Final Exam
Briefing Memorandum
The Continental and Northwestern Company Case

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1. Derive current year (FY2003) projected market share and ROI goals for the merged C&NW Company from the S&P industry analysis web site above (this will be a prediction/assumption on the student's part, based on information found at the web site, using Georgia Pacific for the Continental figures, and International Paper Company for Northwestern figures). Completing this step will prepare you to answer the question on super ordinate goals.

Pre-merger Continental and pre-merger Northwestern are the two largest domestic firms in the paper and forest products industry. Once the two are combined, the new C&NW firm will out-produce the next five largest firms in the industry.

Continental (based on Georgia-Pacific Corp.) [Data in million $]

	2002	2001	2000
Operating Revenues	25,016	22,076	17,796
Net Income	-476	343	716
Ratio Analysis [Expressed in %]:			
Return on Revenues	-1.9	1.6	4.0
Return on Assets	-1.8	1.5	5.3
Earnings per Share ($)	-2.09	1.95	4.17

Northwestern (based on Int'l Paper Co.) [Data in million $]

	2002	2001	2000
Operating Revenues	26,363	28,180	24,573
Net Income	-1,142	268	199
Ratio Analysis [Expressed in %]:			
Return on Revenues	-4.3	1.3	0.8
Return on Assets	-3.1	1.0	0.7
Earnings per Share ($)	-2.37	0.82	0.48

Based on the above data, the most-likely scenario entails a 3.0% growth in sales, a break-even in earnings, and a disposal of assets resulting from the merger, including write-offs of bad debt and disposal of plant and equipment. These predictions are based on the mean and standard deviation of the last three years of operating revenue figures, as well as assumptions about the general economy and the paper and forest products industry. The most likely results for the fiscal 2003 will entail:

<u>Revenue, Income, and Asset Projections for C&NW [Data in Million $]</u>

Operating Revenue:	$52,910	(3.0% growth)
Net Income:	$53	(break-even)
Assets at Year End	$56,534	(reflecting disposal of assets)

<u>Ratio Analysis for C&NW</u>

Net Profit Margin:	0.1%	(NI / Revenue)
Return on Assets:	0.1%	(NI / Assets)
Total Asset Turnover:	0.936	(Revenue / Assets)
Return on Investment:	0.1%	(NPM x TAT)

Earnings per Share: $0.01

As is plain, this is not a great outlook, although certainly better than the hefty operating loss sustained in fiscal 2002.

<u>2. Complete a SWOT analysis for the newly merged company (post merger) based on tow enclosed WSJ articles (above reference) and/or S&P industry survey (web site reference above). Completing this step will prepare you to answer the question 2 on SWOT in your briefing memo.</u>

<u>The Internal Side</u>

Strengths:

1. Vast holdings of timberlands in the US and Canada from Northwestern
2. Operates 20 logging camps, 5 sawmills, and 10 pulp mills to harvest and process timber products (from Northwestern)
3. Complimentary combination of the products from Northwestern and Continental
4. Combined experience of the two top executives, B.R. Foster (President from Northwestern) and C.D. Owens (president from Continental)
5. Potential to exercise greater control over the going prices of the company’s products, due to the combined resources of the company and the ability to cut production and reduce supply
6. Potential for even greater cost savings from the amalgamation of machinery and processing equipment
7. Combined assets of the two former companies will allow greater opportunities for expansion in the future
8. The new company will have the potential ability to out-produce the next five largest firms in the paper and forest products industry

Weaknesses:

1. Large number of employees (13,000 = 4000 from Continental + 9000 from Northwestern), with overlapping duties
2. Conflicting management styles of Foster (maintains tight control, retaining much of the authority in his own hands) and Owens (delegates authority quickly and operates in an informal, decentralized manner).
3. The uncertainty that many employees feel over the future of their positions in the post-merger company
4. The veritable megalithic size of the new corporation will make control of this GM of paper and forest products incredibly difficult

<u>The External Side</u>

Opportunities:

1. Signs of improving demand for paper and forest products in early 2003
2. Signs of an accelerating economic recovery in early 2003, due to tax cuts, historically low interest rates, and increased government spending
3. An industry-wide conservative stance on increased capacity
4. Stabilization of prices in the paper and forest products industry
5. Potential increase in manufacturing and advertising, leading to greater domestic demand of various paper products
6. Potential price increases of various paper and forest products, due to lower levels of inventory and production on the part of domestic producers

Threats:

1. Pending outcomes of several lawsuits filed by the EPA and major firms in the lumber industry, concerning an agreement to replant harvested trees mad during the Clinton administration
2. The strength of the US dollar, allowing imports to enter the domestic market and reduce demand for US exports
3. Rising costs of energy
4. The general economic condition, resulting in overall weakened demand for paper and packaging products
5. Past volatility of product prices in the paper and forest products industry
6. The current low level of the price of timber
7. An overabundance of supply created by the overproduction of paper and forest products
8. A generally high level of fixed costs throughout the paper and forest products industry

<u>**3. Derive a feasible relevant corporate strategy and appropriate structure from the SWOT analysis in step 2 above. You must keep in mind the ROI and market share from step 1 above. Additionally, explain the six steps in restructuring this merged organization, and draw the merged organization chart, keeping in mind that structure flows from strategy. Completing this step will prepare you to answer the question 2 on strategy and question 3 on structure in your briefing memo.**</u>

The strategy for the new C&NW firm will have several components, including product mix, cost position, inventory, capacity, and financial statements.

The product mix will continue to include paper products and lumber products. These two separate product lines cater to many different customers, and often when demand for one product line is softening, demand for the other is holding steady or increasing. Maintaining operations in both areas will help diversify our product bas and customer base against any lags in certain sectors of the economy, such as housing materials or print advertising.

One of the chief emphases in fiscal 2003 will be on reducing expenses. In fiscal 2002, the bottom line suffered because of exorbitant costs. For 2003, the projection is to have energy costs under control. Closing some facilities will help decrease our overall costs, but plant and facility managers must do a better job of managing costs.

Capacity levels will be reduced company wide in an effort to help reduce inventory, and exert more influence over prices in the market. Inventory levels have been to high in recent years, helping to drive down product prices. A more effectively controlled level of inventory will result in better prices, and more rapid turnover. While industry wide operating rates have been near 85%, we are projecting an operating rate in 90-92% range, due to the closure of some facilities.

The pro forma income statement for 2003 will be characterized by a 3.0% projected growth in sales, along with a break-even position in net income. The break-even position is derived from two assumptions:

- ❖ Reduced operating expense from discontinued facilities will be offset by charges relating to the disposition of assets and the write off of bad debts, resulting in a break-even net income position,
- ❖ The general stabilization of product prices at a level lower than recent years coupled with a slight increase in gross revenues, due to soft economic recovery.

The projected balance sheet for 2003 will show a reduced level of assets, stemming from disposals of redundant operations following the merger

4. With the above organization chart in mind, discuss company staffing and human recourse policies which would motivate "best in class" people with needed distinctive competencies (skills) to want to work for this company instead of its competitors.

First of all, we are talking about the internal staff and how to continue making their jobs attractive, continue to built their morale and keep high quality employees. If an employee knows that the company he or she works for is one of the biggest and strongest in the market of that specific industry, they will always work toward the goal of maintaining their jobs, how they can do it better, but also what sort of benefit the employee will receive from the company. Some of the ways that the company could retain the "best in class", would be: continuous training since this is an important tool in the developing of employees skills. It will never be enough with the knowledge that the employee has, since we live in a daily changing world, where things are invented every day for a better performance. The employee will always feel motivated, if he or she feels that the company is interested in contributing to that persons professional development for its benefit and the company's. Another way of attracting and maintaining these employees is when the company extends the view or focus of their performance, abilities and job tasks along with the future of the company. Well, the employee likes to feel secured and that their knowledge is contributing to the success of the company. We could also mention that determining benefits for the employees is another attractive way of compromising the employee with the company. Now a days, not just the salary will make happy or satisfied the employee. He or she also need of extras that can give them security, and not worry about things that the company can take care of. Instead that time and energy would be focused on their job. Some of these compensations would be medical sick leave, vacation, holidays, unemployment compensation, health insurance, long and short term care, life insurance and in some companies they would also include 401K and cafeteria benefits. All of these flexible systems are expected to encourage people to stay in the organization and even help the company attract new employees.

5. With the above organization chart in mind, discuss company leadership styles and employee motivation in terms of:

a.) McGregor's Theory X and Theory Y
b.) Fiedler's approach to engineering the manager to fit the job.
c.) Path Goal and Expectancy Theories.
d.) Group and Team theories used to improve individual motivation.

a.) Our opinion regarding Theory X, is that this one does not fit the situation. When we are talking about a merge between companies, the management realizes how much the employees like their jobs. If they analyze this situation before the merge purpose and they analyze it now, they can see that their personal is focused in a positive way in reference to their job. Which is the complete opposite meaning of this theory. Instead Theory Y does apply to this situation. Here we can see how the employees take their jobs as a natural part of their lives, people are motivated to reach objectives, people are committed to achieve their goals, they will also accept responsibility, and also even though you will find very bright people, sometimes their potential is underutilized.

b.) With the Theory developed by Fiedler, which its goal is to identify key situational factors and to specify how they interact to determine appropriate leader behavior, we may see it apply to this situation, when both owners of each company, at the moment of the merge, think that they can redefine all jobs in new descriptions through the new human resources department. They could apply the task oriented and relationship oriented styles. Which would make since from the point that the author sees it. Well the appropriate leader behavior varies from one situation to another.

c.) The Path Goal Theory, would be very helpful in this situation of the merge, since it focuses in that the primary functions of a leader are to make valued or desired rewards available in the workplace and to clarify for the subordinates the kinds of behavior that will lead to those rewards. The merge situation leads to a tense environment in which people loose their focus on their job or they could be more efficient . Either situation could be present. But if this theory were to be applied it would have head people lead the rest of the groups, towards working in a more relaxed environment, where the employees can reach their goals obtaining rewards and been efficient and productive for the organization.

d.) In reference to Group and Team Theories used to improve individual motivation we need to refer primarily to the individual human needs. The three most important individual needs are achievement, affiliation, and power. In a merging environment, such as the one described in this situation, it is very common to hear all of the employees questioning one another regarding the situation of the organization and what will happen in the short and long future. Well, they definitely feel that they need some type of security after giving so many years of their lives to these organizations. It is here when they should and do focus on their individual human needs. They have the desire to accomplish goals or tasks more effectively than in the past. This carries along the desire to assume more responsibility and a preoccupation with their task. Also they experience the need for affiliation as a desire for human companionship and acceptance. People with this strong feeling are likely to prefer a job that entails a lot of social interaction and offers opportunities to make friends. The last need to mention is the need for power. Which is the desire to be influential in a group and to control one’s environment. This type of people are likely to be superior performers and occupy supervisory positions.

6. What are the main sources of conflict in this organization (internal and external)? What are the main methods of conflict resolution that they should use to resolve the conflicts? Cite a particular example of a conflict form the case.

The external source of conflict in this merger is the breach of an agreement made in the Clinton administration. The agreement was that all trees harvested by the company would be replanted and they have not done so. This has resulted in several lawsuits by the environmental protection agency (EPA) and other major firms in the industry.
An internal source of conflict is the continual battle between B.R.Ford and C.D. Owens, each holds a different view on how goals should be set and accomplished. Mr. Ford is from the old school and believes in domination while Mr. Owens holds a more relaxed view but with better results as can be seen in the brief.

The main methods of conflict resolutions are compromise and the confrontation approach. In compromise the middle position is taken between the two while the confrontation approach or interpersonal problem solving involves both parties getting together to deal with the conflict. Any one of these two methods should be used to solve the conflicts. One example of a conflict is that Mr. Foster the president wants to reduce the amount of employees by using performance appraisals which is based on a bell-shaped curve to measure distinctions in the employee's performance. Mr. Owens the vice president thinks this practice is based on ludicrous assumptions that 50% of employees are above average and 50% are below average.

<u>Question 7</u>

<u>What are the four requirements of traditional control/system evaluation? Show how controls and goals are tied together during the budgeting process.</u>

a) What needs to be done to improve controls? Be specific for financial, Quality, Human, and operating controls.
b) Provide du Pont and ratio analysis to compare results to main competitors for 2001 and 2002.

Operations Control consists of preliminary control which to some extent monitors the quality and quantity of financial, material, human and information that is brought into the organization from the environment. Screening control is to make sure the quality of quantity of the product, produced by the company meets the required standards and this is done with the help of the feed back processes. Finally postaction control which is also under the umbrella of operations control is the final check on good s produced to make sure it meets the required standards and also keep track of the defective rate.

Next there is Financial Control which controls the organizations income and expenditure. Financial control basically makes sure that there is a profit for owners at the end of the year. Budgeting Control also falls under this portfolio and budgets is normally shown in financial terms and used to compare departments and performances. Conservative budgeting in a successful firm can result in a large cash reserve for the owners. Other tools of financial control are ratio analysis, financial statements and financial audits. The financial statement gives incite into the financial situation of the organization. Ratio analysis calculates of the balance sheet and income statement.
Structural controls includes bureaucratic and clan control. These are organizational designs of six parts that are completely opposite to each other and cover employee's behaviors, expectations, performance etc. The bureaucratic design is more rigid and mechanical and employees are expected to comply with it. Clan control is opposite in that it is informal and organic in design. This design gives employees, more freedom but expects them to perform above minimum level.

Strategic control covers integrating strategy and control as well as international strategic control. The integration of strategy and controls carried out by checking at specific intervals during the year to make sure goals set are met and if not what can be changed to improve on the current strategy. The international strategic control operates on either a centralized or decentralized control system. In the centralized organization structure the companies based in different countries is expected to report to headquarters on its achievements frequently. While in the decentralized organization the branches based abroad reports less frequently but give a detailed report on performance once per year. Controls and goals are tied together during the budgeting process because the goals each company set are based on the budget or amount of money they received for that time period. Controls are set up strategically to make sure these goals are attained or excelled because the performance level of each company is measured by the success or failure of these goals and controls.

(a) Operational control can be improved by having Mr. C.D.Owens and Mr. B. R. Foster reaching a compromise and work together for the good of the organization. It would seem that an improvement in the quality of products from the Great Northwestern Lumber Company along with strategic locations of sawmills as well as the upgrading machinery and increasing efficiency would cause an improvement in operations and financial controls. The human control could be achieved by introducing a reward system for employees as well as having their participating and input in the planning stages. This could lead to more commitment form them.

Du Pont & Ratio Analysis

		C&NW	Georgia Pacific	International Paper
Liquidity -	Current Ratio	1.23	0.9	1.5
	Quick Ratio	-	-	-
Leverage -	Debt to Total assets	0.76	0.002	0.0018
	Interest earned	-2.64	NM	NM
Profitability –	Return on sales	0.03	NM	NM
	Return on total assets	0.025	1.5	NM
	Return on equity	0.106	NM	NM
	Earnings per share	-2.09	-2.37	
Activity -	Total Asset turnover			
	Collection Period			
	Inventory			