

Delivering results

Key findings in the Forest, Paper and Packaging industry

15th Annual Global
CEO Survey

Sector summary



Commitments to doing more business globally are accelerating in 2012 despite economic, regulatory and other uncertainties. CEOs see the fundamentals for future growth still squarely in place.

To understand how businesses are preparing for growth in their priority markets, we surveyed 1,258 CEOs based in 60 different countries and talked to a further 38 CEOs face-to-face for our 15th Annual Global CEO Survey. *Delivering results: Growth and value in a volatile world* explores CEOs' confidence in prospects, and how they are building local capabilities and creating new networks for new markets.

CEOs are adapting how they go to market, reconfiguring processes and at times entire operating models. They are also addressing risks that greater integration can amplify and are focused on making talent more strategic to pursue market opportunities.

This report looks at key findings in the Forest, Paper & Packaging (FPP) industry sector, based on interviews with 49 FPP CEOs in 23 countries and in-depth interviews with Jouko Karvinen, CEO of Finnish paper producer Stora Enso, Cheung Yan, Chairlady of Chinese paper packaging producer Nine Dragons and Antonio Rios Amorim, Chairman and CEO of Portuguese cork products producer Corticeira Amorim.

To explore the full results of the 15th Annual Global CEO Survey, please visit www.pwc.com/ceosurvey.

Confidence disrupted

As 2012 starts, the outlook is more uncertain than ever. Weak demand in the industrialised economies, a slowdown in the emerging economies and greater volatility have all dented the confidence of the business community. FPP CEOs are no exception: 53% expect the global economy to decline and only 10% believe it will improve in the next 12 months.

They're particularly worried about the impact on their businesses. Only 22% of FPP CEOs are very confident they can grow their own companies' revenue over the coming year – which is far less than the overall average of 40%. That's because forest, paper and packaging is a largely cyclical industry, where demand is intimately tied to the overall economic situation. Indeed, 82% of FPP CEOs say they're concerned about uncertain or volatile economic growth.

Looking further out, FPP CEOs are more optimistic: 41% are very confident of being able to increase their company's revenues over the next three years. Their response on this score is much the same as that of their peers in other industries.

How are FPP CEOs getting their companies back on track? Most are keeping a tight rein on costs: 84% have implemented a cost-reduction initiative over the past 12 months. Almost as many (82%) expect to trim any remaining fat in the next 12 months, which is markedly more than the 66% of CEOs in our total sample who plan to wield the knife. Many of these cuts will hit the talent base: 37% of FPP CEOs – double the overall percentage – intend to reduce their company's headcount over the next 12 months.

FPP CEOs are also taking a close look at their portfolios and cutting them, where necessary. They're twice as likely as their fellow CEOs to be planning to make major divestments or exit from significant markets in the coming year (29% versus 14%). Economic considerations are one key factor here, but the FPP industry as a whole is currently in the middle of a period of radical change. Some segments, like newsprint, are experiencing a structural decline; others are flat in certain mature markets, but booming in emerging markets. And technology looks set to redefine what's possible across the value chain, from raw materials to consumer packaging.

Antonio Rios Amorim, Chairman and Chief Executive Officer of Corticeira Amorim SGPS SA in Portugal tells us: "[...] the focus of our company at the moment is on innovation – innovation in processes, in new products, in new applications, innovations that can really enhance the perceived value of our products. If volume growth is not going to be there, you need to have value growth, and in order to have value growth you need to offer the market innovative solutions, products, materials."

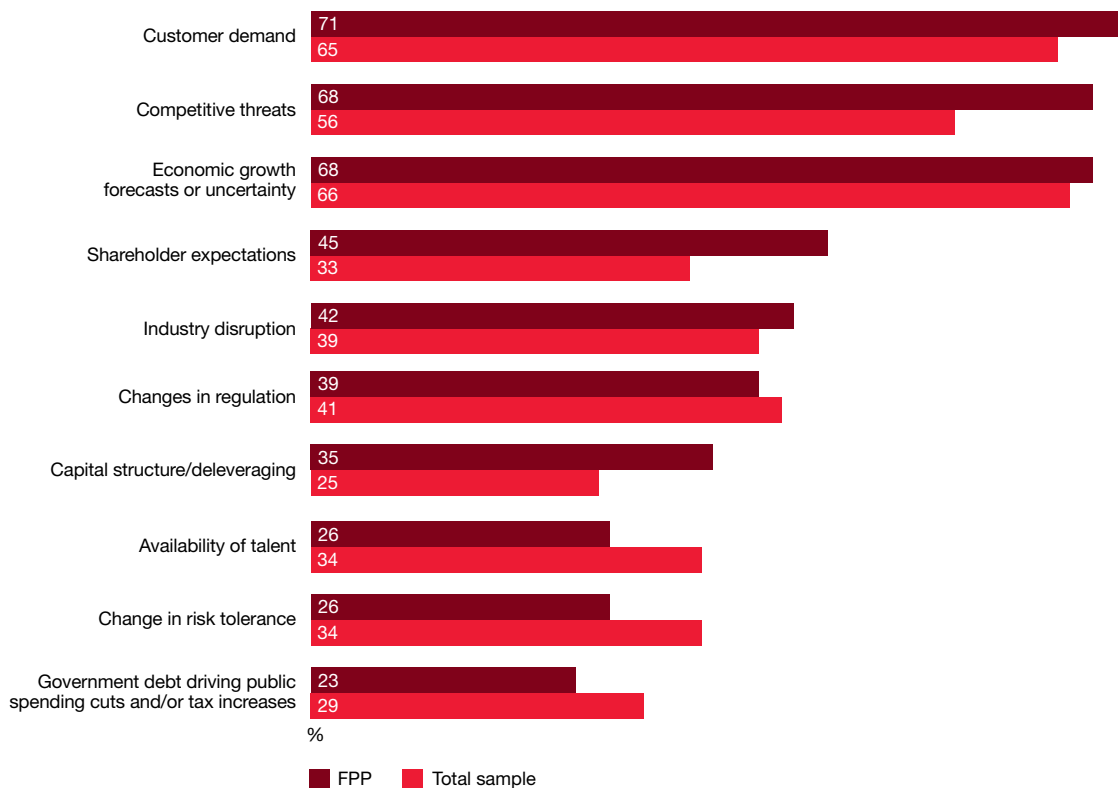
The changing marketplace is why many FPP CEOs are revisiting their corporate strategies: 63% anticipate changing course this year – and 24% of them plan to make 'fundamental' changes. They're making sure their companies are well-placed for tough economic times and greater competition, two of the main reasons they cite for shifting direction. Above all, though, they're responding to changing customer demand (see Figure 1).

"Innovation in most industries is too driven by technical perspectives rather than consumer perspectives. We're very fond of talking about all sorts of technical possibilities. But in many cases, we don't actually understand many of the markets that we're trying to sell into. And I happen to believe that's where you should start. You need to bring the consumer into the equation first, before pushing out technical solutions."

Jouko Karvinen
CEO
Stora Enso

Figure 1: Customer demand, competition and economic uncertainty top the strategic agenda

Q: Which of the following factors is influencing your need to change your strategy?



Base: All respondents anticipating a change in corporate strategy over the next 12 months (Total sample, 888; FPP, 31)
 Source: PwC 15th Annual Global CEO Survey 2012

“We are looking more and more at the balance sheet. We are looking much more at working capital needs. It is clear an economy that is going to be de-levered is going to have credit restrictions in the market so your investment policy, your acquisition policy has to be a lot more prudent than ever before. But it is also clear that the markets are not going to be growing. So you really need to invest.”

Antonio Rios Amorim
Chairman and CEO,
Corticeira Amorim, Portugal

The commercial environment is becoming increasingly challenging, as a result of rising customer expectations and changing consumption patterns. Customers want more and better products, at ever lower prices, and they want them manufactured using ‘green’ processes. The pressure is coming directly from end users in many cases, which explains why 63% of FPP CEOs worry that shifts in consumer behaviour could hurt their company’s growth (as opposed to just 50% of the total sample).

New competitors – many of them from the emerging economies – are compounding these problems. They can often supply fibre or make end-products more economically than traditional producers and thus undercut them in international markets. New forms of competition are also emerging. Disruptive technologies like digitisation are, for example, eroding the markets for print media.

It’s clear why customers, competitors and the economic situation feature so prominently on the radar screens of FPP CEOs. What’s also noteworthy, though, is that shareholder expectations and concerns about capital structure loom much larger for FPP CEOs than for their peers in other industries.

The explanation lies in the sector’s struggle to create shareholder value. In 2010, return on capital employed for the PwC Top 100 FPP companies was a lowly 4.9%, well below the cost of capital – and 2010 was a better year than previous ones.¹ Some forest, paper and packaging companies also have high gearing levels, while others are finding it hard to secure additional funding. FPP CEOs are well aware of the problem; nearly half are concerned about being able to finance their company’s growth.

Making it happen

Despite the present gloom, FPP CEOs – like their peers – are focusing on the upside more than the downside. They’re refashioning their business models to cope with a world where the risks and opportunities are increasingly interconnected but the sources of growth are often local. This presents three related challenges:

- **Reconfiguring operations to meet local market needs:** Building the right portfolio mix – the right infrastructure, operating model, strategic alliances, products and services for the right markets.
- **Defending against micro risks and macro disruptions:** Managing the consequences of local risks that may become global disruptions – such as the political upheavals in many regions, nuclear disaster in Japan and unfolding sovereign debt crisis in Europe that featured in 2011.
- **Getting the right talent:** Putting the right employees in the right places, and managing serious short-term problems like the shortage of technically skilled people

¹ PwC, ‘Global Forest, Paper & Packaging Industry Survey’ (2011). Note that this only covers fibre packaging companies, and the results relate to the 2010 financial year.

Balancing global capabilities and local opportunities

Most CEOs believe greater global integration is reshaping the business landscape. FPP CEOs concur: 51% think the emerging markets will play a bigger role than the developed markets in their company's future growth.

For some companies, this may simply be a case of moving specific activities to low-cost locations; pulp and paper producers based in the northern hemisphere may, for example, switch their pulp production to more competitive areas in the southern hemisphere. But succeeding in a globally integrated environment isn't just about making products cheaply in one place and selling them in another. It's also about becoming 'multi-local' – about building fully-fledged operations in key markets to forge deeper relationships with customers, innovate anew, take advantage of local talent, reduce risk and capitalise on the advantages each market has to offer.

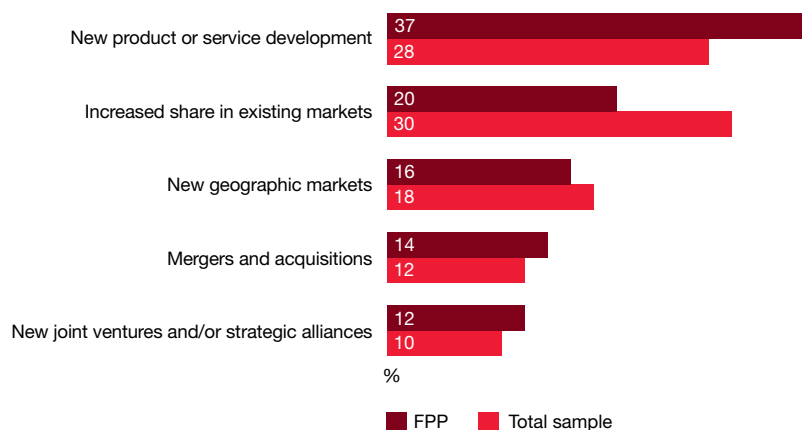
FPP CEOs think Brazil, Russia, India and China hold the greatest potential. In fact, the BRIC economies occupy four of the top six spots on the list of countries (other than their home territories) they consider most important for growth over the next 12 months. China comes in at number one, with 29% of FPP CEOs citing it as a key growth market.

That said, FPP CEOs aren't ignoring traditional markets. Germany and the US are nearly as popular as China – with 24% and 20%, respectively, listing it among their hot spots. Germany's strong showing probably reflects its size and stability, relative to the rest of the Eurozone.

But though FPP CEOs are as interested in tapping new geographic markets as their peers in other sectors, it's not the main route by which they're hoping to grow. Nor is capturing a bigger share of their existing markets. They're focusing, instead, on developing new products and services (see Figure 2). While demand for many traditional FPP products, such as graphic papers, is flat or falling, new opportunities are opening up for both fibre-based materials and plastics packaging.²

Figure 2: FPP CEOs are focusing on new product and service development

Q: Which one of these do you see as the main opportunity to grow your business over the next 12 months?



Base: All respondents (Total sample, 1,258; FPP, 49)
Source: PwC 15th Annual Global CEO Survey 2012

² PwC, 'Growing the Future: Exploring new values and new directions in the forest, paper and packaging industry' (2011).

Resilience to macro disruptions and micro risks

FPP CEOs are less likely to be changing the way they manage risk than they are the way they manage other areas of business – from technology investments to organisational structure and R&D innovation capacity – this year. They’re also much less likely to be revising their approach to risk than CEOs in other sectors.

That may be because many of them have already taken significant steps in this area. For example, 53% of FPP CEOs say their companies have been financially affected by the sovereign debt crisis in Europe. Nearly as many say they’ve already adapted their strategy, risk management or operational planning in response.

Yet some FPP CEOs may need to reconsider whether they’re doing enough to manage risk. Developing new products and services, and entering new markets, poses more dangers than expanding in existing markets with existing products. These intrinsic dangers are heightened in periods of economic turbulence where GDP forecasts are downgraded regularly, stock markets and exchange rates yo-yo and key input costs behave erratically. And, of course, there’s the underlying uncertainty stemming from government responses to fiscal deficits and debt burdens. Such macroeconomic risk factors will all have a significant impact on the sector’s performance.

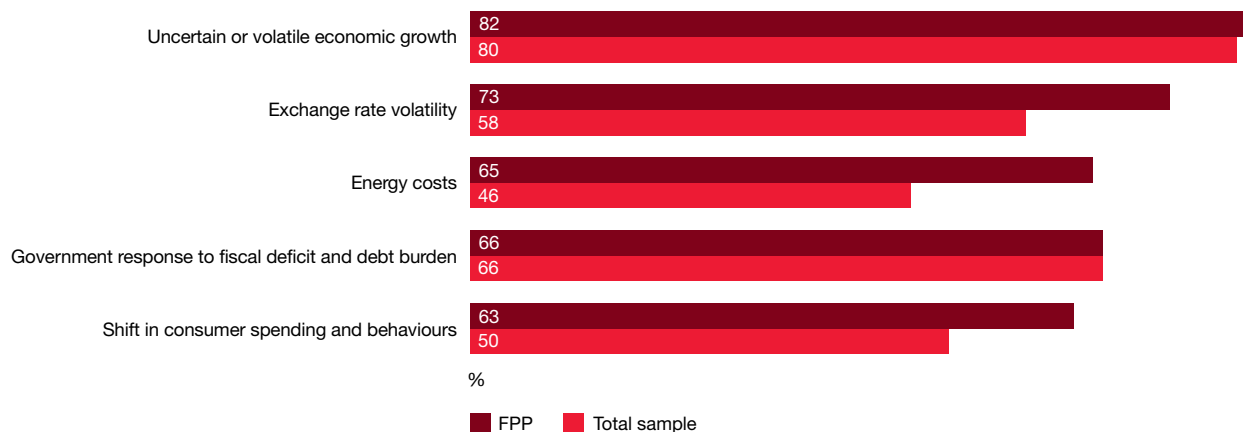
FPP CEOs are understandably nervous. A full 82% are ‘somewhat’ or ‘extremely’ concerned about the volatile economic climate (see Figure 3). Similarly, 73% are worried about exchange rate volatility, while 65% are worried about energy costs. Consumer spending shifts are a top cause for concern, too, as we’ve already noted.

“At the end of the day, managing risk is the central job of management. The decisions that we take on a daily basis have got to be considered through the lens of risk management.”

Antonio Rios Amorim
Chairman and CEO,
Corticeira Amorim, Portugal

Figure 3: The five economic and business issues that worry FPP CEOs most

Q: How concerned are you about the following issues?



Base: All respondents (Total sample, 1,258; FPP, 49)

Note: Respondents answering ‘somewhat’ or ‘extremely’ concerned

Source: PwC 15th Annual Global CEO Survey 2012

Managing exchange rate volatility

Most FPP companies are directly or indirectly subject to significant foreign exchange exposure: directly, because they incur material and/or production costs and liabilities in one currency and sell in another; or indirectly, because reference prices are in US dollars. Many of them have well-established techniques for coping with foreign currency risk, but exchange rate volatility is difficult to manage and has unpredictable effects on competitiveness. So FPP CEOs have reason to be concerned.

Controlling energy costs

Forest, paper and packaging producers, especially those engaged in pulp and paper production, are also high energy users; indeed, energy accounted for nearly 18% of the cash manufacturing cost of the European pulp and paper industry in 2010.³ And resins – which are the basis for plastics packaging – are a derivative of oil.

The industry has been investing in energy efficiency measures for many years and most primary producers now use renewable energy sources, notably forest biomass, much more extensively. These measures have reduced their dependence on energy and fossil fuels, as well as helping them eliminate waste and cut their carbon footprints. In the European Union pulp and paper sector, for example, electricity consumption per ton of product output was some 15% lower in 2010 than in 1990, and more than half of total primary energy consumption is based on biomass.⁴

Despite such progress, though, forest, paper and packaging companies remain vulnerable to rising and fluctuating energy prices. It's therefore easy to see why FPP CEOs should be so concerned. The CEOs of EU-based pulp and paper producers have further grounds for worry over the impact of the carbon Emission Trading System (ETS). They've lived with the ETS since 2005, but new rules effective from 2013 could make them less competitive in the international arena.

The talent challenge

Creating a company that can draw on its global strengths to realise local opportunities and manage micro risks with macro implications are two of the key challenges FPP CEOs face. The third is managing a global workforce and competing for scarce human resources.

FPP CEOs seem less concerned about the problem than their peers in many other sectors. Only 41% see the shortage of talent as a potential threat to growth (versus 53%). Similarly, fewer FPP CEOs see it as a reason to make strategic changes, and fewer want to spend more time developing the talent and leadership pipeline.

Why? The answer is probably that many companies in the industry are under pressure to reduce their headcount. FPP CEOs are more likely to be cutting the number of people they employ, and less likely to be hiring additional staff, than those in other sectors. Fewer FPP CEOs also report problems meeting their growth objectives in overseas markets or maintaining quality standards as a result of talent constraints.

Keeping up the focus on talent

But there are clear signs that FPP CEOs need to look past the immediate future and keep focusing on the talent challenge. Skills shortages have a direct impact on the bottom line, as some FPP CEOs have already discovered: 43% say their labour costs have risen more than expected in the past 12 months and 31% say talent constraints have impaired their company's ability to innovate.

“We’re pushing hard on workforce mobility, succession planning, and – by mixing experienced people with the less experienced people – on-the-job mentoring.”

Jouko Karvinen
CEO, StoraEnso
Finland

³ CEPI (Confederation of European Paper Industries), 'Sustainability Report 2011'.

⁴ Ibid.

CEOs around the world are paying attention to middle managers.

“It isn’t about young versus old, or the developing world versus the developed world. The most critical selection criteria that we used in putting together our team of junior managers together was to maximise diversity of thought. So we recruited young and not-so-young managers. We recruited different nationalities. We recruited people on very different career paths.”

Jouko Karvinen
CEO, StoraEnso
Finland

“We have many middle management positions taken up by this young generation too, and they share the same visions and corporate culture as their colleagues. They are also committed on the paper business. I feel very confident that they will make significant contribution to the enterprise, and build a promising career future for themselves.”

Cheung Yan
Chairlady
Nine Dragons Paper (Holding) Ltd, China

The situation could get worse: 43% of FPP CEOs think hiring people to work in the FPP industry has become harder, primarily because of the shortage of skilled candidates. And though CEOs in our overall sample report that the biggest problem is hiring high-flying middle managers, FPP CEOs say it’s just as difficult to find and keep skilled production workers. In many mature markets, that’s because the workforce is aging.

Recruiting millennials and retaining managers

But 39% of FPP CEOs also experience trouble recruiting and retaining younger workers. This mirrors our findings in earlier studies, as well as other industry reports.⁵ Forest, paper and packaging companies will have to do far more to attract the ‘millennials’, since the sector’s appeal to young workers is currently limited.

That means promoting the industry more actively to young people, who often want to work for environmentally responsible companies. Forests, and the services and materials they provide, make a major contribution to society. And while packaging is often maligned as the biggest source of the world’s trash, it can also alleviate social problems – by preventing food spoilage, for example. E-learning, multimedia and social networks can all be used to engage with potential employees from a generation that’s more comfortable absorbing information electronically than its predecessors.⁶

Of course, young workers aren’t the only people on whom the industry should focus. It will also need to adopt more flexible working patterns to encourage diversity and retain people at the other end of the age spectrum.

5 PwC, ‘CEO Perspectives: Viewpoints of CEOs in the forest, paper & packaging industry worldwide’ (2010); and CEPI (Confederation of European Paper Industries), ‘Sustainability Report 2011’.

6 PwC, ‘Millennials at Work: Shaping the workplace’ (December 2011).

But it's arguably operational managers in mid career who are the most important employees to retain; they're often closest to changing customer demands and responsible for executing a company's strategy. They're also the pool of people from whom tomorrow's CEOs will be drawn. One way of encouraging them to remain is to push formal succession planning deeper into the organisation. A growing number of companies are trying to identify talented managers earlier in their careers and devote resources specifically to developing them.

Mobilising expertise

Many forest, paper and packaging companies, like those in other industries, are also moving talented people from one market to another, although the flow is still mainly one way. Some 47% of FPP CEOs plan to use experienced employees from their home countries to plug skills shortages in new markets, while only 22% plan to do the reverse.

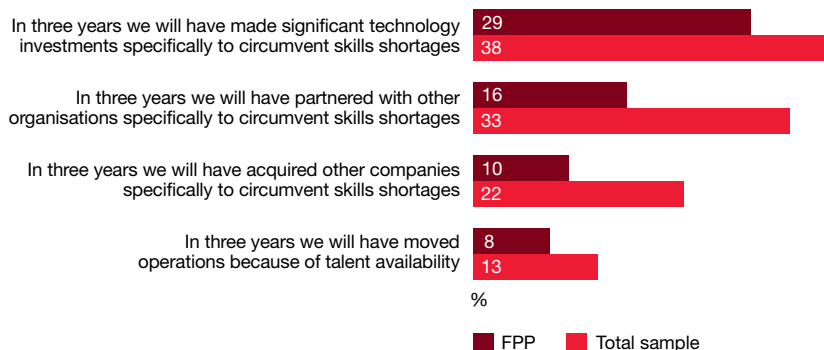
Yet, though FPP CEOs agree with their peers in other sectors about the problems skills shortages are causing – and they're equally uncertain whether they'll have the talent they need to execute their corporate strategy over the next three years – they're doing less to deal with the situation. The percentage of FPP CEOs planning to make acquisitions, relocate operations or adopt other such strategies to supplement the skills base is substantially smaller than it is in the overall sample (see Figure 4).

Getting the whole story

Adopting a more creative and flexible approach to the talent challenge is only part of the equation. The other is getting the information required to make the right decisions in the first place. All FPP CEOs regard productivity data as important and most also track traditional measures like labour costs. In fact, many of them have a much better handle on labour costs than their peers in other industries.

Figure 4: FPP CEOs are less likely to be planning strategic solutions to meet skill shortages

Q How much do you agree that in three years we will have undertaken the following steps to circumvent skill shortages?



Base: All respondents (Total sample, 1,258; FPP, 49)
Source: PwC 15th Annual Global CEO Survey 2012

They're less likely to value information on the cost of losing talent or the return they get on training and other such activities, and these are also critical benchmarks. But even those who measure everything that matters don't get the whole story. At least two-thirds of FPP CEOs would like to get more information on five of the six key pointers listed in Figure 5.

FPP CEOs are committed to workforce development. They're convinced that both the public and private sectors need to play a major role in creating and fostering a skilled workforce.

A full 61% of FPP CEOs think it should be a top government priority. That's significantly more than in the total sample. In fact, FPP CEOs put the development of a skilled workforce before infrastructure improvements or financial stability – the two issues on which most CEOs believe governments should concentrate first.

But FPP CEOs are willing to share the load: 80% think companies have a role to play in developing a skilled workforce above and beyond their own employees. And 69% already invest in training programmes of one kind or another in the key markets where they do business.

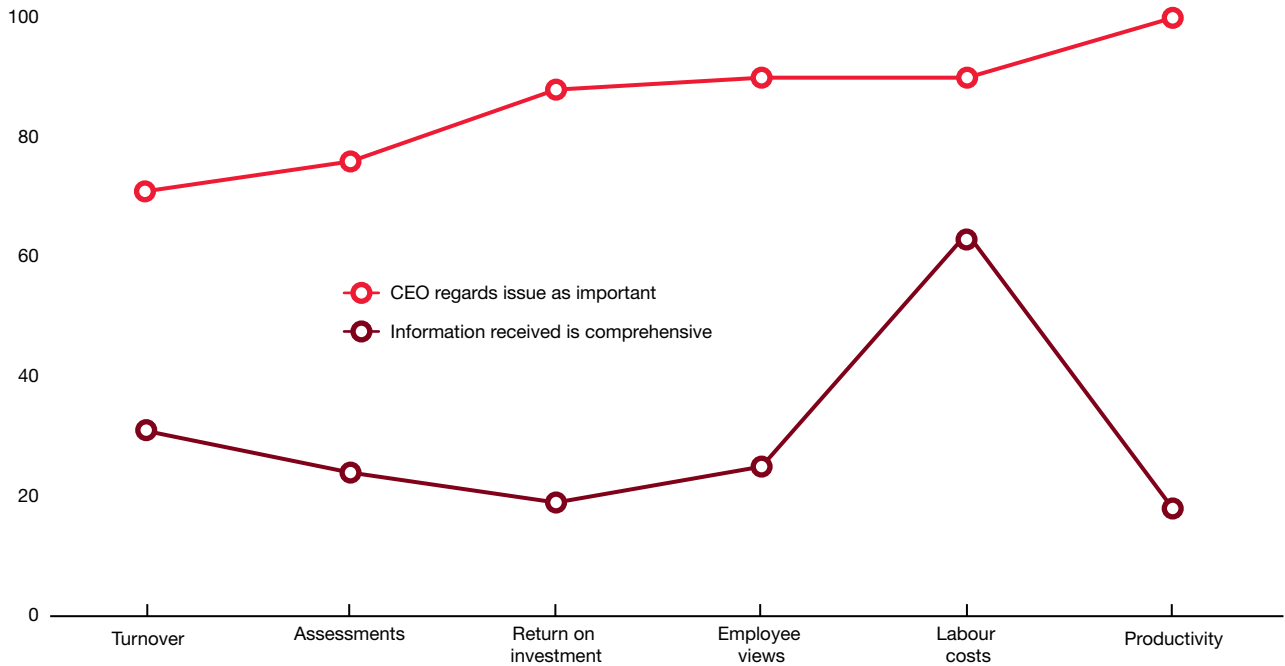
Their main aim is to secure a future supply of potential employees, though some FPP CEOs have a social agenda, too: 26% 'agree strongly' that they're investing primarily to improve living and working conditions in the countries where they operate. Over the next three years, most FPP CEOs also intend to increase investments in creating and fostering a skilled workforce, despite the tough economic conditions that currently prevail.

“Today, we are particularly invested in Corporate Responsibility in the emerging markets because we understand that that’s where our future lies. We want to be seen in those markets as a welcomed friend – not just a company that’s bringing in technology to exploit a financial opportunity. Consequently, we work very hard with local communities in the developing world on issues like education and health care. And we’ve introduced exchange programmes between universities in the developed and developing world. So, I can stand up in Uruguay or Brazil or China and say, we’re here because we want to better your community and your society.”

Jouko Karvinen
CEO
Stora Enso

Figure 5: FPP CEOs want more information on key talent measures

Q: When making decisions, how important is it to have information on the following issues? And how adequate is the information you receive?



Base: All respondents (Total sample, 1,258; FPP, 49)
Source: PwC 15th Annual Global CEO Survey 2012

What's next?

Deciding which processes and capabilities need to be global, regional and local isn't just about taking advantage of growth opportunities; it's also about developing the flexibility to survive disruptions, wherever they may surface. That's not an easy balance to strike. We've distilled eight key questions from the feedback CEOs have given us in this year's CEO Survey:

1. How local is your global growth strategy?
2. How are you balancing global capabilities with local opportunities?
3. Is your talent strategy fit for growth?
4. Are your innovations creating value for your customers – or just novelty?
5. Do your strategic plans account for the macro impact of micro risks?
6. Are you responding to the needs and constraints of the communities in which you operate?
7. Where are the biggest opportunities for business and government to coordinate better?
8. Does your governance model account for the ways in which organisations' and people's expectations are changing?

If you'd like to discuss any of these questions, please contact me:

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