

Ten years ago, Canada's newsprint makers were at a crossroads. Unfortunately, little has changed over the past decade. With falling prices, the industry depended on a low dollar to stay competitive. It hasn't worked

Weak newsprint makers a metaphor for Canada

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In 1991, newsprint was one of Canada's leading export industries, with \$5.5-billion in sales and a world export share of 62%. The Canadian industry consisted of seven large companies (Canadian Pacific Forest Products, Abitibi-Price, Fletcher Challenge Canada, Stone Consolidated, Quebec and Ontario Paper Company, Kruger, and MacMillan Bloedel) who controlled 65% of Canadian capacity. Newsprint exports comprised 43% of Canadian pulp and paper industry exports.

It was an industry with important but narrow strengths, and with vulnerabilities for the future. Canada's primary strengths were low wood fibre cost and low energy costs. In addition, Canada enjoyed proximity to the largest market in the world, which lowered shipping costs and facilitated selling and customer service. However, Canada's advantage in wood fibre cost was coming under pressure due to the development of thermomechanical pulping (TMP), which allowed the efficient use of low-cost fibre found in the southeastern United States and Latin America. Also, the increasing use of recovered paper, economically available in the United States, reduced the advantage provided by inexpensive Canadian fibre.

In addition, the industry had weaknesses in its microeconomic context. Although there were a number of rivals, they did not compete on innovation and upgrading. As with most parts of the Canadian forest products sector, Canada lagged by a decade or more in implementing new techniques such as the production of groundwood pulp and the use of a soda process for chemical pulping. The lack of local related and supporting industries, such as equipment suppliers, made the likelihood and challenge of technological upgrading more difficult. Historically lax environmental regulation had also not prepared Canadian firms for the heightening of environment concerns worldwide.

Overall, the industry personified the crossroads faced by the economy as a whole. The lack of pressure for upgrading had left the Canadian firms with smaller machines, lower labour productivity, and lower capital spending than their international competitors. With governments, especially in British Columbia, putting upward pressure on wood fibre costs through higher stumpage fees, the 1990s promised to be more challenging than the previous decades.

The question was: Would Canadian firms move forward to higher productivity and more distinctive strategies, or would their fundamental competitiveness erode? Unfortunately, relatively little has changed over the past decade with respect to the Canadian newsprint industry and its approach to competition, and Canada's position in the industry has eroded.

Characteristic of many commodities, prices in the industry have continued their long-term drift downward at a real rate of approximately 1.1% per year. Newsprint, a commodity product, continues to decline as a proportion of global pulp and paper production, dropping from 39% to 30% between 1989 and 1999. Increases have come in the production of value-added



grades of paper and paperboard.

In this environment of falling prices and slow growth, Canadian share of world exports of newsprint has fallen from 62% in 1991 to 53% in 1997, a significant reduction. Continued growth in the use of TMP and recovered paper has weakened Canada's basic wood fibre advantage.

With a weakening competitive position, the Canadian sector depended on the falling Canadian dollar to maintain its competitiveness. The dollar stood at approximately US\$0.66 at the end of 2000. If the Canadian dollar were back near its 1991 level of US\$0.85, the

CANADA'S SHARE OF THE GLOBAL NEWSPRINT INDUSTRY FELL FROM 62% IN 1991 TO 53% IN 1997

Canadian mills and the Canadian industry would be in a precarious position, with cash costs almost \$100/tonne higher. In this way, a depreciating currency hides fundamental competitiveness problems, rather than indicating true competitiveness.

Even with a falling currency, the Canadian paper and forest industry has not performed well. In 2000, the Canadian industry had a return on capital employed of 4%, well below the average return for Europe (5.9%) and the United States (6%). Finland was a particularly impressive performer with a return of 7%.

Perhaps the most substantial change in the newsprint industry is increased globalization. Some major firms began to acquire outside their home markets in order to establish a more global presence.

The leaders in this new wave were the Scandinavian firms, who invested heavily to upgrade during the 1990s. At home, they worked together through industry associations and linkages with universities to promote innovation. The average worker in the Scandinavian industry has a related university degree and a high level of technological literacy. Abroad, firms invested heavily in North American assets. Swedish/Finnish firm Stora Enso acquired U.S. fine paper producer Con-

solidated Papers, and Finland's UPM-Kymmene acquired Canadian fine paper producer Repap Canada. Norway's Norske Skog purchased Canadian newsprint player Fletcher Challenge Canada, and recently made a bid for Pacifica Papers, the Canadian firm to which the newsprint assets of MacMillan Bloedel were spun off. In addition, Bowater, a U.S. newsprint manufacturer, acquired Avenor, successor to Canadian Pacific Forest Products.

The Canadian newsprint industry has participated passively in the globalization of the industry with the acquisition of three of the seven major Canadian players by global competitors. Abitibi has focused on consolidating the industry within Canada, having combined Abitibi-Price, Stone Consolidated, Quebec and Ontario Paper Company, and Donahue into Canada's dominant player Abitibi-Consolidated. In contrast, Abitibi-Consolidated has made only very minor forays into the global industry with one joint venture in Asia and no presence in Europe or Latin America.

Unlike its Scandinavian competitors, which have invested more heavily in upgrading at home, expanded in the faster growing value-added papers sector, and acquired to create global reach, the Canadian pulp and paper sector — exemplified by newsprint — has focused primarily on domestic consolidation rather than on upgrading and globalizing.

These trends were evident in 1991. The Canadian industry had a choice to upgrade its capability in newsprint, migrate to more value-added products and establish a more robust global position or to continue the status quo. In large part, the Canadian industry chose the latter, while other countries' newsprint industries chose the former.

While the newsprint industry remains an important Canadian industry and one with leading global export share, it is an industry that has allowed its position to decay slowly rather than invest in upgrading and innovation. It will remain an important Canadian industry for years to come, but it is unlikely to contribute to a high and rising standard of living on the current path. It will continue to lose share in a business whose output is falling slowly in real value.

The newsprint industry is a metaphor for the Canadian economy. Its trajectory, as well as the overall evidence, suggests that Canada has followed an unfortunate path. Substantial progress has been made in the macroeconomic context, and there are some microeconomic improvements. However, the progress has not been sufficient to move Canada ahead in relative terms against other highly developed economies. Finally, companies have on average not reacted to these changes in their competitive environment by taking the necessary decisions to upgrade their strategies and operations. As a consequence, Canada is drifting slowly down in relative ranking across a number of measures from GDP per capita, to productivity, to Innovation Index.

Excerpted from Canadian Competitiveness: A Decade After the Crossroads, published by the C.D. Howe Institute. Roger Martin is dean of the Joseph L. Rotman School of Management at the University of Toronto. Michael E. Porter is Bishop William Lawrence Harvey University Professor at the Harvard Business School.