good as it could be. It's been created largely by the unions and political parties and there has been aspects of politics in this which was typical during the leftist movement. The left said they know what's safe. I don't think we're as good as Georgia-Pacific. We're trying to do our very best and I think we've added this in the last year as we've added a dimension in the local operations in the safety area. Germany and Switzerland, have a very strong old tradition of safety. I think we have very, very good safety figures in these countries, where politics has not been part of the process.

Aguiar: In Brazil the issue is quite political. We also have the question of educating our society. In Aracruz, three years ago we decided that safety was going to be under the same management as quality and environmental to show that safety was very important for us. We also created teams in different areas to work on safety and we see the results–decreasing quite fast the amount of accidents. Of course, we are not as good as Georgia-Pacific. We are now in the learning process. But it gave a good signal to our people. The area where we had a lot of accidents was in harvesting, among people who use chainsaws. So we decided to invest in replacing the chainsaw with harvesters. Now in this area we have almost zero accidents. So, safety has become very important in Brazil. The cost of accidents is quite high and the society is pushing for health and safety issues.

Q: Mr. Correll, what were the key items that you did in regard to safety that were accomplished at the worker and/or front line supervisor level?

Correll: What we did was convince them it was important to us. People always respond to whatever management thinks is important. The problem is we change our mind every week and they can't keep up with us. So, what we said was "there will be an enduring priority at Georgia-Pacific and it will be safety." We would visit a mill population that was having an accident every other day. We'd get them together and say, "look, we have to hurt three of you this week and it's going to be a simpler system if you'll just volunteer. So will the ones that want to get hurt, please come up here so we can get it over with and then we can run our business."

Of course, it sounds hokey but we agreed we didn't want to hurt anybody and then we asked, "why *are* we hurting people?" I think we all underestimate the power we have as managers. Your organization will perform the way you expect it to. You must tell them that safety is number one, and then never vary.

Q: To conclude our discussion would each of you share with us your view of the future for the industry and what we all have to look forward to?

Björnberg: I think the pulp and paper industry is a very, very interesting and exciting industry. There is a lot of opportunity here. At times people say, "information technology will kill the paper consumption and there will be no newspapers, etc." We've heard this many, many times over the last 40 years. When looking into the future, I think there is a heck of an opportunity for everyone in this room in the pulp and paper industry, and let's not forget that.

Let's not get overexcited about the impact of information technology. Paper is one of the greatest products we have around. It's recyclable, it's great in every aspect. I think we all have a tremendous future if we do our work and seriously invest in the future and try to find new niches, new products and solve the problems of today in a different way in the future. I think it's a great industry. I try to tell everyone in our industry, "hey, this is a fun industry." At times pulp mills smell bad, but it's still fun.

Aguiar: I'm also an optimist. So if somebody that grows the trees in 100 years is an optimist and we can grow them in seven years, I have to be optimistic. I believe this industry currently is in a bad situation. But next year I expect that the balance between supply and demand is going to be more in equilibrium. Many people who are talking bad about us now will come back and ask us to invest and to expand into new mills. I think for us who have been 20, 30, 40 years in the industry we have seen a lot of these cycles–ups and downs—and this is not the end. This is the starting point for the new century. So I am very optimistic about our future.

Correll: I guess I'm reminded of the Chinese curse, "may you live in interesting times." I think we're in for a decade of unprecedented change in this industry. I think 10 years from now, as we look back, we will not recognize the structure of this industry. I believe that in times of change and uncertainty people with facts and knowledge emerge. So I think it's going to be a good industry for talented people and a terrible industry for incompetent people. We're going to go through a lot in the next 10 years, but clearly we make a product the world wants; we just don't make any money making it. So we've got half the equation and we have to solve the other half. And I think the financial world will force us to. So I too think it will be fun. **TJ**

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