IN SEARCH OF LOYALTY: PRIVATE LABEL PACKAGING SOLUTIONS FOR THE RETAIL GROCERY INDUSTRY

by

Christine Angela Holly Bullen
B.Sc., University of Alberta, 1974
Graduate Diploma in Business Administration, Simon Fraser University, 2005

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Name: **Christine Angela Holly Bullen**

Degree: **Master of Business Administration**

Title of Project: **In Search of Loyalty: Private Label Packaging Solutions for the Retail Grocery Industry**

SupervisPory Committee:

____

Dr. Leyland Pitt
Senior Supervisor
Professor
Faculty of Business Administration

____

Dr. Mark Selman
Second Reader
Executive Director
Learning Strategies Group
Faculty of Business Administration

Date Approved: December 1, 2006

ABSTRACT

The U.S. corrugated packaging industry is highly concentrated, competitive and mature, facing only modest growth in the United States. The objective of this paper is to understand the opportunity that private label grocery products present to the corrugated packaging industry and how Weyerhaeuser Company might increase demand of corrugated boxes.

Industry analyses of both the U.S. retail and corrugated packaging industry are provided in conjunction with summaries of major firms in the respective industries. Private label programs are a point of differentiation in the retail industry with implications to national brand manufacturers and the corrugated packaging industry. The use of SWOT analysis provides an insight into Weyerhaeuser and presents a number of opportunities to improve market share in corrugated packaging.

Keywords: Private label; corrugated packaging; retail grocery industry; marketing

Subject Terms: Brand choice; Groceries – Marketing; Grocery trade – United States; Industrial Marketing -- Management

DEDICATION

This paper is dedicated to my husband Jim who supported me throughout the MBA. I could not have completed this program without your sacrifices and encouragement.

To my father, who emphasized the value of an education; I wish you could have been here to share in this milestone.

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GLOSSARY

CBPR	Containerboard, Packaging and Recycling
CPG	Consumer Product Goods
EBIT	Earnings Before Interest and Taxes
EDLP	Every Day Low Prices
FMCG	Fast Moving Consumer Goods
FMI	Food Marketing Institute
GP	Georgia-Pacific Corp.
IP	International Paper Company
MPS	Mechanical Packaging Systems
OCC	Old Corrugated Container
PCA	Packaging Corporation of America
PLMA	Private Label Manufacturers Association
P-O-P	Point of Purchase
POPAI	Point-of-Purchase Advertising Institute
REN	Retail Experience Network
RONA	Return on Net Assets
SG&A	Sales, General and Administration
SKUs	Stock Keeping Units
SSCC	Smurfit-Stone Container Corporation
SWOT	Strengths, Weaknesses, Opportunities and Threats
TIN	Temple-Inland Inc.
Weyco	Weyerhaeuser Company
WY	Weyerhaeuser Company

1 INTRODUCTION

1.1 Overview

Firms in the competitive retail industry are exerting increased influence on packaging solutions as a means to remove supply chain costs and to differentiate from competitors. Consumers are also increasing their demands on the retail industry and have many product and shopping choices to accommodate their lifestyles. National brand manufacturers are now competing with retailers' private labels for shelf space. There is also the power of Wal-Mart that consumers rush to or retailers react to.

This paper explores the opportunity for Weyerhaeuser to grow market share and profitability in their corrugated packaging business, by providing private label packaging solutions to the retail grocery industry. The concept of private label has proliferated beyond retail grocery and certainly extends throughout the retail industry. An overview of Weyerhaeuser Company (Weyco) and their Containerboard, Packaging and Recycling (CBPR) business is provided in section 1, for the reader's consideration when reviewing the analysis provided in this paper.

Section 2 provides an industry analysis of the retail grocery industry, using Porter's five forces (Porter, 1979), to understand the rivalry, threats, and power base in the industry. This section also includes a discussion of firms in the industry and private label advantages, disadvantages and trends. Private labels, also known as retail brands, have existed for many years but are an increasing threat to national brands.

Section 3 delves into the corrugated packaging industry and includes an industry analysis and competitive landscape. An internal analysis of Weyerhaeuser's packaging business utilizes SWOT (strengths, weaknesses, opportunities and threats) to identify areas of competitive advantage and vulnerabilities and is provided in section 4. Recommendations, provided in section 5, identify three areas of consideration to increase market share and profits. A summary is provided in section 6.

1.2 Weyerhaeuser Company

Weyerhaeuser Company, publicly traded on the New York Stock Exchange and incorporated in 1900, is U.S. based and engages internationally in managing forests and manufacturing forest based products. Located in 18 countries, Weyerhaeuser is ranked 90th on *FORTUNE* magazine's ranking of America's largest corporations, and operates in 5 segments – Timberlands, Wood Products, Pulp & Paper, Containerboard Packaging & Recycling (CBPR) and Real Estate. Weyerhaeuser employed 49,887 people at the end of 2005. The Timberlands segment, representing 4.6% of 2005 total company sales, involves operations in North America and the Southern Hemisphere with harvesting of timber for internal use as well as third party sales. Weyerhaeuser manages 34 million acres (13.8 million hectares) of forests and is one of the largest owners of private merchantable softwood timber in North America. The Wood Products segment, with 94 facilities, manufacture and sell lumber, plywood, oriented strand board and engineered wood, such as Trus-Joist™ beams, for export and North American consumption and represented 41.5% of the company's total sales in 2005. Weyerhaeuser's Pulp & Paper division, at 19.2% of total 2005 company sales, includes manufacturing facilities in the U.S. and Canada, serving global markets. The CBPR segment, contributing 20.8% of

2005 total sales, involves the manufacture and sale of linerboard, medium, corrugated products, paper bags, ink and plates, graphics and displays. Weyerhaeuser also owned three real estate companies in 2005, contributing 12.9% of total 2005 sales and all operating in the U.S. A fourth real estate company was acquired in 2006. Other businesses include a shipping line and 72 building materials distribution centers.

Weyerhaeuser's share price, for the period of 2000 – 2006, has ranged from a low of \$36.06 (2000 4^{th} Qtr.) to a high of \$73.77 (2006 1st Qtr.), representing a change of 205%. The industries in all business sectors are highly competitive and the markets for most products have been over-supplied. This competitive environment has resulted in significant restructuring, industry wide. Weyerhaeuser has been significantly active in such restructuring that has included acquisitions of competitors such as MacMillan Bloedel in 1999 and Willamette Industries in 2002, and subsequent rationalizing of the new organization. Although most segments are largely commodity based, Weyerhaeuser's strategy involves an integrated approach that focuses on both adding value and throughput. Value adding initiatives are primarily through some differentiation of product and services and cost effective production, while throughput has focused on acquisitions, closing inefficient operations and seeking economies of scale with the remaining facilities through investments and increased operating hours.

Weyerhaeuser's goals are simple – safety results (less than 1 recordable incident rate) and return on net assets (RONA greater than 17%) although the efforts to achieve these results are complex. The company has recently committed to a market back strategy and is in the midst of significant organizational restructuring that also involves implementation of an Enterprise Business System. The company also seeks a 30-40% debt to equity ratio and a major focus over the last four years has been to reduce the debt incurred with the acquisition of Willamette.

Net sales for the 2005 fiscal year were $22.629 billion, compared to $21.931 billion in 2004. Net earnings were $0.733 billion compared to $1.283 billion in 2004.

1.3 Containerboard, Packaging and Recycling Division

Weyerhaeuser's CBPR division operates primarily in the U.S. but does have converting plants in Mexico and one retail sales center in Hong Kong. In 2005, the CBPR segment included 10 containerboard mills, 86 converting plants, 19 recycling facilities, four paper bag plants, and various specialty facilities. Net sales for 2005 were $4.707 billion, an increase from $4.535 billion in 2004. Net operating loss for 2005 was $5 million as compared to a net operating income of $249 million in 2004. This business is highly dependent on paper based raw material, ultimately sourced from two supply streams – timber and recycling. Virgin fibre, originating from timber, is a material input to the pulp and paper business either as a by-product from sawmills in the form of chips, or as a primary input, in the form of round wood into the pulp mill's wood room. Old corrugated container (OCC) is sourced from recycling centers and enters the paper production stream to be re-processed. Weyerhaeuser's extensive operations in pulp, paper, sawmills, recycling, containerboard and packaging provide integrated value and reduced risk to the company. Additional integrated value is generated through a variety of specialty facilities to provide structural and graphic products and services.

1.4 Packaging and Specialty Business

Weyerhaeuser, ranked the second largest producer of corrugated boxes, is positioned nationwide in the U.S. and also operates facilities in Mexico. The corrugated box business is highly competitive, largely due to over capacity in the industry.

Converting facilities essentially transform containerboard products into corrugated boxes for sale to a variety of industries. This secondary packaging essentially serves to protect goods from damage, facilitate transportation and can also serve to promote the sale of its contents. Converting facilities focus on low cost production while the sales and marketing strategy is one of product and service differentiation. It is worth noting, however, that some component of the customer base requires nothing more than a commodity product with standard service offerings.

Weyerhaeuser has integrated some of the capabilities required to compete in this industry. Products and services generated from these capabilities are utilized internally as well as sold to third party customers. These capabilities include an ink and plate division, enhanced graphics business and pre-print facilities. Weyerhaeuser acquired Wilton Connor LLC in 2003, a firm specializing in full-service, value-added turnkey packaging solutions to assist product manufacturers with retail marketing and distribution. This business is known as the Retail Experience Network (REN) and is discussed further in section 1.4.1. These capabilities position Weyerhaeuser to better service the retail industry and provide a venue for non-retail companies to increase their sales to retailers. The REN business also provides an opportunity to further add value through an integrated supply chain.

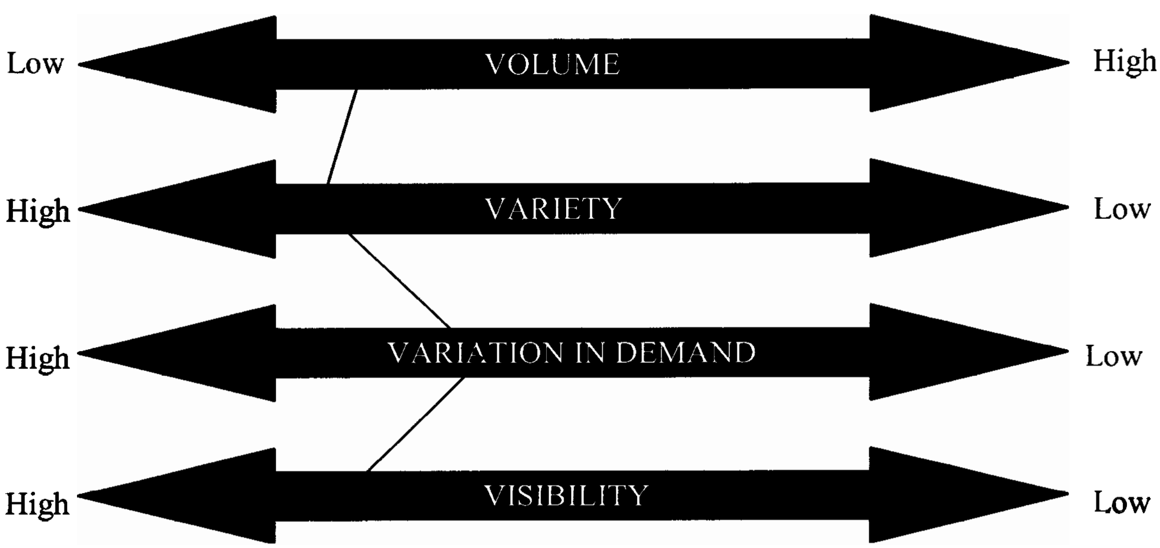
1.4.1 Retail Experience Network (REN)

Weyerhaeuser entered into a joint venture partnership with Wilton Connor LLC, located in Charlotte, N.C. and in 2003 acquired the remaining 50% interest. The company has since invested in additional facilities located in Los Angeles and Chicago as well as a retail sales center in Cincinnati. The business mission is to provide, "At the Speed of Retail", fully integrated, nationwide network retail solutions that range from design to the retail store floor.

The network is designed to provide capabilities and logistical benefits to fulfill customer needs, and two locations also have digital printing capabilities. The Charlotte location relies on internal production capabilities while the other two locations outsource to alliance partners. The REN system also includes three sales centers that are strategically located near three larger companies. The Bentonville, Arkansas location provides access to Wal-Mart and the Cincinnati, Ohio site provides access to Kroger and Proctor & Gamble. The Hong Kong location provides access to Wal-Mart in Asia. Nationwide capabilities not only provide freight advantages but also position the facilities closer to the customer.

A Four V's analysis (Slack, Chambers and Johnston, 2004) indicates this business leans toward the low end of the scale for volume and high end for variety, variation in demand and visibility (see Figure 1.1). The tendency is towards low volume, as compared to mass production, and customers gravitate toward smaller quantities. Each project is unique, often not repeated, and designed to match the customer's specific needs with complexity varying from simple displays to total turnkey solutions, fulfillment and inventory management. The organization requires a relatively high degree of flexibility to accommodate variability in demand and short lead time from customers. Currently, there is strong correlation between demand and cultural or social events such as Christmas, Halloween and barbeque season. This business would be categorized in the fashion/jobbing sector classification where critical capabilities include knowledge acquisition and innovative product creation.

Figure 1.1: Four V's Analysis - Retail Experience Network



Adapted from Slack, Chambers and Johnston "*Operations Management*", 2004, p. 25

The critical competencies include creative design, market vision, "speed to market" and project management. There is a strong correlation between design and advertising and the consensus among retailers is that point of purchase (P-O-P) displays provide for cost effective and responsive solutions. Further supporting the significance of creativity in retailing is the survey results reported in "2004 POP Trends". The survey indicated that creativity was ranked as more important than low cost and design capabilities when selecting P-O-P display suppliers. Creativity is a difficult attribute to measure.

1.4.2 Products and Services

Weyerhaeuser's packaging business provides corrugated boxes to a wide range of customers for various applications. Boxes would be regarded as a homogenous product with similar pricing regardless of the source. However, customization generally occurs to meet specific customer requirements for structural design based on size, shape and strength requirements as well as graphic design ranging from minimal or no graphics on a box to multiple color and high resolution features. Differentiation is possible through methods such as production capabilities, services and non-tangible features such as creative design. Weyerhaeuser also offers a number of patented products including wax replacement solutions known as Clima™Series. These wax replacement products are recyclable and include:

- ClimaGuard™ containerboard: Patented medium and liner offering additional moisture resistance over dry packaging while being repulpable.
- ClimaCoat™ barriers: Series of custom or commercial coatings applied to the box.
- Ex-Ply™ packaging: Multi-ply solid fibre material made up of layers of liner and/or medium.
- ClimaPack™: Upgraded bag-in-box system providing modified atmosphere packaging as an iceless alternative to wax saturated boxes.
- AquaSafe: Corrugated board with the outer or inner liner made up of two lighter weight liners laminated together with poly film producing a water-impervious liner.
- ClimaProof™: A finished box blank completely encapsulated in thin, poly film.

Weyerhaeuser's product and service offerings also include Mechanical Packaging Systems (MPS). This offering includes expertise in equipment selection for the customer's packaging applications, mechanical troubleshooting, consultation regarding finance decisions (purchase, lease or rent), machinery maintenance, education and training.

The Retail Experience Network product and service offerings include:

Turnkey solutions	Assembly, Fulfillment and Logistics
Full Service Design	Private Label/Branding
Printing and manufacturing	Promotional Packaging & Displays
Retail Solutions (graphic & structural design, video, aisle planning)	

1.4.3 Customers

Jim Keller, Weyerhaeuser Vice President of Containerboard, Packaging and Recycling describes a changing vision as "a fundamental shift from a 'product-out' to a 'market-driven' organization that will help us become the leader in the packaging industry by truly delivering the total package experience™ to customers". Weyerhaeuser's CBPR business has recently reorganized to pursue a market driven strategy and consequently have segmented their customers by strategic business unit. These segments include: durables, fast moving consumer goods, produce, protein and retailers. The customer list is extensive and includes major manufacturing and retail companies involved in food, beverage, agriculture, industrial and produce with a range from international to local operations. A portion of current sales are with national brand manufacturers who are increasingly impacted by retailer private label.

1.5 Sustainability

This section is intended to be a brief overview of some initiatives Weyerhaeuser has undertaken that are relevant to the retail grocery industry's sustainability movement. Weyerhaeuser Company's extensive Sustainability Report can be found at http://www.weyerhaeuser.com/environment/sustainability/.

Weyerhaeuser became the first company in the industry to adopt an environmental policy and has since undertaken a number of initiatives to ensure environmental stewardship. Their Sustainability Report discusses their commitment to a 40 percent reduction in greenhouse gas emissions by 2020 and assumes a comparable portfolio and regulations. Toward this goal, Weyerhaeuser plans to replace the power and recovery boilers in their pulp and paper mills. The new boilers will also be more energy efficient and use more biomass fuel, thereby reducing the reliance on natural gas. The company also practices sustainable forest management and is 100% certified to SFI or CSA standards in the U.S. and Canada. Nearly all the operations have implemented environmental management systems that may include ISO 14001 certification.

In response to retailer demands to eliminate non-recyclable containers, such as wax impregnated or coated corrugated containers, a joint industry committee developed a standard with testing and certification requirements. Weyerhaeuser's Technology Center, in the state of Washington, is one of only four labs in North America certified to conduct testing.

Weyerhaeuser Company was again included on the Dow Jones Sustainability Indexes for North America and the United States and is the only North American forest products company in the industry category of basic materials to be named to these indexes. Weyerhaeuser has also been recognized in *FORTUNE* magazine's "Most Admired Companies" in the Forest and Paper Products category placing first in financial soundness and long-term investment and second in social responsibility. Recently, Weyerhaeuser was among the first 19 companies to launch the SEE Change initiative to improve society, the environment and the economy – the elements of the triple bottom line of sustainability.

Weyerhaeuser also has a long tradition of philanthropic endeavours that have included educational scholarships, granting of land for wild life habitat and community as well as other support in the local communities in which they operate in. Other initiatives include sponsorship of "Extreme Makeover – Home Edition" and partnership with CARE International, a humanitarian organization dedicated to fighting global poverty. Weyerhaeuser's reputation as a solid, ethical corporate citizen can be evidenced by the initiatives undertaken and recognition received. The importance of this reputation in relationship to the retail industry will be explored in section 4.

2 RETAIL GROCERY INDUSTRY

2.1 Industry Analysis

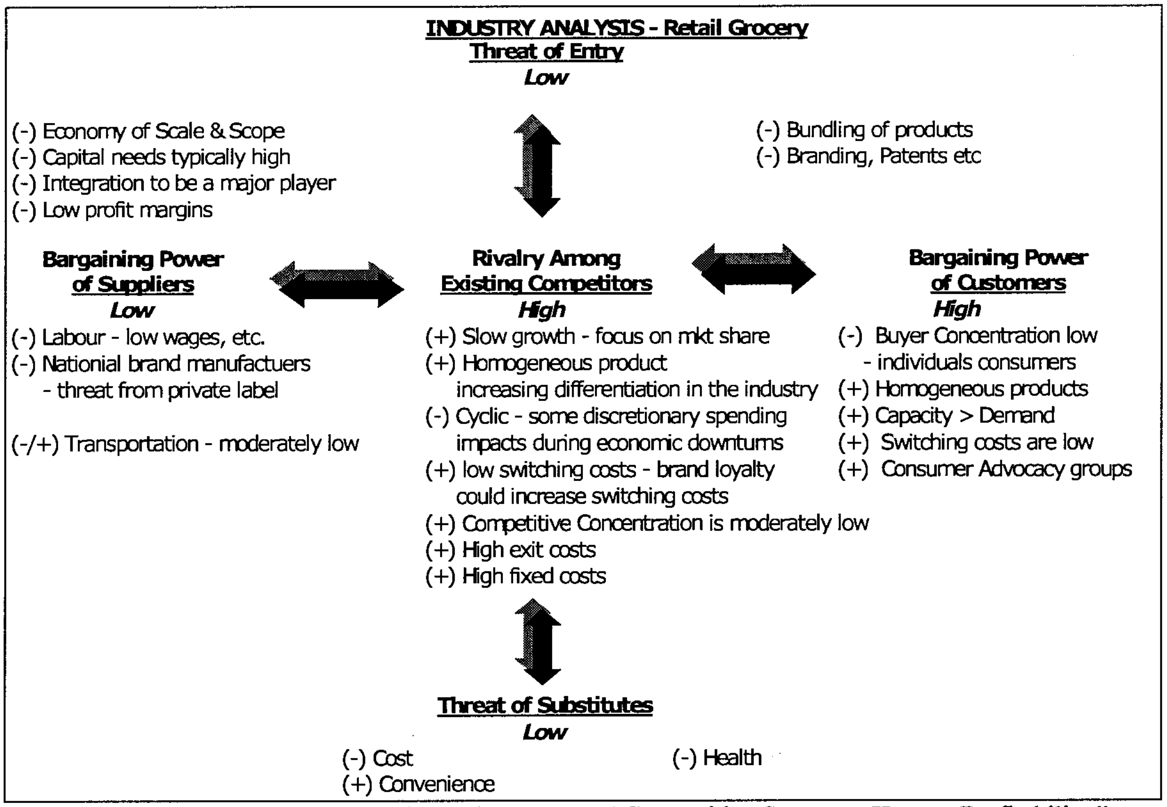
The retail grocery industry, for purposes of this paper, is defined as grocery stores, supermarkets (including warehouse club), convenience and specialty food stores located in the United States. The North American Industry Classification System identifies this group under codes #4451 and #4452.

2.1.1 Industry Overview

The industry is highly competitive, fragmented and mature with approximately 95,000 firms. U.S. Census Bureau data estimates grocery store sales, for 2005, at $463.9 billion with growth of 17.5% since 2000. Warehouse club and superstore sales are the fastest growing segment in retail grocery with $270.8 billion in sales and growth of 227.9% since 2000. Gross margin for 2004 (last year available from U.S. Census Bureau) was 28.7% for grocery stores and 19.9% for warehouse clubs and superstores.

Figure 2.1 provides an overview of the industry analysis using Porter's five forces (Porter, 1979) of rivalry, threat of entry, threat of substitutes, bargaining power of customers and of suppliers.

Figure 2.1: Retail Grocery Industry Analysis



Adapted from Michael E. Porter, "Industry Structure and Competitive Strategy: Keys to Profitability," Financial Analysis Journal, July – August 1980, p. 33

2.1.2 Industry Rivalry

U.S. retail grocery sales growth, averaging 3.5% per year, is considered to be slow considering some of the sales increase would be attributable to inflation. Generally, firms in the industry are focused on retaining or increasing market share and driving costs down. Population growth in the U.S. is estimated to be 0.92% for the year 2005. The industry experiences seasonal fluctuations in sales related to holiday events and discretionary spending may be curbed during periods of economic downturns. Generally however, this industry would not be subjected to cyclical sales.

Switching costs for consumers is considered to be low in urban locations where competition is more prevalent and choices are abundant and in close proximity to one another. However, customers that are loyal due to branding or unique products and services would exhibit some reluctance to switch.

Large retail grocery chains incur high fixed asset costs for building, land and equipment and firms that also manufacture private label products internally would incur additional costs associated with production facilities. Small independent grocery firms, operating one or two establishments would obviously have relatively low fixed costs. Exit costs are moderately high where disposal of assets at acceptable returns could be difficult due to the capacity and competition in place. Many larger firms employ a unionized work force where severance costs could be higher. Small independents have a personal stake in the investment in both time and money and exiting could be particularly difficult.

Differentiation strategies in the retail food industry aim to maintain or increase market share and improve gross margin. One strategy offers non-food products and services, often through "partnerships" with other companies and could be regarded as a bundling strategy providing one-stop shopping. Other strategies cater to the cost-conscious or high-end consumer. The warehouse club format seeks to deliver value to card carrying members. Other retail grocers focus on organic products or provide on-line shopping. One strategy increasingly deployed is private label programs to increase both market share and gross margin.

Management Ventures, Inc. indicates that 11 of the top 25 retailers are in the retail grocery industry. The parent company and ranking are shown in Table 2.1.

Table 2.1: Retail Grocery Firms Ranking Among top 25 Retailers of all Product Lines (Mainland US)

Retail Rank	World Rank	Parent Company	# of US Stores (2005)	US Retail Sales (2005) billions	% Retail Sales Outside US (2005)
1	1	Wal-Mart	3,857	250.53	19.04%
3	6	Kroger	3,743	66.99	0%
4	10	Target Corp.	1,397	51.27	0%
7	7	Costco	335	42.64	21,24%
8	17	Albertsons	2,471	40.36	0%
11	18	Safeway	1,566	33.45	14.96%
14	12	Ahold	829	22.55	55.17%
15	37	Publix	885	20.14	0%
18	32	Delhaize Group	1,512	16.28	29.38%
22	61	SuperValu	1,595	12.59	0%
23	62	Meijer	171	12.54	0%

Despite a variety of differentiating strategies, the sheer size of the industry results in many competitors for any given format, and numerous variations of the same product. The conclusion is that products and services still tend to be homogenous, however many firms in the industry are attempting some form of differentiation and are in various stages of transitioning. Success will be somewhat dependent on properly evaluating the trends in consumer behaviour and focusing on a few key areas rather than trying to be everything to everyone. Firms in the industry also focus on reducing operating costs and look to suppliers to provide solutions. Wal-Mart has been criticized for their recent focus on sustainability that includes a targeted 5% reduction in packaging. Critics have been quick to suggest the real motivation is the \$10.98 billion in savings, with Wal-Mart noting their share to be \$3.4 billion.

Data from the U.S. Census Bureau indicates that in 2002, slightly less than one third of market share was held by the four largest establishments in both the grocery and supermarket categories. A summary of the data is illustrated in Table 2.2. Although the industry has seen some consolidation, the industry is still fragmented. Certain segments in the industry such as super centers (example is Wal-Mart) and warehouse club stores (example is Costco) are highly concentrated. The intense rivalry in the retail grocery industry is fuelled by traditionally low margins and therefore the need to drive sales. Significant consolidation is occurring in the industry such as Supervalu's recent acquisition of Albertsons. Supermarkets are besieged with over capacity which is further aggravated when a super center such as Wal-Mart or a wholesale club such as Costco moves into the area. According to Food Marketing Institute (FMI), Wal-Mart's annual grocery sales of $155.5 billion far surpasses Kroger Company, the second largest grocer with $57.2 billion in sales or 36% of Wal-Mart's sales. The industry is also facing increased competition from substitutes such as restaurants.

Table 2.2: Retail Food Industry Concentration

		Grocery Stores	Supermarkets	Convenience Stores	Specialty Food Stores
Number of Establishments	Total	95,362	66,150	29,212	24,485
	4 largest	7,013	6,844	1,485	1,755
	8 largest	10,667	10,948	1,880	2,312
	20 largest	13,708	13,538	2,587	3,567
	50 largest	17,864	16,735	3,098	3,939
Sales as a % of Total	4 largest	31.0%	32.5%	15.5	6.8
	8 largest	43.1%	45.6%	18.4%	9.4%
	20 largest	54.5%	57.3%	21.6%	13.3%
	50 largest	65.3%	63.3%	24.7%	17.7%

Specialty stores include meat, fish & seafood, fruit & vegetable markets, bakery and confectionary.

Data Source: U.S. Census Bureau – 2002 Establishment and Firm Size

Another source of competition faced by public grocery corporations is the level of privately held competition. The latter group is not accountable to shareholders or scrutiny of Wall Street and that translates into flexibility and nimbleness due to different decision making processes. In 2005, eleven of the top 25 grocery firms were privately held (Schmeiser, 2006).

2.1.3 Threat of New Entrants

The threat of new entrants varies by segment or store format, largely due to the degree of investment and integration required. For most platforms, economy of scale and scope are requirements to effectively compete. Entrants contemplating a national platform will require a large investment to match the economies of scale afforded the existing nationwide competitors. That investment not only includes facilities but an infrastructure involving a nationwide distribution channel (transportation and warehousing), procurement, and various other business services such as finance, human resources and legal. Entrants to the super center or warehouse club format not only require large investments but must also have sophisticated supply chains to be able to compete with the likes of Wal-Mart or Costco. There is a significant learning curve to overcome.

Many retail grocery formats offer one stop shopping by bundling food with non-food items such as drugs, photo shops, fast food restaurants, finance, insurance, etc. that essentially creates complexity for the new entrant to replicate. Firms with private label strategies present another set of barriers for new entrants to overcome and could be viewed as akin to patents and trademarks. Developing brand equity requires marketing, commitment, investment and internal or external resources to execute and be competitive.

The supply and demand equilibrium would be disrupted if new entrants were to locate in established markets. A similar disequilibrium would occur where a new entrant chooses a national or regional scope. Such situations will enhance rivalry and could trigger retaliation by the established firms. New entrants providing unique products and/or services should be perceived as the bigger threat in the industry. Generally, the existing industry is slow to react to consumer preferences.

2.1.4 Bargaining Power of Suppliers

End consumers are increasing their influence on the bargaining relationship between retail grocery firms and their suppliers. Retailers are often the voice of the consumer in communicating to the suppliers of manufactured products. Retailers are the medium through which most manufacturers sell their product. Another key factor affecting bargaining relationships is Wal-Mart's dominance and impact, where clearly the supplier is not in a powerful bargaining position and this has enabled other retailers to assume greater bargaining power. A third key factor is the increased adoption of private label products, putting pressure on manufacturers of national brands that in turn respond by pursuing different marketing tactics, lowering prices or joining the retailer by producing private label products to the detriment of their own brand.

Another supplier to the retail grocery industry is labour with 2.4 million employees (U.S.) in 2004. The U.S. Department of Labor reports that 32% of the jobs in grocery stores were held by 16-24 year olds, part-time workers accounted for 31% of all grocery store employees, the average non-supervisory work week was 30.8 hrs, the average weekly wage in May 2004 was $332 (considerably lower than other industries), and over 22% of workers belonged to or were covered by a union contract. The increased movement of self check-out by customers and radio frequency identification may unfavourably affect employment of cashiers. The combination of low wages, inexperienced and young work-force and part-time employment suggests that despite the level of unionization, labour does not possess bargaining power with retail grocers. The 145 day strike/lockout in Southern and Central California during 2003/2004 involving about 59,000 workers was eventually settled in favour of the companies involved.

One final group critical to the grocery industry is the transportation sector and could be viewed as having moderate bargaining power. The typical grocery establishment needs to rely on fresh perishable items and limited storage space requires regular deliveries of produce, meats, dry and canned goods as well as other products carried in the store. Capacity in the trucking industry has shrunk along with profitability, impacted by fewer owner operators and drivers, rising fuel costs and regulations. Retail grocery firms that have integrated warehousing and transportation in their supply chain are at less risk while small firms and independents have increased exposure.

2.1.5 Bargaining Power of Customers

Consumers today have many options as to products to purchase and retailers to patronize and a popular belief is that consumers are on information and product overload. Typically consumers are price sensitive and expect high quality, especially of the foods they consume. Retailers are influenced by consumer behaviours precipitated by an aging population, hectic lifestyles, environment and health concerns. Buyer concentration is low in that each buyer typically is an individual consumer. However, ability of individuals to rally around an issue or requirement is strong, therefore, through consumer groups and watchdogs, individuals can strengthen their bargaining power.

Switching costs are low for consumers in urban areas but may be higher in small or rural communities where travel costs could be incurred to shop at outlets outside the local community. Another factor providing customers bargaining power is the retail grocery industry's capacity to exceed demand, leaving customers with many choices.

Products sold at retail grocery stores vary by brand, size and features however, with some exceptions, most products are not unique to one firm in terms of functionality and most national brands are available across channels. It is the private label and the experience that consumers associate with that product that may set one retailer's product apart from its competitors. Retailers are also motivated to improve on their supply chain due to pressures to deliver value to consumers.

2.1.6 Threat of Substitutes

Food is a basic necessity to sustaining life however consumers do have options as to how these vital products are sourced. Sourcing substitutes could include restaurants, street and other markets or even farmers and growers. According to FMI, nearly half of the food dollars spent are done so on "food-away-from-home" and is twice the amount spent 40 years ago. There is also the option of growing and raising some food products. Another area of substitution is pre-ordered meals or services where consumers assemble meals to take home using ingredients collected by a service provider.

Some substitutes such as sourcing from farmers and growers or growing your own food are either impractical, lack scope to sustain a large population or are inconvenient and therefore pose a low threat. Increasing emphasis on healthy lifestyles would suggest consumers would gravitate to grocery stores as opposed to restaurants and fast food take-out which are also higher cost options but are more convenient. Efforts by the restaurant and fast food industry to eliminate trans-fats may position that industry to better compete with retail grocery stores for healthy options. Affordable, healthy and convenient options would certainly pose a threat but no substitutes offering all three of these attributes currently exist.

2.1.7 Overall Industry Attractiveness

The analysis indicates that retail grocery is an industry with *high rivalry* fuelled by slow growth, moderately low concentration, high fixed and exit costs, over capacity and low profit margins. Although brand loyalty is on the increase, 75-80% of products purchased are still national brands, typically found at most competitor establishments. *Threat of entry is low* because of poor profit margins and the capital required for entry at a competitive scale. The increased adoption of private labels and the bundling of products and services further escalate the capital investment required. *Customers have high bargaining power* through advocacy groups, many options, over capacity, expectations of high quality at reasonable prices, low switching costs and product overload. Employment conditions (wages, hours, etc) and private label threats *minimize bargaining power to suppliers of labour and national brand goods respectively.* Threat of substitutes is low as options to shopping at grocery stores tend to increase the food dollars spent and are viewed to be less healthy.

The retail grocery industry has traditionally been slow to respond but many firms are increasingly cognizant of consumer trends in healthy and environmentally responsible lifestyles, private label acceptance and organic products. The industry is comprised of a number of different platforms, undergoing further consolidation, will increasingly be impacted by Wal-Mart and has yet to experience the implications of Tesco plc's entry into the U.S. Tesco plc, from the U.K. reportedly provides the largest home shopping service globally, is the fourth largest retailer in the world and has just purchased their first facility in the U.S.

Furthermore, this industry delivered a low after tax return of 1.16% and an average return on equity of 11.08% for the 2004-2005 fiscal year (FMI, 2006), making this industry a rather poor investment.

2.2 Private Labels

2.2.1 Overview

Brands are considered to be strategic assets providing competitive advantage for owners (Aaker, 1996), and represent a promise of value associated with the product or service (Hutt and Speh, 2004). Brands make consumer choices easier largely because of their functionality and emotions they create.

Private labels are brands, differing from national brands in that private label products are sold under a retailer's own name or a name exclusive to that retailer. National brands, on the other hand, are products produced and named by a manufacturer for sale to many retailers. An example would be *Coca-Cola*. Private label is pervasive in many products but this paper will focus on grocery products. Retailers saw an opportunity to capture economic rents created by national brand manufacturers' pricing strategies. They were perfectly positioned to influence the shelf content in their stores in response to consumer preferences.

Many but not all private label retailers use price to differentiate against national brands. Pricing of national brand products are typically 20-25% higher than private labels. Private label has become an avenue of product differentiation in a highly competitive industry and also affords retail grocery firms bargaining power with suppliers, but this has also increased competition within the industry. Competition also exists between the various retail formats and is especially fuelled by the growth of discounters and warehouse clubs who have also adopted private label programs. The adoption and importance of private label resulted in formulation of a trade association dedicated to servicing private label. The Private Label Manufacturers Association (PMLA) was founded in 1979 and represents over 3,000 companies world wide. ACNielsen (Smurfit Stone Container Corporation webcast, 2005) reports growth of private label is double that of national brands and are leading in 240 categories. Private label products in the U.S. represent about 16% of dollars spent and 22% of items purchased. Penetration over the last few years has been relatively flat, so tremendous opportunity still exists. A survey of consumer perceptions of private label (Hartman Group, October 2006) indicated that relative to national brands, 33% of respondents regarded private label to be identical, another 49% viewed them to be close to and 13% viewed private label to be superior, leaving the remainder that regarded national brands to be superior.

Retail grocery firms with private label products have two avenues to manufacture their goods – internally or outsourcing. Some grocery retailers invest in manufacturing capabilities to produce their own private label products. There are typically three options to outsourcing the production. One option is to use national brand manufacturers, particularly attractive to the latter if they possess excess plant capacity. A second option is to partner with regional manufacturers for specific markets. A third option is partnering with small manufacturers owned by national brand manufacturers or with other, independent suppliers.

Marketing and advertising budgets for national brand manufacturers are high in comparison to private label marketing budgets, and rely on various media. The retail grocers place higher reliance on in-store merchandising techniques that include point of purchase (P-O-P) displays to stimulate impulse buying. These displays can be constructed from a variety of material and corrugated material is a popular medium due to its cost, ease of disposal and ability to create high quality graphics. These P-O-P displays can be dedicated to private label, national brands or a combination of both. Displays that include both national brand and private label products can actually create consumer pull for the retailer's private label. This notion is confirmed by Ailawadi and Keller (2004) who state that private label sales are influenced by national brands, operating almost as "ingredient brands" creating consumer pull on private label. Other influential factors on private label sales include an appealing in-store environment and shaping the consumer's image of the retailer to establish differentiation. The consumer's image of the retailer is influenced by the retailer's quality of product, service and experience or brand personality.

Successful private label programs that create a brand personality are composed of five factors: 1) Sincerity, 2) Excitement, 3) Ruggedness, 4) Competence, and 5) Sophistication (Ailawadi and Keller, 2004; Aaker, 1996). As Hutt and Speh (2004) suggest, successful brands evoke psychological and emotional well-being from the product. Retailers are also in a position to create the shopping experience to enhance those rewards. At least four tiers of private label products exist: 1) no-name generics of low quality, 2) cheap, medium quality private labels, 3) slightly less expensive labels of comparable quality to national brands, and 5) premium quality, value added private labels priced at or higher than national brands (Ailawadi and Keller, 2004: Laaksonen and Reynolds 1994). Many retailers strive to create a multiple tier private label line but the downside is that each requires an investment to build, establish and nurture.

Competition from national brands is strong in fast moving consumer goods (FMCG) and evident in the retail grocery industry. Private label retailers need to overcome numerous areas of resistance. In many cases it is difficult to differentiate a product on technical or functional criteria so consumers can be reluctant to switch to an unknown brand. Successful national brands generate strong cash flows enabling the brand owner firms to reinvest in brand promotion reinforcing the perception that the national brand is superior.

2.2.2 Types of Private Label

Stanley (2006) categorizes private labels into the following groups:

Store Brands: Retailer's name is prominently displayed on the packaging.

Store Sub-Brands: Retailer's name displayed low-key on the packaging.

Umbrella Brands: Generic brand independent of retailer's name.

Individual Brands: A name used in one category used to promote discount product line.

Exclusive Brands: A name used in one category to promote 'added value" product

Another area gaining popularity and being marketed as private label is organic products. The development of the National Organic Standards in 1999 and subsequent implementation in 2002 was instrumental in legitimizing this market. According to the Organic Trade Association's 2004 Manufacturer Survey, U.S. growth in organic food sales have been in the range of 17-21 percent annually since 1997 and represents about 2 percent of total U.S. food sales (Clark, 2006). The organics business generates $14 billion but accounts for a small amount of the food sales despite large marketing expenditures (Thomson, 2006). Consumers' reluctance to pay the high price for organic products could well dampen this market. Both consumer product goods (CPG) companies and retail grocers are offering organic versions of their brands and private labels. Unilever, Kraft Foods, Campbell Soup, H.J. Heinz, Proctor and Gamble and Kellogg are among the CPG companies that are or will be introducing organic products. The organic label is now evolving into another label – locally grown organic products!

Harvey Hartman (Hartman Group, 2004) states: "Today's successful brands have learned they are not merely selling products, they are creating lifestyle worlds around their products and brands. The more you know about the world in which your product exists, the more successful your brand will be." Hartman suggests there are 5 components to building cultural brands. The first element is to create the brand experience by fostering community and generating surprise and delight. The second element is to build community by creating stores as interactive gathering places for consumers with similar lifestyles and consumption habits. The third element is to sell cultural occasions by being relevant to the consumer. Fourth, retailers need to learn and use the language of the consumer, not the industry. The final element is to create the culture of food by responding to trends in consumer tastes. Hartman suggests these five elements work in tandem to build the brand. Examples of firms with cultural brands are Whole Foods Market, Kashi and Stonyfield Farm. Whole Foods Market provides the experience of the neighbourhood market, providing food products to keep you healthy and whole. This experience has an effect on the consumer's wellness - emotionally, physically and mentally. Kashi has created an experience around telling a story of how consumers use, cook and loose weight with the product and this has generated customer loyalty. Stonyfield Farm represents integrity, quality and even a sense of humour.

2.2.3 Advantages and Disadvantages

Retailers are in control of shelf space in their stores and use private label products as a differentiation strategy to increase sales, market share and win customer loyalty. Private label products, only available at the retailer's store, are designed to target a retailer's specific market and reinforce relationships with customers. Private labels can also enhance a retailer's image providing retailers with price flexibility and lower costs for national brand products.

Using private labels as marketing tools, rather than national brand alternatives, can build and enhance a retailer's image. One in five items sold in U.S. supermarkets, drug chains and mass merchandisers are store brands and represents over $50 billion in sales (Private Label Manufacturers Association, 2006)."

Kevin Coupe's e-interview with Laurie Demeritt of the Hartman Group concluded that retailers can command a premium price when an emotional connection with the consumer is created and this connection is derived largely from store experiences and shopper's association of the retailer for unique, well made products (MorningNewsBeat.com, October, 2006). However, shoppers still like to compare national brands to private label. The PLMA, using industry data, indicate that consumers have saved over $15.8 billion annually, on grocery products, by selecting private label over national brand products. These savings can be largely attributed to the lower marketing costs associated with private label products. Private labels provide consumers with alternatives for quality food at a savings over national brands, and these products are made of comparable ingredients as national brands with an assurance from the retailer as to product standards and specifications. Many private label owners outsource manufacturing to producers of national brands, so private label owners need to recognize the advantages and disadvantages from this interesting relationship.

Stanley (2006) identified numerous advantages and disadvantages or risks to three groups that are summarized in Table 2.3.

Table 2.3: Advantages and Disadvantages of Private Label

	Advantages	Disadvantages
Retailers	• Increased sales & variety for consumers • Differentiation from competitors • Reduces national brand dominance • Increases consumer dependence on retailer • Increases customer loyalty • Increases positive image of retailer • Increases freedom in pricing • Increases control over inventory • Increases bargaining position with national brand producers	• Sales per sq. foot negatively impacted if turnover lower occurs • Perception of lower quality can occur where pricing below national brand • Negative impact to retailer's image if private label backfires • If standards are lacking between categories customers can be upset s • Focus on private label at expense of other products • At risk of Financial control issues • Lower national brand promotion could lessen bargaining power for retailer • Suppliers may reduce financial support • If product fails, consumers not forgiving
Customers	• Same Quality, lower price • Increased variety • Trust the product if retailer trusted • Product can fill a void where categories were missing products	• Product is of low quality or consumer perceives lower quality due to lower price • A failure in one private label could reflect on other private label products
Outsourced suppliers of private label – national brand manufacturers or independents	• Blocks competitor from the opportunity • Can enter the marketplace at lower cost • The secondary product gives the company a new profile • Can influence the competitor product to position against their own national brands • Can provide scale to smaller suppliers • Can increase shelf space in store • Opens doors to build strategic partnerships with select retailers	• Relationship with retailer is jeopardized if the product doesn't perform • For national brand manufacturers, are competing with own brand.

2.2.4 Trends

Reference to U.S. trends in various trade associations and publications suggest the U.S. private label market is following trends found in the European market but is still lagging. ACNielson (MorningNewsBeat.com, 2006) reports that adoption of private label in Europe continues to grow and exceeds 40% in the United Kingdom, Germany, Belgium and Switzerland and is about 1/3 in France and Spain. The study suggests the long term future of private label is strong given that consumers 25 years and younger are the most dedicated supporters. The European study also indicates about 25% of purchased products are private label, quality has equal importance to price in private label selection and 40% of shoppers would like their supermarkets to increase the selection of private labels. Pricing strategies differ between Europe and the U.S. with the former showing prices 10-18% below national brand leaders while in the U.S. some private label products are 25% less.

Wal-Mart's domination in the retail arena has and will certainly continue to exert influence on retail trends. Wal-Mart has experienced increased acceptance of their private label, giving them leverage to pressure national brand companies. An example is Wal-Mart's insistence that Coca-Cola's *Powerade* drink be distributed through their warehouses rather than directly to stores.

Over the last year, private label growth in the U.S. was 1.1% in supermarket products. The general thought is that in times of recession, private labels increase their market share, but tend to maintain that market share as economies recover. Manufacturers of national brands have responded to the increased purchases of private labels by decreasing costs, dropping prices, increasing research and development spending, increasing promotional activities and introducing discount brands (Ailawadi and Keller, 2004). They are also manufacturing private labels for retail grocers.

The Consumer Network conducted a survey on 25 product categories and discovered that packaging has gained influence in purchasing decisions and concluded marketers should increase use and spending on packaging for brand building.

The Hartman Group's Organics 2006 survey (Hartman Group, Inc. 2005) explored organic food trends by reviewing changes in 2005 as compared to 2000. They found that increasingly, organic food and beverage purchases are being made at natural food stores – 49% in 2005, up from 29% in 2000. Organic food purchases at grocery stores have also declined 5% in the last five years but increased 6% at super centers. Their findings also showed increased concerns on the impact of hormones in food products, especially the effects on children's health. Some demographic patterns that they surfaced show about 50% of organic product users are aged 45 and older, over 90% of users have at least some college education and that about 58% of users have an income of $50,000 (U.S.$) or more. The Hartman study also concluded that 82% of consumers believe that private label is closing in on national brands and 90% are not aware of stores such as Trader Joe's, dedicated only to selling their private label.

2.3 Firms in the Industry

The retail grocery industry consists of many firms however this discussion will only focus on six firms identified among the top 25 retailers in mainland U.S. (Table 2.1) and a few other firms noted for their private label initiatives or recent consolidations. A brief explanation of the various formats in retail grocery are first provided and is based on definitions sourced from Progressive Grocer's 2005 Marketing Guidebook and Willard Bishop, 2005 obtained through the Food Marketing Institute.

2.3.1 Segmentation in the Industry

Industry segments, once a short list of formats, has now expanded as retailers seek to differentiate themselves from competitors. Retailers are looking to sell exclusive products and special services, tailoring promotion and packaging specific to geographical markets, stores and consumers. Retailers are also pursing new categories, blurring the traditional segments (or channels) with initiatives such as prepared meals, or adding gasoline, pharmacies, insurance, financial services etc. Technology, such as self check-out, is also shaping the format of stores and internet shopping is becoming more prevalent in the industry.

Store Formats

- **Conventional supermarkets** offer a full line of groceries typically carrying 15,000 stock keeping units (SKUs) usually offering a service deli and bakery. Sales exceed $2 million annually and include a small percentage of general merchandise.
- **Superstores** are larger versions of conventional supermarkets carrying about 25,000 SKUs and offer an expanded selection of general merchandise.
- **Food/Drug combinations** are superstores with a drug store that includes a pharmacy and shared checkout. General merchandise represents about 15% of store sales and occupies at least one-third of the store's selling area.
- **Warehouse stores** offer reduced selection, less service with minimal decor and operate on low margin. Usually these stores don't have specialty departments.
- **Super Warehouses** are a high-volume blend of a superstore and warehouse store offering a full range of services, perishables and reduced prices.

- **Limited-Assortment stores** are basic low priced grocery stores carrying fewer than 2,000 SKUs with little if any perishables. Services are limited.

- **Other stores** are small corner stores generating about $1 million in sales annually and carry staples and convenience goods.

- **Traditional convenience stores** are small higher-margin outlets carrying a selected array of staple groceries, non-food items and convenient ready to eat foods.

- **Petroleum based convenience stores** are essentially gas stations with a convenience store attached.

- **Hypermarket stores** are large food and general merchandise stores typically dedicating the majority of their selling area to general merchandise but generating about 60% of sales from food.

- **Wholesale Clubs** are membership based on a warehouse platform, carrying 60-70% as general merchandise and a grocery line focused on bulk sales. Customers include both business and general consumers.

- **Mini-Club stores** are smaller versions of wholesale club carrying about 60% of the SKUs. Some stores do not have membership fees.

- **Supercenters** are large food/drug combination stores and mass merchandisers carrying a wide variety of food and non-food merchandise.

- **Deep-discount drug stores** carry about 25,000 SKUs but food accounts for only 20% of sales.

- **Internet based grocers** use the internet as the principal format of accepting orders and carrying 12,000 or more SKUs for home delivery.

2.3.2 Top Ranking Firms

Wal-Mart Stores, Inc.

Wal-Mart, ranked #2 on *FORTUNE*'s list of the top 500 companies is the largest U.S. retail grocer and operates internationally under multiple store formats. Sales for fiscal year ending January 31, 2006 were $312.4 billion, up 9.5% over the prior year. Net income grew by 9.4% to $11.2 billion and gross profit of 23.06% increased from 22.94% in 2005. Sales under the grocery category were approximately $155 billion, nearly three times that of the 2nd largest retail grocer. Operations outside the U.S. include 279 stores in Canada, 845 stores in Mexico, 753 stores in Central and South America, 411 stores in Europe (primarily in the U.K.) and 457 stores in Asia (66 in China). Wal-Mart has recently announced the sale of their German operations and is considering an acquisition of Trust-Mart, a hypermarket format in China as part of their strategy to double their presence there. Their U.S. operations include 1,123 Wal-Mart stores, 2,142 supercenters, 570 warehouse club stores (Sam's Club) and 109 Neighborhood Market stores which are full line supermarkets with limited line general merchandise. Wal-Mart's expertise is in logistics, information technology, merchandising innovation and supply chain efficiencies. Their pricing strategy revolves around "Every Day Low Prices" (EDLP) although more recently they are shifting to higher end products. In 2005, Sam's Club sold an 82-carat diamond necklace for over $260,000 and they are looking to sell high end items, typically found in a Neiman Marcus catalogue, for the 2006 Christmas season.

Wal-Mart's dominance in the industry impacts not only their competitors but their suppliers. Their environmental initiative to reduce overall packaging by 5% equates to 213,000 trucks annually, several million pounds of trash and is purported to create nearly $11 billion in savings with Wal-Mart poised to take $3.4 billion of that (MorningNewsBeat.com, September, 2006).

Wal-Mart's CEO Lee Scott states "Packaging is where consumers and suppliers come together and can have a real impact both on business efficiency and environmental stewardship." Their scorecard will be introduced to more than 2,000 private label suppliers on November 1, 2006 with the intent that suppliers share processes and results to enact the change by 2008. Their intent is to also shift to reusable and recyclable packaging within two years.

Wal-Mart also carries a series of private labels and has recently announced entry into organic products, with the intent of pricing this category of products 10% higher than conventionally produced products. This announcement has created uproar with organic growers and in the retail community due to concerns of margin erosion and supply.

The Kroger Company

Kroger, the second largest retail grocer and #21 on *FORTUNE*'s list of top 500 firms is the nation's largest pure grocery chain and operates nationally in the U.S. under a variety of formats. Sales for fiscal year ending January 28, 2006 were $60.6 billion, an increase of 7.3% over the prior year. Net income was $958 million as compared to a loss of $100 million for 2005. Gross profit of 24.75% declined from 2005's level of 25.33%. Their operations include 2,477 grocery stores under supermarket, discount warehouse and supercenters format, some of which are combination food and drug and have gas stations. They also have 773 convenience stores and 418 jewellery stores. In addition to their retail operations, operating under numerous banners such as Ralph's, Fred Meyer and Food-4-Less, Kroger also operates 42 food processing and manufacturing facilities to support their private label program.

Their expertise lies in utilizing customer shopping data to create target programs, by partnering with a marketing firm – Dunnhumby. Differentiating strategies include a three tiered private label program accounting for approximately 25% of total sales, and economies of scope to enhance brand equity in a given region. Their promotions often involve financial support from suppliers in return for advertising, shelf space and display placement. Kroger's private label strategy is to meet the national brands head on and their three tiered private label program is intended to appeal to a wide range of consumers offering options in quality and price. Each tier of private labels has a unique set of graphics. Another private label is currently being tested and is being affiliated with Disney and healthier food.

Target Corp.

Target, the 3rd largest retailer in the mainland U.S. and 29th on *FORTUNE*'s list of top 500 firms operates under a supercenter platform. Sales for 2005 were $52.62 billion, a 12% increase over the prior year and net income was $2.408 billion dropping from $3.2 billion in 2004. The drop in earnings is largely attributable to a $1.24 billion gain on the 2004 disposal of Marshall Field's and Mervyn's. Gross profit of 31.9% improved from the 2004 level of 31.2%. These levels are higher than other competitors in this discussion and are influenced by the lower percentage of grocery sales that typically deliver lower gross margins. Target has a total of 1,397 outlets comprised of 158 SuperTarget and 1,239 general merchandise stores.

Target's strategy encompasses creativity and design as a means to maintaining relevance to consumers, providing an exceptional shopping experience. Their stores include pharmacies, Pizza Hut, Starbucks and digital photo-labs. To avoid battling with Wal-Mart on price, Target's differentiating strategy involves strong brand identity using exclusive product lines from high-profile designers. Their challenge will be to transfer this to food items. Their private label strategy is to exceed value while matching competitors' prices with their brand promise of "Expect More. Pay Less." Target is expanding its food sections and their private label program includes a premium brand and a national brand equivalent. Investment in their supply chain includes technology and additional warehouse and distribution centers to support their growth plans.

Costco

Costco, the 4th largest retailer of grocery products, is ranked 28th on *FORTUNE*'s top 500 list and is the largest wholesale club in the U.S. Sales for the year ended September 3, 2006 were $60.15 billion, an increase of 13.5% over 2005. Net income was $1.103 billion or 3.8% above 2005 net income of $1.063 billion. Gross profit of 12.3% was close to the 2005 level of 12.47%. Statistics on food sales for the fiscal year weren't available but 2005 was 31% of total sales. Operations include 359 warehouses in the U.S. and Puerto Rico, 68 in Canada, 18 in the U.K, 14 in Asian and 29 in Mexico. Costco-Online provides internet sales in both the U.S. and Canada and the company also operates some plants such as meat processing.

Membership is required, except for online purchases, generating both customer loyalty and revenues to Costco and in return they offer the lowest possible prices for higher quality products, capping their gross profit margin at 14-15%. Costco promises 20% savings on their private label, Kirkland Signature, over leading national brands and accomplish this by carrying only items that will provide savings to their members. As a result they carry about 4,000 SKUs compared to 40,000-60,000 typical of discount retailers and supermarkets. They also co-brand with national brands such as Kirkland

Signature-Tyson chicken breasts and Kirkland Signature-Starbucks coffee as a strategy to enhance perception and increase adoption of their private labels. Thayer (2003) suggests this strategy is not unique but is rarely used and Costco is likely pursuing this undetected. Some potential suppliers could be reluctant to co-brand with Costco for fear of alienating their other customers. Costco is also rolling out an organic products program. Their selling strategy revolves around a "Treasure Hunt" experience to provide their customers with surprise and delight. Many of their warehouses also incorporate gas stations and additional services such as real-estate and mortgage services, home and auto insurance, and a travel agency. Some of these services are only available to those prepared to pay a higher membership fee. Costco is able to finance a large portion of their inventory with accounts payable because of their consumer payment policy of cash, cheque or with their partner credit card provider.

Supervalu Inc.

Supervalu is currently ranked #22 among the top 25 retailers in mainland U.S. with about 1,500 stores. Their acquisition of Albertsons will give them the largest store count, with 2,653 stores, and they will become a major player in the supermarket format. Supervalu operates under a number of formats – supermarkets, food/drug combinations, super warehouse, limited assortment and hypermarket stores. Supervalu is currently ranked 113th on *Fortune*'s 500 list. Albertsons is currently the second largest supermarket chain behind Kroger and ranks 47th on *FORTUNE*'s list of top 500 firms. Supervalu's sales for the year ended February 25, 2006 were $19.86 billion, a 1.6% increase over the prior year. Sales after the Albertsons acquisition are expected to be $44 billion, 80% in retail.

Net income, at $206.2 million was a decline from $385.8 million in the prior year, largely due to a $109.2 million gain on disposal of WinCo in 2005. Gross profit of 14.5% was relatively unchanged from 14.6% in 2005. Gross profit is positively influenced by the higher margin "Third Party Logistics" business. Sales from retail food represented 53.5% of total sales for 2006 fiscal year.

Supervalu is an established wholesaler to independent grocers, and their acquisition of Albertsons could place them in a delicate situation as they compete directly with their customers. Supervalu, the largest publicly traded distributor to retail grocers, has structured a supply chain to serve about 2,200 retailers and provide secondary service to over 500 retailers. Their expertise is in providing asset and non-asset based solutions, transportation and logistics and design and management of customers' entire supply chains. Their capabilities include third party logistics, 35 distribution centers, purchasing scale and electronic business-to-business systems for both customer and supplier applications. Supervalu owns their own truck fleet but also utilizes 3rd party independent trucking firms. Their three tiered private label program encompasses over 6,000 SKUs and they also sell organic products.

Safeway Inc.

Safeway is the 11th largest retailer in the mainland U.S. and will become the 5th largest grocery retailer after Supervalu's acquisition of Albertsons. Ranked 50th *on FORTUNE*'s list of top 500 firms, Safeway operates primarily as food and drug combination stores. Sales for 2005 were $38.4 billion, an increase of 7.2% over 2004, and net income of $561.1 million marginally grew from $560.2 in 2004. Gross profit was 28.9% declining from 29.6% in 2004. Safeway operates 1,767 stores, 17 distribution facilities in the U.S. and Canada and 33 manufacturing and processing plants that focus on their extensive private label products. Recently Safeway purchased the remaining 44% interest in an internet grocer from Tesco.

Safeway is embarking on three significant changes. The first initiative, to create efficiencies and drive down cost, involves centralization of their marketing, merchandising and operational decisions. The second initiative is to convert their stores to "Lifestyle stores" to create a new shopping experience targeting high-end products. Thirdly they are repositioning their brand message to "Ingredients for Life". Safeway has already converted 458 stores to Lifestyle stores and intend to convert the remainder as well as open up 20-25 new stores. Their "Ingredients for Life" strategy incorporates private label organics products. Their pricing strategy includes EDLP for certain categories. Safeway started recycling cardboard in 1960 and pursued numerous initiatives to reduce energy consumption, most recently acquiring an additional 174,000 megawatts of wind energy making them California's largest corporate purchaser of green wind energy.

Other

A number of other firms in the U.S. industry have found niche markets for their private labels. Three of these firms are Whole Foods Market Inc., Trader Joe's and Publix Super Markets. Tesco, plc intentions of entering the U.S. market also warrants mention.

Whole Foods Market Inc., with a large presence in organic foods has 187 stores in North America and the U.K. as well as 8 distribution centers. Ranked 449th on

FORTUNE's 500 list they are also recognized as one of the "100 Best Companies to Work For in America". Their focus is quality, gourmet foods and service and their portfolio of products include private label. Sales for 2005 were $4.7 billion with a 35% gross profit margin that generated $136.4 million in net income.

Trader Joe's, with 255 stores in the U.S., is a high-end specialty retail grocery firm and is privately held. They are continuously introducing new products and their product line includes organic foods, ready to eat meals and private label products.

Publix Super Markets is the largest privately owned supermarket firm in the U.S. with 884 stores all in the southeast, 8 distribution centers and 5 manufacturing centers. Ranking 104th on *FORTUNE*'s 500 list of firms, they have also been recognized as one of the "100 Best Companies to Work For in America" for 9 straight years. Publix excels in customer service and superior quality. Sales in 2005 were $20.6 billion and net income was $989.2 million. Publix also offers a private label product line.

Tesco plc is a large international retailer with intentions of making a large entry into the U.S. Their competitive advantage is their wide breadth of capabilities and includes experience with prepared foods, high quality private label, consumer direct selling, shopper data base marketing, world class logistics systems and numerous store formats.

2.3.3 Summary

Wal-Mart clearly dominates the industry from the perspective of sales and scale and their actions typically influence not only the retail grocery industry but the retail industry in general. The larger firms in the industry have found a way to co-exist with Wal-Mart through differentiating strategies and often private label is one component of their strategy. Another strategy is to blur the segmentation thereby offering products and services that are uncommon, if not unique. Research conducted by Bain & Company (Anderson, 2005) indicated companies competing with Wal-Mart have pursued four activities. Firstly they have built market share from retailers who have not faired well against Wal-Mart. Secondly they have focused on important customer segments. Thirdly they have firmed up pricing policies and trained local managers to recognize and react to opportunities and threats. And lastly, they have focused on reducing costs.

In this chapter a number of issues and trends were considered. A variety of store formats have evolved as firms have sought to compete in the retail grocery industry. Industry consolidation and growth of warehouse club and superstores have changed the competitive landscape in the industry. Retailers are increasingly responsive to consumer behaviours and have identified private label products as an opportunity to satisfy consumers and increase profits and market share. The importance of brand personality is derived from the ability to generate customer loyalty and stimulate sales. National brand manufacturers appear to be caught in the middle with one in five products now supplied as a private label and some firms are resorting to private label production. All of these are issues and trends that the corrugated packaging industry needs to consider.

3 CORRUGATED PACKAGING INDUSTRY

This chapter will provide an assessment of the U.S. corrugated packaging industry utilizing Porter's five forces (Porter, 1979) of rivalry, threat of entry, threat of substitutes, bargaining power of customers and of suppliers. A competitive landscape is also provided using Bergen and Peteraf's (2002) marketplace view.

3.1 Industry Analysis

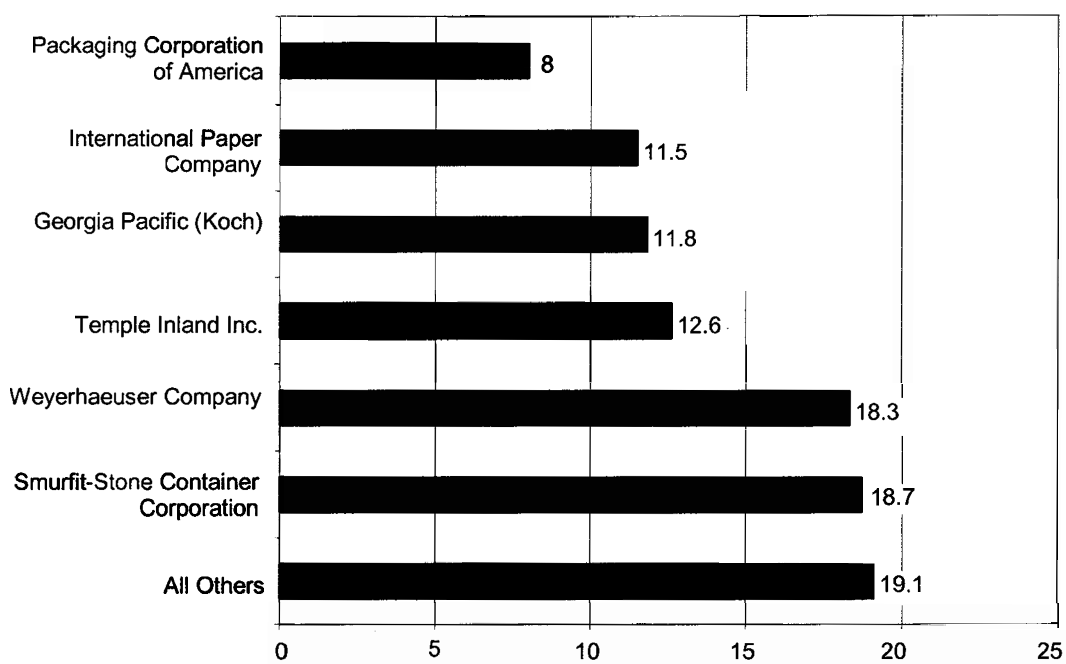
3.1.1 Industry Overview

Globally, the U.S. is the largest market for packaging materials and corrugated boxes constitutes the largest percentage of total packaging. The value of U.S. corrugated packaging shipments in 2004 was $23.2 billion, produced by about 650 firms operating 1,417 manufacturing plants. This industry provides packaging for a large array of consumer products that include durable, food, personal care, drug, entertainment, electronics, apparel, automotive business equipment, electrical, books, beverage, toys, entertainment goods, sporting goods, etc. The customer base is too vast to provide a comprehensive list that touches all our lives and embraces all areas of consumerism and business. Customers include manufacturers, resellers, distributors, brokers and retailers. The industry is impacted by a host of factors influencing consumer behaviour that include general economic conditions, demographics and lifestyle trends.

The U.S. industry is in the mature phase of its life cycle and domestic growth is predicted to be 2% for the period 2003-2008. Typically, growth for one firm has been at the expense of other firms in the industry through pricing or services, consolidation or attrition. Corrugated packaging materials are homogenous products manufactured to customer specifications, with competing firms having similar capabilities although some differentiation has occurred through product innovation.

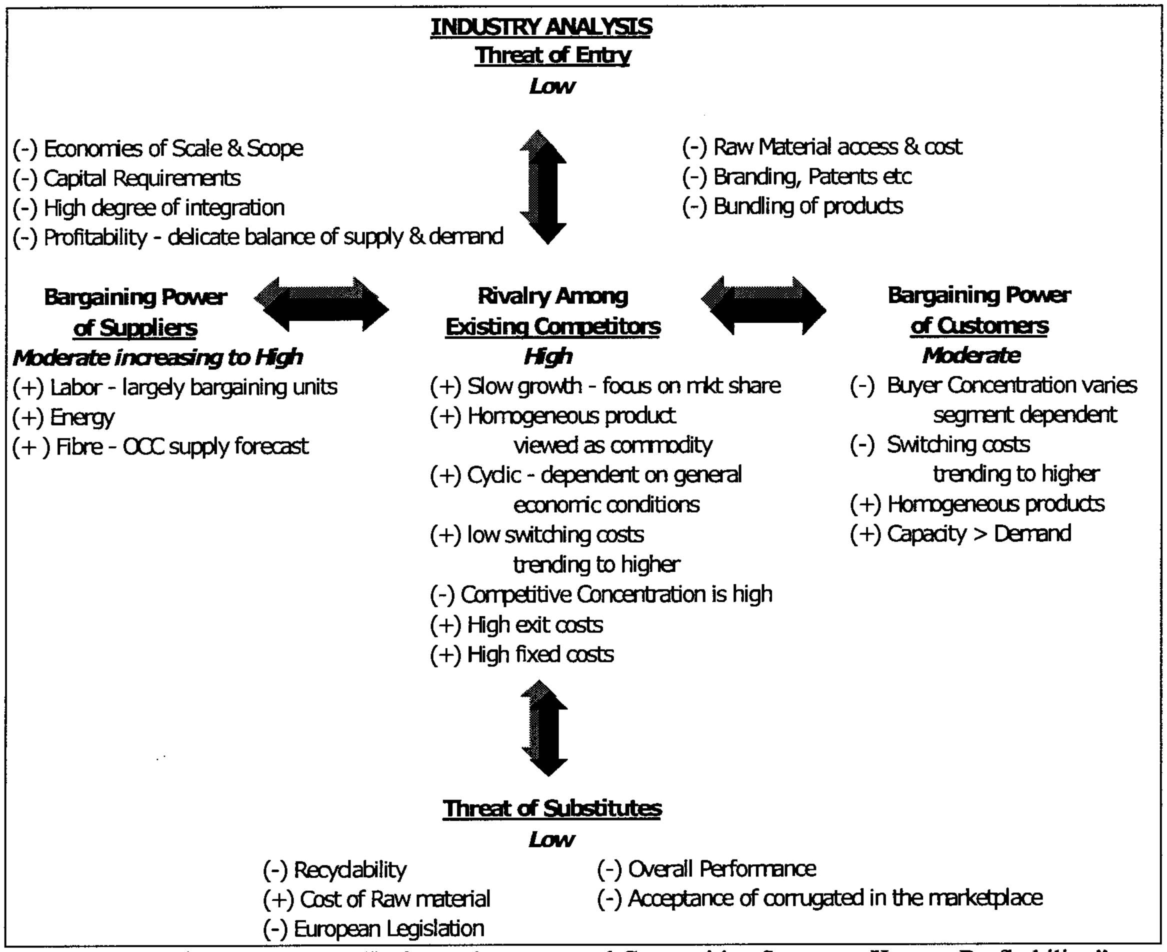
Manufacturing facilities are geographically dispersed nationwide, indicative of this industry's need to be close to their customers to provide the required service level and minimize freight costs. The oversupplied market has resulted in industry rationalization with a series of consolidations and repositioning tactics such as closures of inefficient facilities coupled with increasing scale at better performing plants. In spite of the large number of firms competing in this industry, over 60% of market share was held by four firms in 2005. Concentration of the top 5 firms shifted from 42% to 70% in the last 8 years. The firms in this industry have faced increasing energy costs and pricing pressure resulting in poor profits and return on net assets (RONA).

Figure 3.1: 2005 U.S. Corrugated Box Market Share (%)



Data Source: Weyerhaeuser Company

Figure 3.2: Corrugated Packaging Industry Analysis



Adapted from Michael E. Porter, "Industry Structure and Competitive Strategy: Keys to Profitability," Financial Analysis Journal, July – August 1980, p. 33

3.1.2 Industry Rivalry

The industry concentration is indicative of an oligopoly, however the under utilized production capacity has limited the market power of sellers who instead vie for market share. Much of the market place is price sensitive, leaving firms in the industry vulnerable to losing market share despite some switching costs for customers. Firms offering differentiated products or services are afforded some protection. Differentiation typically occurs through price, service, quality, design, and product innovation. During economic downturns, competition intensifies as firms struggle to continue operating their facilities unprofitably. 'Riding out the storm' also protects market share and provides for capacity when the economy recovers. Industry health is directly correlated to general economic conditions and therefore exhibits cyclical behaviour. During periods of recession discretionary spending declines, impacting many of the customer segments.

The market size is also undergoing change due to offshore manufacturing and changes in the retail industry. Some former domestic manufacturing of goods has now been relocated to offshore facilities. The strength of the U.S. dollar is also an influencing factor on the competitiveness of U.S industrial production. A strengthening U.S. dollar negatively affects domestic production of some goods, reducing demand for corrugated packaging and increasing rivalry for share of the remaining market. The retail industry, a major consumer of corrugated packaging, has been influenced by mega stores and on-line shoppers where lighter weight and less expensive packaging are desired. Wal-Mart, the largest retailer in the world has recently targeted a 5% reduction in overall packaging to commence in 2008.

Typical of manufacturing, this industry faces higher fixed costs due to the numerous plant and equipment facilities. Operating cost structures vary, with larger scaled operations in a position to drive down per unit costs. Energy costs and raw material are major cost elements in the production of corrugated containers. Plants that have converted to use of recycled raw material or OCC (old corrugated container) may benefit from lower raw material costs however China's growing corrugated industry is expected to adversely affect OCC supply and costs. The U.S. is China's largest supplier of OCC and China is gearing up to increase corrugated supply rather than rely on imports to support their growing economy. Roberts (2004) suggested China's ravenous appetite for OCC may well drive prices of OCC beyond the competitive reach of the U.S. domestic industry reliant on recycled raw material.

The firms in this industry vary in their degree of integration and range from internal corrugation mills supplying converting (box) plants to timber based firms that supply their own raw material needs. Some firms have also integrated recycling to capture OCC and centers to service retailers with display, fulfillment and turnkey solutions. The entire U.S. industry has faced increased costs in transportation and energy as a result of high oil prices. Such costs are likely to be somewhat differential by geography within the U.S. So, not all firms co-existing in this industry operate under a similar cost structure. Severance of the labour force, potential environmental remediation and likely disposal of production facilities with little to no resale value would result in moderately high exit costs.

In summary, rivalry in the industry is high. As a result of rationalization in the industry, concentration has increased with the top 5 firms now holding over 70% of market share and growth in the U.S. is forecasted to be only modest. Any additional consolidation is likely through acquisition of small independent or specialty firms. Large scale mills have flattened cost curves in the drive for low cost production. The Big 5 are all struggling to produce adequate earnings to cover the cost of capital. The industry is positioning itself to moderate rivalry among its competitors essentially by addressing the imbalance of supply and demand. Firms will seek to differentiate their products and services and this will likely result in higher switching costs. Recent strategy announcements by a number of the larger firms suggest a common direction of reorganizing to focus on two parts of the business - low cost and value added. As the industry completes its rationalizing, fixed costs are predicted to decline.

3.1.3 Threat of New Entrants

Although the industry generates in excess of $23 billion in sales annually in the U.S., the grim profitability for the largest firms should alone be a sufficient barrier to entry. Reported incomes, from 2005 Annual Reports of four of the five largest firms support the earlier comment that these firms are struggling to return their cost of capital. These firms operate on a large scale with plants located throughout the U.S., focus on low cost production and are located in close proximity to customers.

Table 3.1: Reported Profits from 2005 Annual Reports[1]

	2005 Year (millions)	# of Facilities
Temple-Inland[2]	$ 120	73
Packaging Corporation of America (PCA)[3]	53	68
Weyerhaeuser	(5)	96
Smurfit-Stone	(327)	165
Total[4]	$ (159)	

New entrants would require significant capital to enter at a sufficient scale to compete with the five largest firms. Entry into niche, small markets could be accomplished with less capital but would provide limited scope geographically. All the large firms participate in the major customer segments – durable, food and drug, beverage, etc. This

1 Where possible, only corrugated and packaging segment results are reflected.
2 Temple-Inland has $316MM of costs not allocated to business sectors
3 PCA earnings include wood products although relatively a small part of their portfolio
4 Georgia-Pacific is not included having been acquired by a Private corporation in 2005

customer mix can buffer firms from cyclical demand whether seasonal or due to economic conditions. Firms entering on a small scale or targeting a particular segment are more vulnerable when in the troughs of the cycle.

The industry is also highly integrated, vertically. Li and Luo (2005) state that 25% of the containerboard production is sold on the open market. The need to enter the industry in an integrated fashion increases the capital requirements significantly. Access to raw material will be more difficult and costly, whether OCC or virgin fibre and is predicted to become an increasing barrier to entry.

Due to the cyclical nature of the business, sources of cash flow to support the down turns are critical. Larger, multi-sector firms are likely to be more successful due to differing cycles among their businesses. The larger firms also have easier access to capital or debt to sustain the down turns or upgrade equipment. The larger companies are able to implement initiatives to achieve economies of scope by centralizing or outsourcing peripheral activities such as finance, engineering, research and human resources management. Such firms can also leverage their size through standardized technical practices and implement common procedures across all facilities to enhance their core competencies. New entrants, entering the industry on a smaller scale would be challenged to compete with firms more resourced and experienced.

A number of firms in the industry hold patents and trademarks, essentially limiting or blocking access to a piece of the market. Therefore, entrants would only have potential access to a portion of the market where demand of proprietary product cannot be met, leaving customers with only traditional packaging choices. New entrants would also need to position themselves to compete against firms offering bundled products and services requiring an investment in capabilities such as display and turnkey solutions for the retail industry.

The industry is currently in turbulence as it tries to reconcile the demand-supply dynamics. As it reaches a state of equilibrium, a new entrant would likely tip the scales leaving the industry grabbing for market share, competing on price and once again creating an unprofitable climate. Although the cost of production offshore can be appreciably less than that of the U.S, offshore firms shipping to the U.S. face a freight disadvantage. Corrugated packaging entering the U.S. from China is not considered to be a significant threat at this time, due to their internal needs, however, this should be closely monitored. Exposure may come from the border countries – Canada and Mexico, and some U.S. based firms already have operations in these countries. In summary, the combination of scale, capital and profitability are the major barriers to entry making this threat low. Small scale entry into niche markets by smaller, nimble firms could certainly be a threat, especially to the existing competitors of like size and market.

3.1.4 Bargaining Power of Suppliers

The three largest costs incurred in this industry are for raw material, labour and energy. Raw material, the largest cost, is sourced from either virgin timber or recycled material. Firms in the industry that are unable to sustain their own requirements must purchase supply in a highly competitive and price sensitive marketplace. Equipment changes to accommodate recycled fibre would reduce dependency on virgin fibre but this conversion cost is high. Fluctuating supply and demand of recycled fibre has resulted in both volatile pricing and earnings. Raw material transportation costs are influenced by proximity of the plants to their sources. Firms supplying their own virgin fibre will also seek highest "return to log" and may divert supply to options such as lumber or panel production, further restricting supply to the corrugated business. These dynamics provide raw material suppliers with a dominant position.

Energy costs impact the industry from two avenues – production and transportation cost. Firms in the industry will seek to negotiate contracts with energy providers to control costs. Increasingly, firms in the industry are seeking alternatives to oil and gas fuels. To the extent firms purchase electricity, suppliers are concentrated and therefore sourcing options are limited, clearly placing the power with the utility providers. Firms strive to rely on some sort of dependence management either through negotiating contracts or minimizing the impact through integrating some of their requirements. Another supplier group is the labour force that leans toward membership in bargaining units. The degree does vary by firm, and unions such as the United Steel Workers of America tend to be large and powerful.

In summary, the large degree of integration in this industry has moderated the power of raw material suppliers. Firms that have converted some of their operations to recycled content are exposed to greater supplier power in the future due to China's forecasted needs. Energy suppliers attain power from their monopoly in a given operating region and labour largely from their bargaining unit power. These three supply streams represent the largest cost elements in the production of corrugated packaging products.

Overall, suppliers' bargaining power is moderate due to the degree of integration of fibre sources but moving to high as supply of OCC further tightens.

3.1.5 Bargaining Power of Customers

Many industries have undergone their own series of consolidations resulting in larger and fewer corporations, however the list of customers serviced by the corrugated packaging industry services is still extensive. Packaging suppliers, focusing on one or a few customer segments, are likely more vulnerable to customer power. Some of the customer segments exhibit some level of buyer concentration – pharmaceuticals being one example.

The corrugated packaging industry currently has capacity to oversupply the market place, providing customers with greater bargaining power. End-user customers, such as retailers, are able to increasingly influence packaging decisions as they respond to factors such as demographic shifts, lifestyle changes or environmental concerns. We live in an age where new products are continuously introduced and competition for shelf space at retail facilities are fierce. The ability to provide point-of-sale packaging can help manufacturers of goods secure space in which to sell their products so corrugated packaging customers are increasingly looking to their suppliers to both enhance the appeal of their product and reduce costs in their supply chain. The mega-retailers (Wal-Mart, Costco, etc) have become increasingly dominant and influential in packaging decisions, an example being Wal-Mart's planned 5% reduction in packaging materials and their intention to evaluate their 60,000 suppliers on performance against this target.

Bargaining power is afforded to customers who are dominant in their segment or who engage in many segments (i.e. PepsiCo in beverage and food industries). Through scale these customers can be large users of corrugated providing them with purchasing power to obtain the best terms, rebates for volume purchases and other features such as inventory management in their contracts. Some corrugated packaging customers have well developed supply chains and continuously seek lower costs. Some firms employ an internet bidding process as well. Transparency of pricing usually limits the ability to pass on increased raw material costs. The corrugated industry can somewhat offset such impacts through differentiation strategies creating higher switching costs. The industry typically "custom" produces, delivering specifications required of each customer that will involve strength criteria, size and shape and graphic features. Customers do incur some switching costs associated with re-establishing the specifications with a new supplier. Developing new contracts, quality assurance and tool and dies for graphics are some of these costs.

In conclusion, buyer concentration does vary by segment and the excess capacity of the corrugated industry to produce a commodity product lends itself to a moderate degree of bargaining power in the hands of the customer. Future buyer power may be impacted by the customer's industry dynamics, including further consolidations and movement to offshore manufacturing.

3.1.6 Threat of Substitutes

Corrugated boxes are highly adaptable, efficient, can be recycled and originate from a renewable resource. The advantages of corrugated products over other materials include its cost effective strength performance, texture (smooth), high acceptance in the marketplace, good graphic presentation, availability of higher grade product and a recycling infrastructure. Corrugated packaging material has adapted to be a medium for in-store displays and bins and is compatible with high speed graphics. It can be used alone or in conjunction with other materials. The product can be shipped in flat form reducing handling and transportation costs and selection in design and size is extensive. It provides protection for packaged goods. The industry is well developed in the area of box specifications, usually in collaboration between the user and supplier, mindful of the rules of the American Trucking Association or the National Freight Railroad Committee. Therefore regulatory requirements are already in place lending credibility to the industry.

Disadvantages of corrugated packaging material provide an inroad for substitutes. These disadvantages include vulnerability to moisture, energy intensiveness to produce and limitations on shape of product. The industry's solution to the moisture concern was wax treatment; however, not being recyclable, the industry has introduced wax free alternatives.

Plastic containers are the main substitute for corrugated packaging and the main component of plastic packaging is polypropylene resin. Li and Luo (2005) suggest the substitution effect of plastic packaging is small. Plastics as an alternative may be loosing its attractiveness with recent and forecasted oil pricing. Pricing of corrugated packaging, on the other hand tends to move with the price of pulp or OCC which has been relatively stable over the past number of years. Forecasted increases in OCC may however support plastic as an attractive alternative.

Legislation in other countries such as the European Packaging Directive could eventually migrate to the U.S. giving corrugated packaging an advantage due to its already well established recycling infrastructure. Clearly, plastics are not produced from renewable resources, an issue for garnering acceptance of environmentally conscious consumers.

Plastics can be moulded into a variety of shapes and forms providing benefits that corrugated currently lacks. Plastics are also effective in protecting packaged goods. However, because many plastic packaging forms are quite rigid, handling and transportation costs are likely to be a concern with buyers. The cost of switching from corrugated to plastic packaging material would involve defining and testing new specifications and costs associated with handling (storage, labour, etc) and transportation of bulkier and heavier material.

Other substitutes for corrugated packaging such as glass, wood and metal have not and are not deemed to be a threat. In summary, the benefits of corrugated packaging materials make this material a preferred medium hence the threat of substitutes is relatively low. The threat has the potential to increase if the cost of producing corrugate materials increases, making substitutes such as plastic more attractive. Wal-Mart's recently announced sustainability initiative will have enormous implications to packaging and fortunately for this industry, corrugated packaging is viewed favourably due to its recycling features and infrastructure.

3.1.7 Overall Industry Attractiveness

The analysis indicates an industry with *high rivalry* fuelled by slow growth and over capacity in largely a commodity market. *Threat of entry is low* because of the poor profitability and the capital required for entry at a scale to be competitive and integrated. The industry today generates a poor return on equity. The best performing of the largest five firms generated a return on investment of 5.6% in 2005 with a profit of $120 million and the next best performer delivered a profit of $53 million. Most of the largest firms generated negative cash flows for the corrugated packaging portion of their business and Wall Street is putting pressure on the industry to improve performance. The movement to offshore manufacturing has had some impact on the industry. Numbers from the Fibre Box Association indicated that 1999 U.S. corrugated and solid fibre shipments, at 405 billion square feet dropped to 391 billion square feet in 2005. *Customers have moderate bargaining power* in large part due to the excess capacity in the industry and a homogenous product making switching costs relatively low. The rising cost of labour, energy and fibre further erodes margins and grants *moderate bargaining power to suppliers*. The positive feature of this industry is high acceptance of a product that is largely recyclable; however other factors just don't make the industry, in its current state, attractive.

The industry is undergoing change and many of the large firms in the industry are implementing similar strategies to address the demand and supply imbalance that has plagued the industry, as well as placing greater focus on customer. These strategies will address two fronts – low cost, efficient production and further differentiation. There are also changes occurring in the marketplace to capture opportunities such as wax replacement products, environmental expectations and retail trends. The industry clearly needs to undergo change and as the opportunities are seized, the threat of entry could increase. Growth in the U.S. is forecasted to be modest and the precarious balancing act between supply and demand needs to be managed. New entrants can quickly put the industry into a state of disequilibrium.

3.1.8 Key Issues Facing the Industry

Stagnant U.S. growth, excess capacity and trends in moving production offshore are today's realities. With growth projected at 2% and the industry capable of overproducing, discipline by the firms in the industry is required to protect any margins. The industry's response, to date has been through repositioning strategies, essentially plant closures. However, scaling up the remaining plants has replaced some of the volume otherwise removed through these closures. The movement of production offshore is also aggravating the supply-demand situation. The U.S. production of durable products is on a decline. Selection of market segments and customers within those segments will also be critical. Stimulating demand through innovation (Slywotzky and Drzik, 2005) is a means of countering the poor growth predictions.

Pricing has been one tactic to compete in the industry and is largely responsible for the dismal financial results. Many of the industry firms have not been profitable, show marginal to negative cash flows and low return on assets. They are unattractive firms for investment and the carrying cost of debt is higher. To be successful, firms need strategies to drive for low cost production and differentiation or some combination of both to improve margins. Firms in the industry need to enhance their product and service features as well as remove costs in the customer's supply chain and respond to growing trends in areas such as retail by providing innovative solutions. Future OCC prices and supply are a looming concern. Firms that have converted their facilities to accommodate recycled content have greater exposure to this risk. Plants with equipment that can handle both OCC and virgin fibre are most flexible. Securing a supply of OCC will become increasingly important. Companies, such as Weyerhaeuser, who have integrated recycling into their business, have buffered themselves from this risk.

This industry also faces high energy costs and the oil price forecast does not appear to provide any relief. Alternate forms of energy supply need to be considered. Some firms have done just that, to varying degrees. A number of firms have adopted a supply chain management philosophy that requires organizational changes and success will obviously be governed by how well firms manage this change. The industry is entrenched in some very traditional thinking where production *volumes* are a measure of success so leadership and changes in key metrics are critical to guide the firms through this journey.

The industry is also faced with changes in the marketplace. Corrugated packaging firms must anticipate and react to consolidation among brand manufacturers and retail companies. National brand manufacturers and private label retailers are implementing changes to their supply chain that include rationalization of the number of suppliers and are increasingly looking for total packaging solutions. Consumers are also influencing packaging decisions to a greater extent. In conclusion, leadership, responsiveness to change, low cost manufacturing, market access capabilities, and demand innovation (products and services) are key competency requirements to be successful in this industry.

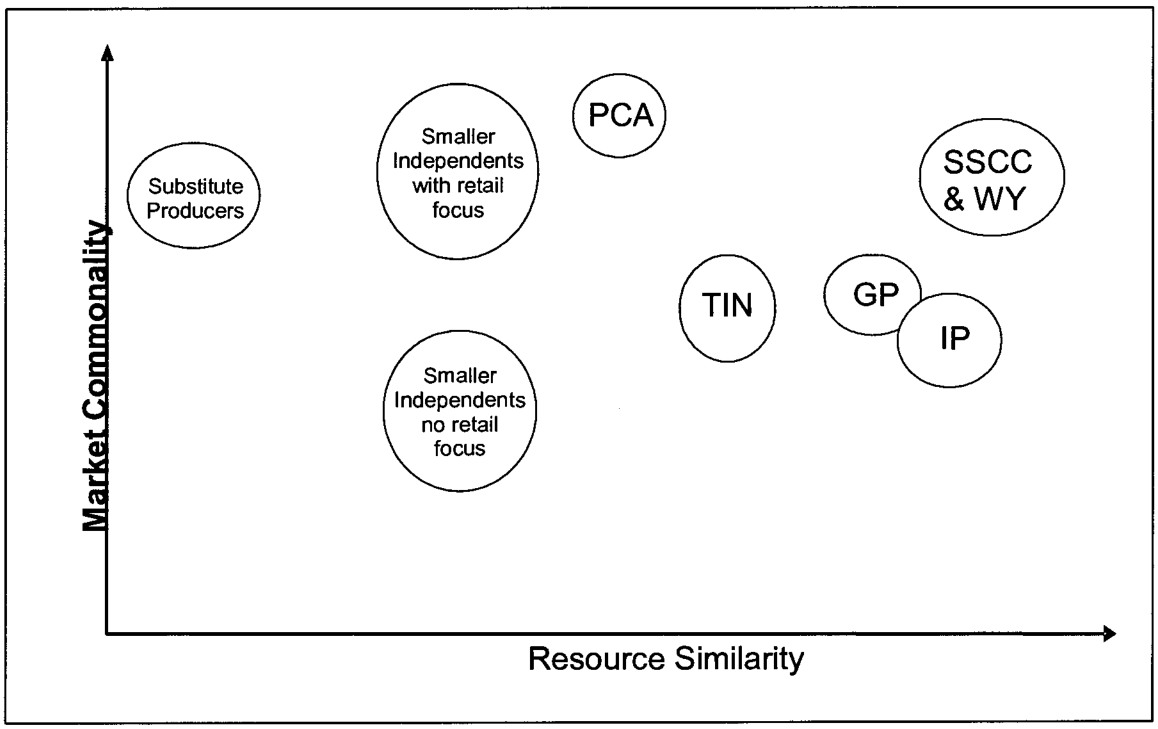
3.2 Competitive Landscape

3.2.1 Competitor Identification

Bergen and Peteraf (2002) present a framework that takes a marketplace view by considering customer needs. The significance for this paper is associated with potential profit improvement, not through increased production or lowered cost, but through stimulating growth, by bundling of products and services to meet the needs of the customer, in this case retail grocery firms. Moreover, numerous firms in the industry are espousing market driven strategies in their communication to various stakeholders. Firms are evaluated on their market commonality for their existing and potential ability to service similar customer needs. The primary need, for purposes of this mapping exercise, is one-stop shopping for packaging requirements that include creative P-O-P displays and corrugated boxes with varying levels of graphics. Another important criteria considered in the mapping exercise is the notion of "consideration set" presented by Bergen and Peteraf (2002), and evaluates the market presence of a given firm. Resource similarity is the second criteria under evaluation in the mapping exercise. The resource similarities or capabilities that are considered include scale (volume and sales revenue), market scope (national, regional or local), design for retail needs (such as P-O-P displays), degree of integration and access to the retail industry. Consistent with Bergen and Peteraf's approach, the mapping is based on Weyerhaeuser Company as the focal firm.

The competitive terrain map presented in Figure 3.3 has intentionally excluded non corrugated alternatives, having established that the threat of substitution is low in the U.S. Certainly a thorough mapping would include all packaging producers, utilizing various medium such as plastics and metal, as well as producers of medium that have yet to be applied to packaging. The mapping exercise is therefore intended to be an overview and a general scan. Six specific and large integrated firms are plotted on the map. These six firms are Weyerhaeuser Company (WY), Smurfit-Stone Container Corporation (SSCC), Temple-Inland, Inc. (TIN), Packaging Corporation of America (PCA), International Paper Company (IP) and Georgia-Pacific Corp (GP).

Figure 3.3: Competitive Landscape: Corrugated Packaging for Retail Grocery



Adapted from Bergen and Peteraf "*Competitor Identification and Competitor Analysis: A Broad-Based Managerial Approach*" 2002

The following discussion of the large integrated firms competing with Weyerhaeuser focuses on those companies identified in Figure 3.1. The discussion of GP will be somewhat dated due to limited access to information since the 2005 acquisition by Koch Industries, a privately held firm. Varying degrees of integration, on the spectrum from timber ownership to retail customers, are evident among these firms. The purpose of a description, by firm is to understand the capabilities or potential of servicing the retail industry with products and services such as displays and other retail solutions in addition to providing corrugated box solutions. The extent of the description, by firm will therefore vary depending on those capabilities. There are numerous smaller integrated firms with the capability of servicing the retail industry. Only a few of these firms are discussed. There are also a number of private equity firms active in this business but they will not be included in this discussion. The information that ensues is largely sourced from corporate websites, annual reports, and Lawson and Bell (2004).

Smurfit-Stone Container Corporation (SSCC)

Smurfit-Stone ranks as the largest corrugated box producer in the U.S. with 2005 shipments reaching 80.8 billion square feet from their 148 converting (box) plants, and market share of 18.7% (see Figure 3.1). Founded in 1968, total assets at 2005 fiscal year end were $9.114 billion. They are integrated backwards, by owning and harvesting timber, and forward by providing packaging solutions targeted at the retail industry that include P-O-P displays. Smurfit-Stone ranks in 274th position on *FORTUNE*'s list of top 1000 companies. Sales for the 2005 fiscal year were $8.396 billion, an increase of 1.3% over the prior year with 55% of total sales comprised of corrugated packaging. Net loss was $339 million as compared to a loss of $57 million in 2004. Smurfit-Stone also operates 16 containerboard mills in the U.S. and 3 in Canada and have equity ownership of 5 mills in Asia. Their corrugated box plants are predominantly in the U.S. but they do have 18 facilities in Canada, 4 in Mexico and 1 in Puerto Rico. Their consumer packaging segment includes 17 folding carton plants, 11 bag packaging plants and 14 other converting plants. Smurfit-Stone is highly integrated, using about 85% of their containerboard production internally with the remainder sold to 3rd parties.

Smurfit-Stone's annual report lists their numerous capabilities that include recycling, labels, folding carton, laminating and flexible packaging plants. Their nationwide presence provides proximity to their customers. They provide full-service design to include both structural and graphics capabilities and maintain technical and graphic centers. Their multiple creative centers and contract packaging services are targeted at the packaging display market. Their centers are in the Chicago, Bentonville (home of Wal-Mart), Hong Kong and Shangai. Smurfit-Stone's four contract packaging plants are located in Canada (3) and Mississippi (1).

In 2004-5, Smurfit-Stone created an operating unit, called i2iSM, to pursue opportunities resulting from trends in private label by utilizing both internal and external capabilities. Their product is "solutions" that include brand development and creative design by providing printing and packaging utilizing their packaging centers through services such as graphic and structural design, assembly, manufacturing, project management and supply chain analysis.

Smurfit-Stone's webcast (November 2005) presented their "Strategic Reassessment" to the financial community. This presentation outlined a three year plan and consists of the following:

- Separate manufacturing from sales and marketing
- Change measurement of manufacturing results to cost metrics
- Cost reductions that include waste, standardization, general and administration expenses and a targeted head count reduction of over 2000

- optimize machine utilization – goal to be best in class manufacturing
- Shift from plant-centric to enterprise focus by centralizing sales and marketing
- Align team around target markets
- Geographic and strategic economies of scale requiring investment in high speed equipment. Incremental capital expenditures required of $400 million
- Further rationalization of their business – targeting 20% fewer facilities. In July 2006, sold their consumer packaging division.
- Maintain specialty capabilities to 14% of their volume
- Implement common business systems
- Judicious growth based on capacity needs and demand trends.

Temple-Inland Inc. (TIN)

Temple-Inland ranks as the third largest corrugated box producer in the U.S. with 67 converting plants, and market share of 12.6% (see Figure 3.1). Founded in 1918, total assets at 2005 fiscal year end were $21.633 billion. They are integrated backwards, through ownership and harvesting of timber, and forward with packaging solutions targeting the retail industry such as P-O-P displays. Temple-Inland ranks in 433rd position on *FORTUNE*'s list of top 1000 companies. Sales for the 2005 fiscal year were $4.888 billion, an increase of 2.9% over the prior year with 58% of total sales comprised of corrugated packaging. Net income was $176 million as compared to $165 million in 2004. Temple-Inland also operates 5 linerboard mills and 1 corrugated medium mill in the U.S. Four of their corrugated box plants are located in Mexico and one is in Puerto Rico with the remainder in the U.S. that are strategically located nationwide. TIN is highly integrated using about 92% of their containerboard production for internal consumption. In 2005, about 36% of total fibre requirements were sourced from recycled fibre. Non-corrugated businesses in Temple-Inland's portfolio include lumber, real-estate and financial services. Their environmental stewardship has garnered them membership on the Dow Jones Sustainability Indexes for both global and North America.

Temple-Inland's capabilities include ability to produce intricate die-cut containers with multi-color graphics. Their nationwide presence provides proximity to their customers. They also have capabilities to create P-O-P displays and claim to provide one-stop sourcing to customers. Their financial arm not only provides services to the general public but is a source of financing for their own business needs.

Temple-Inland's strategy is to be a market driven, customer focused organization with low-cost production. Their strategy is to also increase volume internally as well as through acquisitions. Temple-Inland is a well run company and despite closing 11 plants in late 2003, TIN was able to grow volume.

Georgia-Pacific Corporation (GP)

Georgia-Pacific ranks as the fourth largest corrugated box producer in the U.S. with 54 converting plants and a market share of 11.8%. Founded in 1927, they were acquired by Koch Industries in 2005 for $21 billion. Their sales in 2004 were $19.656 billion, identical to the prior year and their packaging business contributed 16% toward total sales. Net income was $623 million as compared to $254 million for 2003. Total assets at 2004 fiscal year end were $23.072 billion. Their extent of backward integration in the packaging business is to containerboard products. Most of their raw material needs are sourced from 3rd party suppliers but their subsidiary, Harmon Associates, provides about 36% of their total fibre needs in the form of recycled fibre. They do have capabilities to provide P-O-P displays, through their Color-Box division. Georgia-Pacific also operates 6 containerboard mills in the U.S. located predominately in the Midwest and east coast. Georgia-Pacific uses 70-75% of their containerboard production for internal consumption.

Georgia-Pacific generated 42% of their total sales from their consumer products business with paper based products such as tissues, paper plates and cups. Their target customers are large retailers such as Wal-Mart, Target, Costco, Kroger and a host of other firms including Tesco plc in Europe. This alignment with mass retailers equips GP with retailer experience and knowledge of some of their branding programs. Georgia-Pacific also owns numerous trademarks and patents. Another capability is their dominant position with litho-laminated products acquired through their purchase of Color-Box in 2001. This division has 8 locations in the U.S., mostly in the east, offering multi-color products cost effectively. Georgia-Pacific also has their GP Innovations Institute that stresses collaboration with customers. Products and services include supply chain analysis and packaging design, development and evaluation, intended to reduce costs and stimulate sales for customers. The institute takes three approaches in servicing customers. The first approach is called "Packaging System Optimization (PSO)", a process to surface supply chain savings opportunities. The second approach is their "Innovation Process" which is a 5-step process to develop new product offerings. Their third approach is "Evaluation and Testing" where certified analysts validate the effectiveness of the customers' packaging, the design and new product prototypes. The institute also provides education modules for customers that include packaging fundamentals, freight regulations, tools for evaluating and predicting product strength, and skills for plant testing. Georgia-Pacific also sponsors the Independent Converters Council, an organization providing members with information on emerging technical trends.

Georgia-Pacific's strategy for 2005 included focus on high value product differentiation, mass retail relationships, inventory and capacity balance, cost advantage relative to world-class operations and optimization of their asset portfolio through sales and acquisition. They in fact became acquired by a large privately held corporation know to be nimble, financially sophisticated and a market-maker.

International Paper Company (IP)

International Paper is ranked the fifth largest corrugated box producer in the U.S. with 11.5% market share in 2005, before their acquisition of Box USA. They are the world's largest forest products company with global operations in wood products, pulp, paper, containerboard and packaging. Founded in 1898, total assets at year end 2005 were $28.78 billion. Recently IP converted most of their approximately 6.5 million acres of forestlands into a real-estate investment trust (REIT). Their integration backwards is therefore dependent on this REIT arrangement. Their product range includes display ready packaging that are containers with high-end graphics. They do not however provide display solutions such as P-O-P to retailers. They deploy a regional concept of graphics support with four centers to support their consumer packaging businesses.

Ranked 82 on *FORTUNE*'s list of top 1000 companies, International Paper has extensive operations in containerboard and converting (box) plants. Their presence is largely in the eastern U.S. Sales for fiscal 2005 were $24.1 billion, an increase of 3.2% over the prior year with 35% of the sales generated from their containerboard and packaging business. Net income of $1.1 billion was a vast improvement over the loss of $35 million in 2004. International Paper is also highly integrated, using 70% of their containerboard production for their converting facilities. International Paper is undergoing a transformation of their business and announced possibilities of divesting or potentially spinning off portions or entire segments. Proceeds of their timberlands sale, to a REIT, were used to pay down their debt of over $12 billion at 2005 fiscal year end. Debt reduction in 2005 contributed to their negative cash flow of $955 million. International Paper's focus is for further debt reduction, cost reduction and revenue improvements. Recently they also spent nearly $1.4 billion for share repurchases. Their focus is to lower manufacturing and supply chain costs, improve their product mix and grow with target customers.

Packaging Corporation of America (PCA)

Packaging Corporation of America is the sixth largest corrugated box producer in the U.S. with 2005 shipments of 31.2 billion square feet from their 68 plants and market share of 8%. Founded in 1867, PCA is unique among the major competitors in that they only operate in this segment. Their total assets at 2005 fiscal year end were $1.973 billion and net income was $53 million, compared to $69 million in 2004. Sales in 2005 were $1.994 billion, an increase of 5.5% over the prior year. PCA also operates 4 containerboard mills, all in the U.S. Their integration backward is to the extent of containerboard production where they convert 82% for internal use. In place of timberlands ownership, they lease the cutting rights to 108,000 acres of timberlands.

Forward integration extends into retail packaging solutions such as P-O-P displays. PCA is positioned as 811th on *FORTUNE*'s list of top 1000 companies.

A major advantage that PCA possesses is their ability to dedicate all their resources to a single business line with solid financial results. Their capabilities include high-end multi-color graphics used in P-O-P displays and retail packaging. Their operations are national however concentrated east of the Mississippi river. Their converting plants are typically of smaller scale than the other integrated firms due to their focus on smaller regional customers. Their differentiation strategy includes value-added products, autonomous operations, a large customer base (8,300 customers) and focus on local accounts (70%). The overall strategy that PCA has adopted involves focus on their single line of business, growing corrugated volume through internal growth and acquisitions and delivering shareholder value through financial and strategic flexibility.

A summary of the six integrated firms, provided in Table 3.2, highlights some financial information as well as product description and markets. Of the largest six firms, all but PCA operate in multiple sectors. In total these firms captured about 81% of the market share, leaving the remaining 19% for the balance of the 1,400 firms in the industry.

There are numerous firms with abilities to provide corrugated packaging products and services to retail grocery firms. Three other integrated producers of corrugated packaging are summarized in Table 3.2 all offering P-O-P displays as part of the product portfolio. Greif operates 160 locations in more than 40 countries while Longview Fibre's locations are throughout the U.S. Rock-Tenn has facilities in all three North American countries and some South American countries and is very focused on P-O-P displays.

Table 3.2: Largest Six Integrated Corrugated Packaging Producers in the U.S. (All Public Companies)

Sales, Net Income and Total Assets based on 2005 year unless otherwise noted ($millions)

Company	Sales	Net Income	Total Assets	Description of Packaging Related Products	Markets
Georgia Pacific - *2004*	19,656	623	23,072	Linerboard, medium, corrugated containers, display ready packaging, double and triple wall boxes, water resistant packaging, P-O-P displays,	Food, produce, beverage, agricultural, bulk, automotive parts, chemical, synthetic rubber, stampings and forgings
International Paper	24,097	1,100	28,771	Containerboard, packaging board, industrial and consumer packaging products.	Agricultural, meats, juice, milk, food, bulk industrial, cosmetics, pharmaceuticals computer software, tobacco, automotive
Packaging Corporation of America	1,944	53	1,973	Sheets, Containerboard, corrugated, multi-color boxes and displays, meat and wax-coated boxes, shipping containers, linerboard	Food, beverages, agricultural, paper, appliances, machinery, automotive, petroleum, plastic, synthetics, rubber
Smurfit-Stone Container Corporation	8,396	(339)	9,114	World's largest producer of paperboard and paper-based packaging. Recycler. Corrugated containers, containerboard, specialty products, folding carton	Home appliances, electric motors, small machinery, grocery, produce, computers, books, furniture
Temple-Inland	4,910	176	21,633	Corrugated cartons and boxes, P-O-P displays, commodity brown boxes, multi-wall bulk containers, tear and water resistant packaging paper	Food, paper, glass containers, chemicals, appliances
Weyerhaeuser Company	22,629	733	28,229	Bags, Recycling, Linerboard, corrugated medium, corrugated containers, multi-wall boxes, industrial, consumer and agricultural packaging, specialty products, Wax-replacement boxes, P-O-P displays	Food, beverage, agricultural, consumer, industrial, produce

Adapted from Lawson and Bell "CORRUGATED CONTAINERS A Mergers and Acquisitions Review" August 2004

Table 3.3: Other Integrated Corrugated Packaging Producers in the U.S.

Sales and Net Income based on 2005 ($millions)

Company	Sales	Net Income	Description of Packaging Related Products	Markets
Greif	2,425	105	Industrial shipping containers, containerboard and corrugated products, fibre drums, medium, linerboard, sheets, corrugated containers and material for protection, bags, P-O-P displays	Agricultural, automotive, ceramics and glassware, food and beverage, furniture, home and building products, industrial and pharmaceutical
Longview Fibre	898	10	Corrugated containers, specialty packaging, P-O-P displays, bags	Computers, appliances, furniture, toys, foods, produce, beverages, hardware, other bulk markets
Rock-Tenn	1.733	18	Packaging, merchandising/ P-O-P displays, specialty paperboard, corrugated medium, folding cartons, solid-fibre interior packaging, corrugated packaging, sheets,	Food, consumer and industrial products

Adapted from Lawson and Bell "CORRUGATED CONTAINERS A Mergers and Acquisitions Review" August 2004

There are firms in the business of providing displays, such as P-O-P, who do not possess corrugated production capacity and therefore source these materials from other firms. These firms are under consideration because of their focus and success in the value adding segment that some of the large corrugated packaging firms are pursuing. These companies are dedicated to providing solutions to the retail industry that include P-O-P displays and other in-store merchandising but tend not to have a national or even regional presence. They could choose to integrate backward and internalize their corrugated needs however the capital required would likely discourage such an action. However they could become partners with corrugated manufacturers that are seeking to enter or increase their presence in the value added segment of retail displays. These smaller, dedicated firms tend to be more successful with retail graphics as they are more flexible, more responsive and can be more creative. The firms are usually small with one or a few locations, relying on a single graphic capability and services created to serve that competence. As a result, these firms are often positioned to do anything for the customer.

The list of such firms is too lengthy to provide and the products and services they provide involve an array of materials such as corrugated, plastic and metals and touching virtually every channel in the retail industry. Such companies would all be characterized as having creative design capabilities, often competing for awards at annual trade shows. Some firms provide supply chain services such as contract packing and fulfillment whereby customers' product is placed on displays prior to delivery. The scale of operations varies with some firms operating at an international level while others are focused on local business.

3.2.2 Competitor Analysis

A framework provided by Bergen and Peteraf (2002) has been applied to evaluate Weyerhaeuser's competitive position and predict rivalry. The analysis is intended to provide an overview rather than an extensive evaluation. Weyerhaeuser should undertake further competitor scanning and analysis to obtain a more thorough understanding of the competitive landscape. This will provide for further insights into new opportunities to pursue cooperative or dominance strategies. A thorough analysis would also establish opportunities to influence customer needs.

Figure 3.4 illustrates the competitor positions relative to Weyerhaeuser, with the right side of the grid representing relative balance in capabilities while the left side represents imbalance of capabilities. Only firms identified in Table 3.2 and Table 3.3 have been considered but many more competitors would be included in a thorough analysis.

Figure 3.4: Competitor Analysis

Indirect Competitors	Producers of substitute products vs. Weyco Design houses focused on Retail displays & in-store merchandising vs. Weyco	
Potential Competitors	Corrugated packaging producers with no retail focus vs. Weyco	International Paper vs. Weyco Georgia-Pacific vs. Weyco
Direct Competitors	Packaging Corp. vs. Weyco Temple-Inland vs. Weyco Greif vs. Weyco Longview Fibre vs. Weyco Rock-Tenn vs. Weyco	Smurfit-Stone vs. Weyco
	Low	**High**
	Resource Equivalence	

Adapted from Bergen and Peteraf "Competitor Identification and Competitor Analysis: A Broad-Based Managerial Approach", 2002

Bergen and Peteraf (2002) state the drivers of competitive behaviour to be awareness, motivation and capability. Their framework places motivation and capability on the right side of the grid and represents balance in resource equivalence. All firms indicated to the right are comparable in capability and therefore balanced in terms of resource equivalence. The degree of threat increases moving from direct competitors to indirect competitors and is largely a function of awareness. Therefore International Paper and Georgia-Pacific would be deemed as greater threats than Smurfit-Stone. International Paper and Georgia-Pacific have high resource similarities but lower market commonality. The left side of the grid illustrates imbalance, relative to the focal firm, in this case Weyerhaeuser, and can reveal both opportunities and threats. Among the direct competitors, Figure 3.4 indicates that Weyerhaeuser has more capabilities and therefore has an advantage over direct competitors identified on the left side of the grid. A position of advantage would then present opportunities as opposed to threats.

The level of awareness is illustrated through the relationship between direct, potential and indirect competitors. Managers are typically most cognizant of firms with similar capabilities and therefore direct competitors are most aware of one another. Therefore Weyerhaeuser and Smurfit-Stone are very much aware of one another's capabilities. Bergen and Peteraf (2002) suggest that an environment of balance actually deters a competitive action because of the likelihood of response to an attack. However the likelihood of some competitor action is higher from potential or indirect competitors. There may be less awareness of potential or indirect competitors with less or different capabilities and market activity.

Focal firms in a position of advantage, due to capabilities, should take measures to increase awareness of their market presence and capabilities, to avert an action of rivalry. This is essentially a signal of power and warning to the less capable firms. On the other hand, firms in a weaker position should minimize awareness of imbalance, taking a defensive approach to prevent an action of rivalry. This would explain Bergen and Peteraf's notion that lack of rival awareness contributes to unawareness of balance with competitors. Firms can also choose to signal competitors of capabilities, stronger than they really possess, in order to reduce possibility of attack. Weyerhaeuser holds a dominant position when compared to firms with less resource capabilities and should take measures to increase awareness of their market presence and capabilities.

In conclusion, on the basis of Bergen and Peteraf's concept, Weyerhaeuser should view International Paper and Georgia-Pacific as greater threats because of the latter firms' high resource capabilities and Weyerhaeuser's somewhat reduced awareness of these potential competitors. They are both large, multi-sector, highly integrated firms with a large asset base and capable of acquiring additional capabilities to integrate further into the retail environment. Georgia-Pacific, through their consumer products division already has strong relationships and experience with retailers and their private label programs. It will be more difficult monitoring Georgia-Pacific now that they are part of a private corporation. Weyerhaeuser's high resource capabilities should also be viewed as providing a competitive advantage when compared to firms with fewer capabilities, and this presents opportunities. The awareness between firms such as Temple-Inland, Packaging Corporation of America, Weyerhaeuser and other firms that have been both noted and excluded, is high because they are direct competitors. Bergen and Peteraf's concepts would suggest lower awareness exists between Weyerhaeuser and smaller corrugated producers dedicated to packaging displays or firms producing substitute products. The degree of awareness is likely dependent on the level of competitor scanning undertaken, and that information is understandably not willingly shared. The application of Bergen and Peteraf's framework suggests likelihood of competitive action between Weyerhaeuser and Smurfit-Stone is reduced because of the balance in resource equivalence and high degree of awareness. Both firms are reportedly pursuing similar strategies of separating manufacturing from sales and marketing and scaling up mills and that could well lend itself to a continued balance in resource equivalence and market commonality.

4 SWOT ANALYSIS

This chapter provides an internal view of Weyerhaeuser Company using a SWOT analysis (strengths, weaknesses, opportunities and threats) where strengths and weaknesses illustrate the internal while opportunities and threats are external to the firm. Competitive advantage occurs when a firm's strengths align with opportunities. Areas of focus in identifying strengths and weaknesses include organizational, human, financial, management/leadership, marketing, information systems and operational resources.

4.1 Strengths

Weyerhaeuser Company, ranked 90th on *FORTUNE*'s list of top 500 companies has developed and nurtured a breadth of capabilities over 106 years and the following discussion provides an overview of those strengths. The firm started as a timber company, acquiring vast timberlands holdings to become the largest timberlands owner in the world. Of course the asset value is represented at historical cost but control of raw material is a key strength. Despite being in a business prone to public scrutiny, Weyerhaeuser is highly regarded for their environmental stewardship and is a member of the Dow Jones Sustainability Global and North America Indexes. The recycling division supports environmental responsibility and contributes as a fibre source. Weyerhaeuser is a respected employer, sets high ethical standards of employee conduct and sponsors many charities, foundations, communities, and noble causes. The company has an international presence and is highly integrated from the forest to the retailer's store.

A core competency is operational strength, technically as well as in capacity. The equipment is well maintained and investments are continuously made in new technologies to capture new marketing opportunities, improve quality, reduce cost, reduce the environmental footprint and ensure employee safety. Weyerhaeuser operates a Research and Technology Center to develop innovative solutions to meet customer needs. Numerous patented and proprietary products and processes have been developed and marketed. The company is one of the few firms certified to test for corrugated 'recyclability' and 'pulpability' in the industry. They have capacity to meet demand and the system provides for a variety of graphics capabilities. The benefits from scale of operations include cost reduction, replication of best practices and flexibility to meet customer needs. Weyerhaeuser operates some of the lowest cost facilities in the industry and also has alliance partners to fill voids in capabilities. Weyerhaeuser has also taken a market driven, as opposed to a plant-centric, approach to conducting business.

Information technology strengths include plant control systems, e-commerce capabilities and progression towards a company wide enterprise business system.

Weyerhaeuser has a favourable reputation for quality products and services and at times takes a leader position in pricing. The breadth and location of facilities and products provide for access to markets and customers. The company endeavours to develop and maintain strong business relationships with customers, and the scale of operations positions them to service very large customers. The portfolio of products and services are offered to a large range of customers in a wide variety of industries. This diverse customer base does mitigate some risk associated with an industry largely influenced by general economic conditions. Weyerhaeuser's extensive knowledge of retail grocers is of relevance to this paper.

A rigorous process of hiring, performance management and succession planning has been in place for many years. Employee development is encouraged and competitive compensation plans are additional factors that attract quality people to the organization. Weyerhaeuser also promotes a team based work culture and decision making processes.

Weyerhaeuser's size and breadth of business sectors has generated benefits of scope by centralizing many support functions such as purchasing, human resources, finance, information systems and transportation.

Weyerhaeuser has had 106 years to develop a full breadth of processes to improve on areas such as safety, operations, planning and forecasting as well as ensuring compliance to a wide set of regulations typical of a large publicly held forest products company.

Further strengths specific to Weyerhaeuser's Retail Experience Network business include a creative work force, project management, processes providing for competitive advantage, international capabilities, design and structural expertise, ability to utilize substrates beyond corrugated, a range of services from basic displays to full turnkey solutions involving multi-product, multi-vendor displays and the latest technology in digital printing. Furthermore, the existing facilities and sales centers are located strategically to markets and customers, including China, and operate as a system to improve speed to market.

Weyerhaeuser is a complex corporation, operating in many countries, sectors and markets. The ability to harmonize all the components to be a dominant firm in the industry should be viewed as a core competence.

4.2 Weaknesses

Some of Weyerhaeuser's strengths also pose as weaknesses. The company is a large, mature, publicly held corporation operating in a renewable resource based industry. Furthermore, the industry is mature and faces low growth nationally. Weyerhaeuser is a target of competition and environmental action groups by virtue of its size and nature of business. The bureaucracy required to operate such a large firm in a highly regulated industry results in a maze of processes and organizational levels that slows the decision making process. Weyerhaeuser also doesn't have the advantages of privately held firms in terms of decisiveness, policy, risk taking and flexibility. Weyerhaeuser's cost structure is also negatively impacted by the size of the company, the leadership position taken on a number of initiatives and selected competencies they choose to retain internally. These include environmental and corporate stewardship as well as research and development. The complexity of the firm and subsequent infrastructure to fuel the business also contributes to higher costs.

The range of product and service offerings in Weyerhaeuser's CBPR business are not widely known and understood by all the members of the sales group and the business complexities are a contributing factor. The business encompasses products and services beyond boxes of varying structure, shape and graphics.

Although elements of information technology are strengths, the fully integrated business wide enterprise system is still evolving so current inefficiencies and deficiencies add costs and constrain decision makers. The vast undertaking of integrating businesses to a common platform has been aggravated by the numerous acquisitions the company undertook. Massive changes in organizational structure that began a few years ago include centralized support services and resultant reduction in employees. The highly competitive nature of the industry and pressures to reduce costs, have also contributed to a reduction in employees. There are fewer people to do the work and the organization is undergoing further change. Financial performance has also been weak over the last few years where supply has exceeded demand, resulting in price erosion. Customers have generally had high bargaining power. Key financial ratios are provided in Table 4.1 for the years 2000-2004. Results specific to the containerboard and corrugated business segment are not available however Weyerhaeuser Company's return on net assets neither meets their goal of 17% nor satisfies the shareholders. Their debt to equity ratio is declining and was 1.91 for 2005 as they continue to disencumber themselves from the large debt assumed with the Willamette Industries acquisition.

Table 4.1: Weyerhaeuser Company – Financial Ratios 2000 – 2004

	2000	2001	2002	2003	2004
RONA	9.20%	4.60%	4.09%	4.42%	9.72%
Financial Leverage	2.66	2.73	4.26	4.02	3.24
Net Asset Turnover	0.99	0.88	0.71	0.76	0.83
EBIT Margin	9.33%	5.20%	5.74%	5.82%	11.71%
SG&A	4.25%	4.85%	4.83%	5.10%	4.57%
Debt to Equity	1.66	1.73	3.26	2.03	2.24

Some further weaknesses specific to the Retail Experience Network include the relative newness of the business to Weyerhaeuser and therefore some lack of awareness in the marketplace. Consequently, there is a need to shape the appropriate customer base for the system. The imposition of a bureaucracy, expected of a large corporation, is occasionally at odds with the needs of a culture that fosters creativity and innovation to be an attractive solution for customers.

4.3 Opportunities

The state of the industry and trends in retail are two broad areas of opportunity for Weyerhaeuser. Growth for corrugated packaging is relatively stagnant in the U.S. but growing in regions such as Asia and Latin America. Contributing factors are the shift in manufacturing from the U.S. to countries such as China, and increased consumption of goods as the standard of living improves. Although China's production of corrugated packaging is on the increase there may still be opportunities to expand production of corrugated packaging offshore and there are certainly opportunities for retail ready packaging solutions.

Another area of opportunity, for Weyerhaeuser, is to increase access to the retail display and solutions market. The retail industry is consolidating and small retail stores are being displaced with large chains and big-box stores. This creates the opportunity for Weyerhaeuser to expand their retail solutions business as typically it is the larger retailers that seek these products and services and it also lends scale to the operations involved in delivering those needs. Expansion can be through acquisition or alliances with firms in the retail display and solutions business or through new retail centers introduced in strategic locations.

An opportunity also exists for Weyerhaeuser to increase awareness of their retail packaging solutions business because of their relatively recent entry in the business. Another venue for growing this business is by leveraging the breadth of Weyerhaeuser packaging products so retailers are purchasing not only their box needs but also buying bags and displays. Bundling of products and services has the potential to increase demand for all products in the portfolio.

Weyerhaeuser has a commendable environmental program and a strong reputation for a firm in the forest products industry. They have opportunities to further market that reputation, ultimately reaching consumers. Wal-Mart's environmental initiative to reduce packaging by 5% and shift to reusable and recyclable packaging also bodes well for corrugated material. Weyerhaeuser's sales force is in a position to gain understanding of the processes and issues that Wal-Mart's suppliers face in meeting the expectation, then find solutions and market that competency.

A final but very important opportunity relates to the role of packaging in the retail grocery industry. As previously discussed, consumers are seeking convenient, healthy options and environmentally responsible packaging. These trends are influenced by an aging population, more informed shoppers, concerns for the environment, desire for a simpler life style and lack of time for meal preparation. Consumers have also increased acceptance of private label over national brands. Firms in the competitive retail industry are striving to differentiate themselves, increase customer loyalty, and increase profits by reducing costs, stimulating sales and improving gross margins. One avenue for retailers to improve gross margin is by retaining some of the profits national brand manufactures have enjoyed and introducing their private label products. Acceptance of private labels, as an alternative to national brands, is showing positive trends.

Firms in the retail industry are increasingly looking for solutions from their suppliers to reduce their costs and increase customer loyalty. One avenue for accomplishing these goals is to influence their suppliers' packaging decisions. More and more firms are examining their supply chains, searching for efficiencies and cost reduction. Firms are also less reluctant to outsource key services and that enables them to focus on their core business. These needs and trends provide possibilities for Weyerhaeuser to pursue.

4.4 Threats

Weyerhaeuser faces a number of threats, many of which are common to other firms in the industry. One area of concern pertains to the demand for corrugated packaging in a mature industry. The shift in manufacturing from the U.S. to Asia is negatively impacting growth, forecasted to be a modest 2% over the next few years. Europe tends to use more recycled plastic containers, a trend that could eventually migrate to the U.S., although heightened concern on the environmental impact and high petroleum costs may mitigate that threat. The industry has been in a state of overcapacity, and although firms are rationalizing their businesses to create a state of equilibrium, the balance could tip with a decline in demand. This would likely result in competitive actions and eroding prices for Weyerhaeuser.

China's influence on costs is a looming threat. Growth in manufacturing has created a demand for corrugated packaging in China and in response some large Chinese firms are building large scale facilities to meet demand. The OCC demands to feed these mills will likely escalate prices and negatively impact Weyerhaeuser's cost of production.

Another possible threat is a customer portfolio that increases the risk of declining demand. Economic and social indicators affecting customers could be misread, and the customer mix, thought to sustain desired growth and profitability, may have opposite results. An example is the increasing acceptance of private label products over national brands. More focus needs to be placed on retail grocery firms that have internal capabilities to produce their own private label products because of the potential declining demand for packaging from national brand manufactures.

Corrugated retail displays are a popular format for stimulating sales. Different formats do exist and are being used. One format is in-store media utilizing television or computer monitors, and could displace some or all corrugated displays as a vehicle for stimulating sales. Currently there are mixed reviews as to the effectiveness of alternate formats but Weyerhaeuser does need to monitor this.

4.5 SWOT Summary

The following SWOT chart summarizes Weyerhaeuser's strengths, weaknesses, opportunities and threats (SWOT).

Table 4.2: SWOT Summary – Weyerhaeuser Company

STRENGTHS	WEAKNESSES
• Large dominant company in the industry • Reputation • Processes • Environmental Stewardship • Respected employer • International presence • Scale of operations • Operational strength • Research & Development • Patents & Proprietary products and processes • Quality and service reputation • Portfolio of products and services • Customer relationships • Hiring, performance management & development • Migrating to common IT platform • Retail Displays and solutions capabilities and strategic locations • Harmonization of complex organization	• Size of firm impedes nimbleness, decisiveness • Mature organization • Overhead cost structure • Sales capabilities for large portfolio of products • Current inefficiencies in information technology • Massive changes • Financial performance • Immature Retail displays and solutions business
OPPORTUNITIES	**THREATS**
• Increase market share in corrugated packaging • Increase market share in retail displays & solutions • Trends in Private Label • Consolidation in the retail industry • Bundling of products and services • Leverage environmental reputation • Leverage capabilities to address Wal-Mart's environmental initiatives • Become the solutions provider for retailers' private label programs	• Shift in manufacturing from U.S. to Asia • Potential migration of Europe's affinity to recycled plastic containers • Price erosion due to overcapacity • China's impact on OCC costs • Customer portfolio mismatch to market trends • In-Store media replaces corrugated displays • Mature industry

5 RECOMMENDATIONS

The U.S. corrugated packaging industry has been adversely affected by overcapacity and Previous discussions elaborated on the competitive nature of both the corrugated packaging and retail grocery industries, trends in private label and consumer trends. Prior to the discussion on recommendations for Weyerhaeuser, a recapitulation of the benefits of corrugated packaging and retail ready displays as well as retail grocers' needs is provided.

5.1 Retail Grocers and Corrugated Packaging

Corrugated packaging not only provides the basic functions of product protection and containment and can also provide additional benefits to customers. It is the lowest cost packaging solution, durable, and saves space during shipping and storage. Its lightweight results in lower transportation costs and recycling generates revenue. Corrugated packaging also has other environmental attributes that include use of recycled material, is sourced from renewable resources and has a high recovery rate due to a well established recycling infrastructure. Corrugated packaging can be highly customized for shape, strength and graphics. It can be the interface to the end-user, conveying various messages about the product and stimulating sales. The messages can represent the company distributing the product and they can convey brand personality very effectively and quickly.

Retail displays using corrugated materials are a cost-effective means to influence consumer purchases and the benefits of P-O-P displays are numerous. They can be dedicated to a single product or can accommodate multiple SKUs and multiple vendors. The latter is a format that has potential for retail grocers in generating demand for their private label. Displays revolving around a theme contain all the products a consumer requires. These products may be supplied from a large array of manufacturers and include the retailers private label. Attractively displaying a combination of products, as a solution to the consumer, can stimulate demand for all manufacturers involved and increase sales for the retail grocer. P-O-P displays also benefit the customer by lowering inventories and lowering store labour because they are deployed onto the retailer's store floor and set-up requires minimal training and time.

As previously stated, retail grocery firms essentially have three needs: stimulate sales, sell more of their private label, and reduce costs. They need packaging that exudes their brand personality, knowledgeable suppliers that are responsive to their needs, and supply coordination. A supplier that can provide all these needs reduces the retailer's procurement costs for packaging solutions and can reduce their in-store labour. Often retail grocers don't have the sophisticated resources that national brand manufactures have in developing and nurturing their private labels.

Solutions to the retailer grocer's needs, to stimulate sales and reduce packaging, can be provided by Weyerhaeuser. These solutions include becoming a single point of contact and managing the supply chain between the supplier and the retailer for packaging and display needs and programs. Weyerhaeuser has an assortment of products and services to bundle as a single offering and a network to fulfill those needs, including creative solutions to generate more impulse purchases. Weyerhaeuser can also provide solutions to help retailers manage their shelf space and offer other cost savings solutions.

5.2 Recommendations

The recommendations for Weyerhaeuser involve three areas of opportunity and will be discussed in further detail. The first recommendation is to leverage the capabilities in retail ready display products and services, becoming experts and the industry leader in private label packaging programs. The second recommendation, a natural extension of the first recommendation, is to exploit the exposure to retailers' suppliers and increase corrugated box market share. The third area is to develop and market competencies to assist suppliers with compliance to Wal-Mart's sustainability initiative, specifically right sizing of packaging.

5.2.1 Leverage Capabilities to Service Retail Grocers

Many of the large retail grocers have implemented private label programs as a means to improve profitability and look to packaging solutions to elevate their brand sales and loyalty. Some retailers have well established private label programs and may look to revitalize the brand with new packaging. Other retailers may be contemplating or are at early stages of a private label rollout. Weyerhaeuser's opportunity is to become the single point of contact, for packaging solutions, to escalate brand adoption. Two formats are discussed. One is focused solely on the private label and the second one involves private label positioning along national brands.

The first format involves graphic and structural features of shelf ready displays that require integration and consistency across the various product lines of a private label program. Retailers with private label programs have three sources for their product. They can produce internally, outsource to national brand manufacturers, or utilize independent manufacturers. The private label line invariably involves numerous product lines and with the exception of internal sourcing, requires a multitude of vendors, or if sourced internally, numerous production facilities. Retailers find that implementing a shelf ready packaging program draws needed resources away from growing their business and instead to coordinating the packaging for their private label program. Weyerhaeuser can provide the solution to the retailer by working with the retailer to create the desired graphics and structural specifications and then interface with the multiple vendors to ensure consistency and compliance. Retailers benefit by dedicating more of their resources to other value adding parts of their business. Suppliers also benefit by knowing their packaging complies with their customers' requirements. Weyerhaeuser benefits through the revenue generated from providing such a service. Developing a model, benefiting from the experience curve and replicating to other retail firms will further stimulate sales for Weyerhaeuser.

Complex product promotions that use multiple vendors and multiple SKUs often utilize P-O-P displays, a desired but difficult format for retailers to execute on their own. The formats often involve private label products positioned along national brand products. There is significant interest from retailers and consumer product goods companies for such programs where a competent firm can assume management of such a program. The programs can be extremely effective in stimulating sales for the retailer and generating demand for the suppliers involved. Often the increased sales are sustained to some degree after the promotion event. The consumer is attracted to the convenience and emotions that the display elicits. These programs require unique relationships to be able to assemble the various partners of such displays. Other needs include high levels of project management, inventory management, administration, logistics, communications, and typically these projects are funded by both the retailer and all the suppliers. The displays require structural design to accommodate a variety of product shapes, sizes and weight and the graphics requires product integration and messaging. Retailers and consumer product goods manufacturers avoid pursing these programs on there own because of the complexity.

Weyerhaeuser should leverage their capabilities in managing multiple vendor, multiple SKU programs by marketing and selling themselves as the service provider for complex displays such as the one described above. All the coordination activities from design to invoicing would be part of the services. This model should be perfected and replicated. Using digital printer capabilities, this program can also be implemented for smaller firms operating at a regional or local level as well as working with buying groups or distributors such as Supervalu.

Implementing these formats requires an intimate knowledge of the retailer's private label program. Capturing the essence of the label personality will assist the graphic designers with developing creative eye-popping packaging complete with brand messaging to stimulate consumer buying.

5.2.2 Provider of Corrugated Packaging to Suppliers of Retailers

The first recommendation, discussed above presents another opportunity for Weyerhaeuser, and that is to gain market share of corrugated box packaging and other products such as paper bags. As the single point of contact for display programs, Weyerhaeuser now needs to capitalize on the relationships developed with the product vendors involved in the multiple vendor displays or roll out of private label programs. These vendors are the national brand and private label manufacturers. Weyerhaeuser also has the opportunity to sell a bundled set of solutions to the retailer to now include paper bags for their stores and corrugated boxes to their internal production plants, where applicable. This will require a new set of skills for the sales force or an organizational structure of teams to sell a wider breadth of products. Many of Weyerhaeuser's sales force are knowledgeable and experienced in selling one or a few of the products, with the fewest skilled in the retail display area and the most skill in boxes. With well over 500 sales employees, skill development across the entire group encompassing all products is a large undertaking. A preferred method may be team based selling, where the appropriate group is assembled dependent on the skills and knowledge gap. Working in teams will also provide for transfer of knowledge over time.

5.2.3 Supplier of Choice for Wal-Mart's Package Right Sizing

One element of Wal-Mart's sustainability initiative includes right sizing as part of their 5% reduction in packaging. A mandate will be given to their suppliers with a targeted implementation date. Weyerhaeuser's opportunity is to leverage their highly regarded environmental reputation and firm size, thoroughly understand Wal-Mart's requirements and develop initiatives to assist Wal-Mart's suppliers in becoming compliant with the initiative. Weyerhaeuser might also be in a position to drive the demand for this service through Wal-Mart, again using their reputation and expertise as leverage. Becoming the solution experts, Weyerhaeuser might approach Wal-Mart for endorsement as the consultant of choice. The assessment and recommendations would be a service, sold at a fee and the assessments may generate leads for additional business with these Wal-Mart suppliers. These assessments may also involve Weyerhaeuser's MPS for mechanical improvements. This recommendation presents the opportunity to develop or strengthen existing relationships with these producers to potentially generate additional sales and therefore increase market share.

All the recommendations presented above can be launched using Weyerhaeuser's retail centers as the interface to retail grocers of private label products. The resulting access to retail suppliers provides the opportunity for increased sales of corrugated boxes by utilizing sales expertise and production capabilities nationwide.

6 SUMMARY

The U.S. corrugated packaging industry has been adversely affected by overcapacity and trends in offshore manufacturing. The mature industry expects growth to be modest, at about 2%, and financial results over the past few years have been dismal. Generally, the industry focus had been one of high volume and low cost, however more of the large firms are seeking differentiation strategies to improve profitability and maintain or increase market share.

Weyerhaeuser Company's forward integration into retail packaging provides the firm with capabilities to differentiate themselves somewhat from their competitors. Some of the other large corrugated packaging manufacturers also have retail packaging capabilities but no one single firm appears to dominate this value added business.

The retail grocery industry is also highly competitive and undergoing consolidation and channel blurring where increasingly, non food items and services are provided. Growth in retail grocery has averaged 3.5% over the past five years however growth in mass and warehouse club formats have more than doubled. These industry dynamics have prompted retail grocers to seek opportunities to lower their cost structure, differentiate themselves and generate customer loyalty. Two approaches to achieving these goals are through private label product offerings and responding to consumer trends in areas such as healthy lifestyles, convenience and environmental responsibility. With only a few seconds to capture the attention of consumers, retailers recognize the importance of packaging to stimulate impulse buying. The retailer's increased influence on packaging presents an opportunity to the packaging industry.

Currently, private label products represent about 20% of purchases in the U.S. and expected to increase. These products have become pervasive among large retail grocery firms and are often multi-tiered programs appealing to a variety of consumers. Some retail grocery firms, such as Kroger, have internalized production of their private labels while others have outsourced their supply. National brand manufacturers face the paradox of losing market share to private labels and manufacturing private label products for retail grocery firms. Here lies the essence of the issue for packaging firms highly reliant on national brand manufacturers. A case in point is ConAgra Foods' (leading national brand manufacturer), announced restructuring plans that involve closures of five plants. Growth opportunities for national brand manufacturers will not come from population growth, expected to be less than 1%, in the U.S. Corrugated packaging firms would be prudent to examine their customer portfolio to mitigate the downside risk of such a trend.

The recommendations presented to Weyerhaeuser are considerations to capture market share, reduce exposure to declining national brand demand and enhance returns from the added value business of retail ready packaging. Essentially these recommendations are:

- Intimate knowledge of private label programs to leverage shelf ready and display capabilities.

  Two tactics are recommended, both involving products and services to retail grocers' private label programs. The first tactic is to become the packaging single point of contact between the retailer and their suppliers. The second tactic is to leverage capabilities in retail displays to promote the retailer's private label. Many retailers are interested but have not entertained multiple vendor, multiple SKU displays because of the complexity that involves both private label and national brand products.

- Capitalize on access to retailer suppliers.

  Implementation of the first recommendation does require access to suppliers of retail grocery firms. Weyerhaeuser's opportunity is to not only provide the required specifications to these suppliers but to also sell corrugated packaging and services. This has the potential to increase market share but will require some changes in the sales organization.

- Solutions Provider to comply with Wal-Mart's sustainability initiative.

  Weyerhaeuser has an opportunity to leverage their environmental reputation and capabilities and market themselves as a solutions provider to comply with Wal-Mart's sustainability initiative. Obviously obtaining endorsement from Wal-Mart as a consultant of choice would be ideal but there are other means to achieve the desired result of generating increased sales. The opportunity is to develop relationships with these Wal-Mart suppliers and convert them to become Weyerhaeuser customers, thereby increasing corrugated box market share.

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