

IPAC Case Study Program

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IPAC Case Series

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Note on the Series: This case study has been developed as part of an “organizational learning” case study series through the IPAC Case Study program. The cases from this series are prepared in conjunction with partners across a variety of governments, with a strong focus on the many activities of the federal government. We thank all those departments and ministries that have agreed to share their insights and experiences for the benefit of others. Each case will consist of the case itself and a short teaching note with ideas for uses and themes that the case suggests. Within the body of the case will be a series of lessons learned, based on the observations of those interviewed, written material and the insights of the case author and editor.

All cases are prepared by a researcher/writer and then edited. The research is based on published material and interviews with those who had been involved with the case. All interviews are treated as confidential and all quotations arising from them are not attributed to an identified individual.

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Canadian Cellulose Company Limited:

A Case Study of Government Rescue and Turnaround

Author, Robert W. Sexty

Abstract

Canadian Cellulose Co. Ltd. (CanCel) was a failing enterprise when taken over by the Government of British Columbia in 1973. The case traces the enterprise’s performance from takeover to 1978; and describes how CanCel management was able to restore the financial condition of the enterprise. The purpose of the case is to analyze the rationale for a government takeover of a troubled business enterprise. The case is written so that public administration issues, for example, the relationship between management and government and the types of control necessary, are examined along with the concept of corporate business strategy. Friday, June 29, 1973. The deal was completed at 10:53 a.m. Champagne was opened and toasts were given. Employees were treated to a smorgasbord lunch. Executives, lawyers, accountants, consultants, and politicians involved in the deal went to a special dinner at the Vancouver Cub.

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IPAC CASE SERIES

CANADIAN CELLULOSE COMPANY:

A CASE STUDY OF GOVERNMENT RESCUE AND TURNAROUND, BY ROBERT W. SIXTY¹

Please note: There is a Teaching Note for this case

The deal was the takeover, by the Government of British Columbia, of Columbia Cellulose Company, Limited (Colcel), a subsidiary, 91.3% owned by Celanese Corporate of New York. A new corporation, Canadian Cellulose Company Limited (CanCel), was formed with 79% of the shares owned by the government.

Colcel had been operating in British Columbia for about 25 years. The company operated plants in two parts of the province: in The Northwest: sulphite and bleached kraft pulp mills at Prince Rupert; and a sawmill at Terrace. And in the southern Interior: a bleached kraft pulp mill and sawmill at Castlegar. The operations of the company had suffered from financial, production, and management problems. Over the years, the parent company, Celanese Corporation, had lost about \$120 million in Colcel; including an operating loss of \$17 million on sales of \$83.5 million in 1971. Colcel had only one small profit in the 1966 to 1972 period; a large accumulated earnings deficit; a negative net worth and; a heavy load of short and long term debt. Highlights of Colcel's performance during the years 1968 to 1972 are included in Exhibit 1.

REASON FOR TAKEOVER

The British Columbia Government decided to take over Colcel in 1973 for several reasons. The majority owner, Celanese, had been attempting since 1968 to sell its interest in Colcel. In 1972, Celanese received an offer to purchase the part of Colcel's British Columbia operations in the Castlegar area from Weyerhaeuser Canada Limited. The proposed sale required the consent of the government, as the transfer of timber rights was necessary. The government would not consent to the transfer, as it was concerned about the future of the Province's Northwest region. It was felt that the Prince Rupert operations, being less viable and unprofitable, might be closed, creating more unemployment. The government had concluded that the takeover was necessary to encourage development in British Columbia's Northwest.

Celanese could not find a purchaser for the entire company. Prospective purchasers were discouraged by the corporation's remote location and a corporate situation that inhibited expansion.

Another consideration was the status of the minority shareholders. When the deal to assume 79% was announced by R. A. Williams, Minister of Lands, Forests, and Water Resources in the Legislature, on April 2 1973, he stated:

¹ At the time of writing, Professor, Faculty of Business Administration, Memorial University, St. John's Newfoundland

... The remaining 21% common shares of Canadian Cellulose would be distributed to Columbia Cellulose's more than 8,000 public shareholders. Thus, under this agreement, the powerless minority within the present corporation structure of these companies would be assured of their position in relation to the assets of the company ... This action by the government ensures the position of the minority shareholders which would have been in jeopardy had the proposed sale of the southern operations gone ahead. If, for example, the company's Castlegar operation (Celgar) had been sold to Weyerhaeuser Canada Limited last August, these shareholders would not have been able to recover any of their original investment which was some \$25 million.²

In addition, many senior employees of Colcel and the government preferred the company be Canadian-owned.

The principal features of the completed deal were:

- The preferred shareholders were to receive \$1.80 per share, accrued dividend arrearages, and two common shares of CanCel for each preferred share of Columbia Cellulose. The estimated \$1.5 million cost of the dividend payment was to be borne by Celanese, the parent company. Former preferred shareholders now hold 14% of the new company's common stock.
- Former Colcel common shareholders now hold 7% of the common stock.
- The government assumed the guarantee obligations for the first mortgage bonds of Columbia Cellulose and the bank debt of some of the subsidiaries, amounting to about \$78 million. An annual standby fee of one-quarter of 1% on the outstanding balance of long-term bonds is paid by Canadian Cellulose to the Province in respect of the guarantee.
- The government made no payments to Celanese or Columbia Cellulose but acquired 79% of the common stock.
- Celanese was to release CanCel from its \$73 million debt to the parent company.
- 9.1 million acres of land in tree arm licensed areas were returned to the Province.

The government already held equity interests in several forest industry enterprises: Kootenay Forest Products Ltd; Ocean Falls Corporation; and Plateau Mills Limited. Opposition politicians and the business community were critical of public ownership in a private sector industry. The skeptic also feared that taxpayer money was to be invested to bail out a financially inept and unprofitable corporation.

² Hon. R. A. Williams (Minister of Lands, Forests, and Water Resources), *Debates of the Legislative Assembly of British Columbia*, 2nd Session, 30th Parliament, April 2, 1973. p. 2004.

THE COMPANY IN 1973

The reorganized management team took over on June 29th. Top management, including former Colcel executives and others hired from outside, was headed by Ronald M. Gross as President and Chief Executive Officer. Mr. Gross had been an Executive Vice-President and Secretary with Colcel. A Board of Directors of nine men was appointed and was comprised of:

E. Bertram Berkley, Chairman and President of Tension Envelope Company of Kansas City, the second largest envelope manufacturer in the U.S.

Alan S. Gordon, Chairman of Merrill Lynch Royal Securities Ltd. of Montreal; and Director of various companies.

Ronald M. Cross, Canadian Cellulose President.

Max Litvine, Managing Director of Compagnie Bruxelles Lambert of Brussels.

Harry L. Purdy of Vancouver, former Professor of Commerce and Business Administration at the University of British Columbia.

John H. Spicer of Edmonton; Vice President of the Mountain Region of Canadian National railways.

Ira D. Wallach of New York; President of Gottesman-Central National Organization, a pulp marketing firm.

Donald N. Watson of Vancouver; President of Pacific Western Airlines Limited.

Charles C. Locke of Vancouver; Partner in the law firm of Ladner Downs.

The Board had been appointed by the government, upon the recommendation of CanCel's management. There were no politicians or civil servants included, all members being from the private sector.

An immediate challenge faced the new management team and Board. Colcel had not been considered as a serious operator in the British Columbia forest industry. Its management had been largely Americans who lacked knowledge of the British Columbia industry. Management had also become demoralized by the performance of the company and the uncertainty created by Celanese's attempts to sell. Some of Colcel's physical plant had been allowed to deteriorate during the period of uncertainty.

The management set about immediately to make CanCel a viable enterprise. It identified several challenges and/or opportunities that had to be faced:

1. there was a need to develop a more appropriate pulp marketing strategy;
2. it was essential to improve the company's financial condition;
3. the problem of an inefficient and obsolete sulphite mill had to be resolved;
4. there had to be an improvement in the wood resource utilization; and
5. a long-term environmental program had to be developed. Studies were initiated immediately on the best use of the Prince Rupert sulphite mill, the availability of timber in the Kootenay operations, and the possible increase in capacity of the Castlegar pulp mill and sawmill operations. Gross also began long-term planning and the settling of priorities for future capital expenditures.

THE DEVELOPMENT OF STRATEGY

Faced with these challenges / opportunities, top management and the Board developed a corporate strategy. The markets of the company's products, timber, sulphite pulp, and draft pulp were assessed. The decision was made that the most viable product was bleached kraft pulp. As Gross stated:

... We decided to build on our principal strength, which is in bleached softwood kraft pulp. We sell this product in more than 20 countries, and concluded that it offered the most promising long-term market prospects.³

With this in mind, CanCel embarked on a capital development program. The program, announced in 1975, was to be in two phases. Phase I involved the conversion of the Prince Rupert sulphite mill to kraft pulp at a cost of about \$100 million. Phase II, which was subject to assessment of market and financial conditions, involved the construction of a new bleached kraft mill at Castlegar at a cost of about \$205 million. The rationale for this program was provided by Gross:

... Expansion first at Castlegar would have been an attractive proposition, but there were disadvantages, ... In the first place, we would still have been saddled with the situation at Prince Rupert. Secondly, the capital required for Castlegar – we estimate \$205 million in 1975 dollars – is double what we will spend at Prince Rupert.

We didn't want to embark on a project of that size right now because it would have been very difficult without additional equity financing. We didn't feel that the company, or the financial markets generally, were in a position to accept equity financing at present. Turning

³ Patrick Durrant, "A Sickly Discard Learns to Stand," *Executive*, June 1976 (Quotation from article).

the Prince Rupert operation around will give us a stronger production and earnings base, and enable us to go ahead later with expansion at Castlegar.⁴

The decision regarding the Prince Rupert sulphite mill was complicated. The sulphite mill was obsolete and the costs of production were high, with 30% more wood, three times more energy, and more chemicals required to produce the sulphite than in a mill using modern technology. The market for the mill's product, an acetate specialty pulp, was also declining. Attempts to produce other grades of sulphite pulp in greater demand were not successful. In addition, the mill was a polluter of the air and water; and an expenditure of approximately \$80 million would have been required to alleviate the problem.

The total investment of \$100 million was only \$20 million more than the expenditure required to meet pollution regulations on the old plant. The new mill would meet pollution regulations and allowed the company to convert production to kraft pulp for which markets were more promising.

CanCel was a non-integrated producer of lumber and pulp. The production of its saw and pulp mills was not sold to another CanCel division or associated company. Management considered this an advantage as CanCel was one of a few pulp producers without an affiliation with a paper plant. There was no "captive" forward integration and thus customers were assured a pulp supply, as supplies would not be preempted by CanCel's own paper mills.

The marketing strategy for pulp became explicit. 80% of the kraft pulp was sold on long-term contracts in over 20 countries. The company decided not to accept 100% of a customer's business, but to take no more than 10% of the market in any one country and supply no more than 50% of an individual customer's needs.

No sales were made in Canada; and the customers were not integrated enterprises in the paper industry. Sales contacts were made from the top management level of CanCel to the top management of the customer. The president participated in the corporation's a marketing program; and two vice-presidents were involved – one handling sales in North America; the other – handling sales in Europe and Japan. Efforts were made to develop close and long-term sales relationships between CanCel, the non-integrated producer of pulp, and its customers – non-integrated producers of paper products. The lumber products were sold in the U.S. to several non-integrated customers by a similar strategy.

The operations of the company are decentralized by plant with a sparse corporate office organization. The corporate office was involved with long-term planning; the establishment of board policy; and the monitoring of progress. Company executives pointed with pride to the low proportion of selling and administrative costs to sales.

⁴ Ibid.

The performance of the company improved immediately. The price of kraft pulp increased from \$175 per ton in 1973 to \$460 in 1975. The company was able to take advantage of this increased demand; a profit was made in 1973; and dividends were paid in 1974. Profits were made every year from 1973 to 1977 (refer to Exhibit 1). Gross attributes CanCel's successful turnaround to several factors:

The company's board of directors and professional management were allowed to operate in an independent fashion without interference from government. We were able to capitalize on the very strong 1973-74 pulp market. And we switched to a long-term marketing strategy from mainly selling pulp into spot markets. Effort was also made to spread the risk around by diversifying our customer base. As a result, CanCel now sells its pulp in about 24 countries, and is not tied to one market.⁵

Sceptics, critical of the takeover, were no silent. One investment firm even recommended CanCel stock as a "... speculative issue for aggressive investors"⁶ A headline of a *The Financial Post* article read, "David Barrett's CanCel Deal Was A Good Buy."⁷ A typical comment from the business press summarizes the change of attitude towards the corporation:

... Three years ago when British Columbia's then-NDP government stepped in to revive the floundering Columbia Cellulose Co. Ltd., the skeptics were vocal in their criticism of the government's rescue of a chronic money loser that was all but disowned by its American parent.

Those critics are no longer heard from. In what must be one of the most dramatic turnabouts in recent corporate history, Canadian Cellulose Co. Ltd. (as it is now called) stands among the biggest and most profitable companies in the Canadian forest products industry.⁸

CHALLENGES TO MANAGEMENT

An improvement in the company's performance came soon after the reorganization. However, in the five years after the reorganization, the management had to confront a series of challenges involving economic, political, and social consequences.

RELATIONSHIP TO GOVERNMENT

Due to the fact that the major shareholder was the British Columbia Government, CanCel was viewed by some as an instrument of government; that is, as a crown corporation. Politicians would frequently boast about "our company." Few people realized that CanCel

⁵ Willard E. Mies, "After Major Turnaround, CanCel Begins Biggest Expansion in British Columbia," *Pulp and Paper*, October 1976.

⁶ "Analyst Likes CanCel Prospects," *The Vancouver Sun*, July 17, 1973 (Quotation from article).

⁷ Mies, op. cit.

⁸ Brian Roger, *The Financial Post*, November 16, 1974.

was not a crown corporation, but instead a separate, legal entity incorporated under the British Columbia company's legislation.

In the early years of CanCel's operations, persons did attempt to communicate through politicians. For example, during a strike at the corporation's Castlegar pulp mill in 1973, the president of the Pulp and Paper Workers of Canada, Local 1, sent a telegram to Resources Minister, Robert Williams, complaining about what he claimed was the intransigent attitude of CanCel's management. Government tried to discourage such communications; and the corporation resisted all such attempts. Nevertheless, various announcements by the company were used politically. For example, layoffs at the Castlegar sawmill during an election campaign or announcement of planned expansions were used by different politicians depending upon their circumstances.

A serious problem for the government was the charge that it was in a conflict of interest position as owner and corporate exploiter of natural resources. Also, there was a charge that the government might use the company to provide expensive employment opportunities. The employment record of government appears to disprove this, as employment was 3,000 in 1973, rose to 3,200 in 1974, and then fell to 2,600 in 1977.

Government and management argued that relations with the government had to be, and were at arm's length; because the policies of government in the areas of resource management, environmental control, and labour relations must apply equally to all. Despite this, Gross frequently claimed that government ownership was a handicap to the company. However, he always insisted that the company received no favoured treatment and that the decision of the government to entrust responsibility for CanCel to an independent Board of Directors and professional management was crucial in the success of the company. In Gross' words:

... We [CanCel] have received no special treatment from the government of British Columbia; none has been asked for, offered or is required. In fact, in everything, our majority ownership may even be a handicap since it frequently appears to us that the province leans over backwards to make sure that it can never be said that we receive any favoured or special treatment of any kind.⁹

Despite Gross' assurances of an independent relationship with government, he still advocated the reduction of government ownership to about 50%. A typical statement by Gross on this matter was:

⁹ Jim Lyon, "Government Takeover Defended," *The Vancouver Sun*, April 24, 1974 (Quotation from article).

... But even though we have an independent relationship, ... we have suggested to the government that it would be in CanCel's best long-term interests for the province to reduce its shareholding in order to obtain a wide distribution of shares.¹⁰

INDUSTRY VIEW

Despite efforts to convince the sceptics of CanCel's independence, the corporation was viewed by other enterprises in the British Columbia forest industry as being in a favoured position. The reputations of Colcel had to be overcome and the viability of CanCel's operations demonstrated. Executives of CanCel became more active in the industry trade associations. Having a Board of Directors from the private sector also helped to dispel industry misconceptions. The president conducted a highly visible public relations effort to "tell CanCel's story" and cited foreign examples of enterprises in similar circumstances that had been successful. Extensive and favourable coverage was given to CanCel in the Canadian financial press and forest industry trade publications. In the five years, CanCel management has done much to dispel the misconceptions and to be viewed as another commercially viable enterprise in the private sector.

INDUSTRIAL RELATIONS

Soon after CanCel was formed in 1973, a series of labour difficulties plagued the company. Workers of the Prince Rupert plants became frustrated with labour negotiations and staged a wildcat strike in July. The Castlegar pulp mill workers went on a legal strike in August. Industry-wide bargaining was involved; but it was speculated that CanCel was the strike target because it was run by the government. It was believed that an N.D.P. government, supported by labour, would not allow a prolonged strike and would perhaps impose a generous settlement that would set the pattern for the rest of the industry.

One of CanCel's long-standing problems had been high employee turnover especially in its northern operations. Factors contributing to the turnover included the uncertainty surrounding the corporation's future prior to the CanCel reorganization and unsatisfactory working conditions in the Prince Rupert operation. Management initiated several programs to alleviate this problem, including a housing project for employees, increased management training, and the conversion designed to make the Prince Rupert operations viable. Employee turnover dropped, but a contributing factor might also have been a shortage of jobs.

Since majority ownership of the company was held by the government, numerous requests were made for worker participation on the Board of Directors. However, management did not consider the approach appropriate, and none of the requests were followed through by their supporters.

¹⁰ Durrant, op. cit.

PLANT CLOSURE AND LAYOFFS

When the company decided to close the Prince Rupert sulphite pulp mill in October 1976 in order to convert it to kraft pulp production, about 300 workers were laid off. The decision met with considerable resistance. It was claimed that the layoff of the 300 workers by CanCel in the Prince Rupert area would have a ripple effect and actually result in the loss of 700 to 800 jobs in the community. The new plant would employ about 60 workers, but would not be completed until late 1978.

The mayor of Prince Rupert claimed that CanCel had a moral obligation to retain those workers losing jobs and to assist workers in finding comparable jobs. The corporation spent \$2 million on a program to ease the problem. The problem involved early retirements, job relocation aid, promises of hiring preferences as jobs became available, and assistance with the expense of real estate sales. CanCel also organized recruiting by Alcan and Cominco. Recruiting teams from these corporations visited Prince Rupert in the fall of 1976; but had limited success in obtaining workers. In December 1976, it was estimated that ½ of the laid off workers had found jobs.

During an election campaign, the leader of the Social Credit party, William Bennett, had promised that the mill would stay open. Bennett was elected Premier and faced a dilemma. If the government, as the principal shareholder, forced CanCel to keep the mill open, it would be vulnerable to an attack from the minority shareholders who would claim that keeping the mill open was not in their best interests. However, social and political goals also confronted the government. The election promise had been made; and it was economically desirable to keep the mill open in an area of high unemployment. There appeared to be no way to satisfy the demands of both sides. The government had also considered paying a subsidy to Canadian Cellulose to keep the mill operating, but decided against it. Bennett summarized the government's actions as "We're acting as the government of the province of British Columbia, not as the shareholders."¹¹ Bennett eventually announced that he would not interfere with the closure. He felt that the company had acted responsibly in making the decision to close the mill as world markets for sulphite pulp were depressed; the plant was a serious polluter of the environment; and generous layoff benefits had been arranged for employees.

ENVIRONMENTAL POLLUTION

As soon as CanCel began operating, the Federal Environment Department was pressuring it to clean up the air and water pollution problems at the Prince Rupert sulphite plant. The pollution problem at this mill was a contributing factor in the decision to close the mill. An investment report from Pemberton Securities Limited noted that the mill was one of the worst polluters in British Columbia; and then went on to observe:

¹¹ Hall, Leiren, "Government Subsidy for CanCel Studies to Delay Announced Plant Closing," *The Vancouver Sun*, July 30, 1976 (Quotation from article).

... Strangely enough, the federal government through Environment Minister Jack Davis, has suddenly adopted a get-tough attitude now that the provincial government holds a controlling interest in the company.

Provincial Resources Minister Robert Williams, under whose jurisdiction the problem lies, has told the federal government that Canadian Cellulose cannot afford to immediately eliminate the discharge problem.¹²

In January 1977, severe pollution was caused when polychlorinated biphenyls (PCBs) were spilled at the Prince Rupert plant. The company spent \$200,000 to clean up the pollution and in March 1978 was fined \$24,500 under the Federal Fisheries Act.

Corporation executives claim that they have responded in the same way as any other corporation would to pollution problems. The fact is that a major shareholder of the corporation has not caused CanCel to pay more or less attention to environmental problems than any other private sector company would in the same circumstances.

MINORITY SHAREHOLDER RIGHTS

In 1974, there were about 6,500 other CanCel shareholders. By 1978, the number was 5,100. Part of this reduction is accounted for by the government's increasing its share ownership by 2% to 81%. Some shareholders claimed that the government, as a major shareholder, was in a conflict of interest situation. The government's concern for employment and development may not be in the minority shareholders' best interests. It was claimed that the dividends paid were too low; as the government was interested in retaining earnings, not dividends. It was suggested that assets of the company were undervalued; and that the directors were not representing all shareholders as they were supposed to - since interest of the majority and the minority shareholders were incompatible.

BUSINESS CONDITIONS

During its 5 years of operation, CanCel has been faced with the usual changes in business conditions applicable to all enterprises in the forest industry. Prices of raw material increased, creating pressure on profits. The Anti-Inflation Board regulations limited the scope of management's actions in some areas. Government policies relating to the management of the province's forests had to be complied with; for example, the additional costs associated with meeting the regulations relating to road building in the logging and woods operations. Management also had to contend with the cyclical nature of the pulp prices that peaked in 1975 then reached a low again in 1978 before recovering. Foreign exchange circumstances had to be closely monitored, especially when the Canadian dollar was at a premium in relation to the American dollar. Additional social responsibility concerns surfaced at various times. In 1975 roads formerly leased by CanCel from 3 Indian reserves, were closed as a tactic in forcing the provincial government to negotiate the

¹² "Analyst Likes CanCel Prospects," op. cit.

Indians' land claims. Canadian Cellulose got into the housing of workers in 1974 by providing rental accommodations for single and married employees. A sit-in occurred at an associated company in Belgium, Papeteries de Gastushe, when the decision was made to liquidate the company in 1976. Canadian diplomats were asked to mediate in the workers' effort to save the company.

In the face of these circumstances, CanCel's president still insisted that the corporation had to operate on the basis of the profit motive and suggested that a 15% return on invested capital would be desirable in the pulp industry in order to compensate for the risks taken and the employment provided. CanCel's performance was considered to be satisfactory during the 1973 to 1977 period, in light of the difficulties faced by the company (refer to Exhibit I). Earnings before a special tax credit for the 1973 fiscal year were \$7.1 million; in 1974, \$29 million; in 1975, \$15.3 million; in 1976, \$14.6 million; and in 1977, \$12.6 million. In 1976, CanCel borrowed \$70 million in long-term promissory notes; and in 1978, arranged for \$45 million in bank credit. Neither borrowing was guaranteed by the government.

THE COMPANY IN 1978

Executive, a business publication, claimed that CanCel's performance was one of the dramatic turnabouts in recent corporate history. The company had come from a non-profitable position prior to 1973 to a state of financial stability in 1978. Operations were expanded and the corporation's position as an important world supplier of softwood pulp and lumber was established. The corporation went from a foreign owned subsidiary to a 98% Canadian owned enterprise. No government money was invested and dividends were paid to shareholders, including the government. The corporation appeared to have responded well to the challenges and opportunities it identified in 1973. The rescue operation had been successful.

There are several reasons to which CanCel's success could be attributed. Management and the business media believed that that the British Columbia Government (under NDP and Social Credit) had accepted the principle that CanCel was to be operated independently by professionals on a business basis, with a Board of Directors comprised of individuals from the private sector.

The ability of top management to use a strategic management approach also may have helped. Management's ability to identify markets, make large capital investment decisions, and cope with social demands with a planned, instead of crisis approach, was bound to have contributed to the performance of the company.

It might also be argued that the success was a result of a good sense of timing and, maybe, even luck. The corporation capitalized on the strong 1973 and 1974 pulp market. The decision to expand bleached kraft softwood pulp capacity was also timely, as demand increased, and prices recovered.

THE FUTURE

Effective March 1, 1978, Ronald M. Gross resigned as president and chief executive officer. Donald N. Watson took over from Mr. Gross. Mr. Watson was the former chief executive of Pacific Western Airlines Limited and had been a CanCel director since 1973; and chairman of the board since 1976. The 5-year period from 1973 to 1977 appears to be a definite stage in the life of the corporation. With performance greatly improved and a new president, the year appears to be the beginning of a new stage.

In 1978, another event occurred that may be important to CanCel's future. The British Columbia Resources Investment Corporation (BCRIC), a crown corporation, was established in 1977 and began operations early in 1978. BCRIC is to be the holding company, or investment company, that would take over several major enterprises in which the British Columbia Government had an investment. Included in the BCRIC portfolio would be the government's 9.8 million shares of CanCel. Two BCRIC directors are also to be on CanCel's board. It is planned that BCRIC would sell shares to the public in the near future, thus reducing government investment to 50% or less.

The question for top management in 1978 was how to maintain the corporation's performance and to ascertain a future course of action. Several possibilities existed for Cancel including:

- Further improvement in the corporation's performance with existing facilities;
- Expansion of existing facilities and building of new plants;
- Participation in joint ventures;
- Diversification horizontally or vertically; and
- Acquisition of other corporations.

Management also had to decide whether to remain British Columbia-based, or to expand outside the province. The reduction of government ownership will be an issue with the possibility existing for the sale of some, or all, of the shares to private sector investors.

EXHIBIT 1
CANADIAN CELLULOSE COMPANY, LIMITED*
TEN YEAR REVIEW OF FINANCIAL PERFORMANCE
1968-1977

| | 1977 | 1976 | 1975 | 1974 | 1973 | 1972 | 1971 | 1970 | 1969 | 1968 |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| EARNINGS AND FINANCIAL POSITION | | | | | | | | | | |
| (Millions) | | | | | | | | | | |
| Net Sales | \$161.1 | \$177.6 | \$156.0 | \$191.5 | \$133.8 | \$118.8 | \$ 83.5 | \$ 83.5 | \$103.5 | \$ 88.2 |
| Net Earnings/Loss | 17.3 | 26.1 | 27.5 | 50.9 | 12.3 | (8.0) | (48.8) | (3.9) | 1.4 | (9.5) |
| Working Capital | 57.1 | 65.3 | 65.6 | 52.6 | 13.2 | (32.6) | 19.5 | 12.0 | 20.6 | 24.4 |
| Fixed Assets | 347.6 | 272.3 | 276.9 | 263.6 | 252.3 | 253.1 | 245.9 | 241.8 | 237.2 | 227.4 |
| Accumulated Depreciation, Amortization & Depletion | (204.8) | (195.5) | (216.0) | (206.4) | (198.1) | (125.3) | (116.9) | (81.7) | (75.6) | (67.4) |
| Other Assets | 3.1 | 4.3 | 4.0 | 3.4 | 2.6 | 3.5 | 4.4 | 4.5 | 2.3 | 2.6 |
| Long Term Debt | 79.5 | 41.2 | 47.7 | 54.2 | 60.5 | 71.2 | 117.4 | 103.6 | 102.8 | 105.4 |
| Deferred Income Taxes | 5.0 | .1 | .1 | .1 | .9 | - | - | 2.7 | 6.5 | 6.4 |
| Minority Interest | - | - | - | - | - | 29.9 | 29.9 | 15.5 | 15.5 | 15.5 |
| Shareholders' Equity | 118.5 | 105.1 | 82.7 | 58.9 | 8.6 | (2.4) | 5.6 | 54.8 | 59.7 | 59.7 |
| <u>Earnings Per Share*</u> | | | | | | | | | | |
| Earnings Before | | | | | | | | | | |
| Extraordinary Items | \$ 1.03 | \$ 1.20 | \$ 1.25 | \$ 2.38 | \$.58 | \$ - | \$ - | \$ - | \$ - | \$ - |
| Net Earnings | 1.41 | 2.14 | 2.25 | 4.17 | 1.01 | - | - | - | - | - |
| Dividends | .32 | .30½ | .30 | .05 | - | - | - | - | - | - |

Exhibit 1 – continued

Changes in Financial Position

(Millions)

| | 1977 | 1976 | 1975 | 1974 | 1973 | 1972 | 1971 | 1970 | 1969 | 1968 |
|--|---------|---------|---------|---------|---------|--------|----------|--------|---------|--------|
| Sources: Cash Flow from Operations | \$ 32.7 | \$ 37.3 | \$ 38.4 | \$ 61.9 | \$ 24.1 | \$ 2.8 | \$ (8.0) | \$ 3.0 | \$ 11.9 | \$ 1.9 |
| Other, including Long Term Debt | 47.5 | .1 | .4 | .1 | 42.3 | 1.6 | 35.3 | 13.1 | 2.7 | 17.6 |
| Total Sources | 80.2 | 37.4 | 38.8 | 67.0 | 66.3 | 4.4 | 27.3 | 16.1 | 14.6 | 19.3 |
| Applications: | | | | | | | | | | |
| Fixed Assets | 77.9 | 27.5 | 14.9 | 14.6 | 9.5 | 10.2 | 12.1 | 11.2 | 12.7 | 4.0 |
| Dividends | 3.9 | 3.7 | 3.7 | .6 | - | - | .5 | 1.0 | 1.5 | .5 |
| Long Term Debt | 6.5 | 6.5 | 6.5 | 7.1 | 7.3 | 46.2 | 7.2 | 9.9 | 4.2 | 4.3 |
| Other | .1 | - | .7 | .3 | 3.7 | .1 | - | 2.6 | - | 15.6 |
| Total Applications | 88.4 | 37.7 | 25.8 | 22.6 | 20.5 | 56.5 | 19.8 | 24.7 | 18.4 | 24.4 |
| Increase (Decrease) In Working Capital | (8.2) | (.1) | 13.0 | 39.4 | 45.8 | (52.1) | 7.5 | (8.6) | (3.8) | (5.1) |

Notes:

* Comparative data for 1972 and prior is that of Columbia Cellulose Company Limited.

** Per share information is not available for 1968-1972

since the reorganization at June 29, 1973, renders comparison with Columbia Cellulose inappropriate

Source:

Company Annual Reports

QUESTIONS:

1. Policymakers (politicians and civil servants) are frequently confronted with the possibility of rescuing a failing private sector corporation by taking over the enterprise. As a policy maker, what criteria should be considered when deciding whether or not a failing enterprise should be taken over by the government?
2. After the government takeover, what should be the nature of the relationship between the policy makers and the management of the corporation?
3. As a policy maker, do you consider use of the “business strategy” approach to corporate planning appropriate in a government-owned corporation?
4. As a Cancel manager, identify various strategic alternatives that the corporation might follow in the future.

IPAC CASE SERIES

**A Case Study of Government Rescue and Turnaround
by Robert W. Sexty**

TEACHING NOTES

CASE OBJECTIVES

1. To analyze the rationale for a government takeover of a troubled business enterprise.
2. To identify and understand the dynamics in the relationship between a government and a business enterprise in which it is a majority shareholder.
3. To study the concept of business strategy in a government-owned enterprise.

The case is written so that the concepts from public administration are combined with concepts from business or corporate administration to analyze the management and control of a commercially oriented enterprise.

GOVERNMENT TAKEOVER

The instructor might review the reasons for government takeover of business enterprises. This could be done in a lecture format, or through class discussion. Some reasons for takeover are (not an exhaustive list):

1. To operate a natural monopoly or essential service. Some governments have felt that it is socially and economically desirable to carry out those activities where natural monopolies exist. Examples are public utilities, in particular the takeover of electricity utilities in Quebec and British Columbia.
2. To maintain employment or to further economic development. Example: Federal and Nova Scotia governments' takeovers of Cape Breton coal mines and Sydney steel mills.
3. To rescue a dying or financially troubled business enterprise. Examples: Labrador Linerboard Limited, Manitoba Forestry Resources Corporation, and CN (originally).
4. To implement a government policy or program. Examples: British Columbia's acquisition of Dunhill Development Corporation Limited (later Housing Corporation of British Columbia) to implement a housing policy.

The instructor should now have students identify which reason was appropriate in the CanCel case. The case emphasizes that several reasons existed: possible fragmentation of the company, welfare of minority shareholders; Canadian ownership of business exploiting a natural resource; the philosophy of the socialist government; and possible loss of employment. Students might be asked to identify the main reason (most likely employment in a particular area) and to state their rationale. The instructor may wish to point out the "situational" circumstances involved, that is, the coming together of several factors: a

socialist government, an indifferent majority owner, need for revitalization of a major British Columbia industry, unwillingness of the private sector to purchase.

A fundamental question that might be asked is “Was the takeover deal a good one?” The question should be answered given the circumstances in 1973. Students should be pressed to give a rationale for their pro or con answers.

CRITERIA TO CONSIDER PRIOR TO TAKEOVER

Policy makers might consider the following criteria in an attempt to ascertain whether a failing private sector corporation should be taken over by the government:

1. **The status of the economy in the area of the failing enterprise** – If other industries are healthy and growing, there is less need to take over the corporation.
2. **The number of persons unemployed** – The greater the number of workers, usually unskilled, that will be put out of work, the greater the need for takeover.
3. **The lack of alternative employment** – This relates to 1. And 2. above, but is considered a separate criterion as comparability of employment may be a factor. If the skills of displaced workers do not match the skills required in the new employment opportunities, the government may be under greater pressure to assume ownership if retraining is not feasible.
4. **Private sector interest** – When the government fails to interest other private sector enterprises after offering various forms of assistance, it is left with only two alternatives, takeover or allow to fail.
5. **The political costs involved** – In a takeover of a failing corporation, the economics and politics of nationalization have not been prohibitive to Canadian governments. Seldom has the business sector strongly opposed a government takeover in the failure/rescue category, and, in some cases, business has endorsed a takeover. In a takeover of a failure/rescue type, business is seldom threatened.
6. **The cost of acquisition** – Usually the direct cost of acquisition is modest, although the assumption of debt may be substantial. Frequently, operating costs are partly offset by subsidies, grants or loans previously made.
7. **Degree of competition for viable private sector enterprises** – If the takeover involves a corporation with no competitors in its economic sphere of operation, the takeover is less threatening to the private sector and more politically feasible.
8. **The impact for private enterprises (or customers) along the industry integration continuum** – If the failure of a corporation will create a “break” in the integration of that industry in Canada, or a region, resulting in additional disruption and need for adjustment, then a government might consider a takeover more appropriate. If

customers of the failing corporation are large in number (that is, the ultimate consumers), a government may feel continued operation of the corporation to be justified, especially if no alternative source of the product is readily available.

9. **The groups to benefit** – If it is perceived that the owners of the failing corporation, or other private sector corporations, are to benefit more than workers, a government is less inclined to takeover.
10. **Future expectations** – If the economic prospects for the affected region, or the industry, look at all optimistic, a government may be less inclined to assume responsibility for a failing corporation.
11. **Complications arising from Federal intervention in provincial jurisdiction** – The Federal Government may be reluctant to become involved in a failing corporation clearly within provincial jurisdiction. On the other hand, ownership is a mechanism for becoming involved in a provincial area.

RELATIONSHIP TO GOVERNMENT

CanCel was able to maintain an independence from the British Columbia government. In the case, there are several reasons for this:

1. A board of directors excluding politicians and civil servants. The instructor may wish to discuss the pros and cons of having politicians and civil servants on a Board.
2. A strong, capitalistic senior management team, particularly the president.
3. Evidence that the government appeared to resist meddling in CanCel's internal affairs; e.g., strike issues, closure of plant issues, etc.
4. The immediate improvement in CanCel's financial performance, whether attributable to luck or good management.
5. The existence of competitors; that is, CanCel operated in a competitive environment.
6. The existence of minority shareholders; that is, shared ownership.

These points are discussed in greater detail in the author's article "Independence Strategies of Crown Corporation Management" (*Optimum*, vol. 9, No. 3, 1978, p. 5-13).

The instructor might wish to point out the events by which Cancel's independence was established and to speculate why this was allowed to occur in this government-owned corporation.

BUSINESS STRATEGY

This section of the analysis is designed to introduce the concept of business strategy in the management of government-owned corporations. Through this analysis, the reasons for Cancel's turnaround and recovery can be identified.

A definition of business strategy is: a unified, comprehensive, and integrated plan designed to assure that the basic objectives of the corporation are achieved. The concept of strategic management is considered to incorporate various activities including: identification of objectives; the determination of present and potential threats and opportunities in the environment; the assessment of the corporation's resources, especially its strengths and weaknesses; the implementation of strategy; and the evaluation of strategy. This case is concerned with CanCel's identification of a strategy in 1973, how well that strategy was implemented through to 1978 and what CanCel's strategy should be for the future.

At this point, the instructor may wish to ask the class a series of questions. Some possible questions are given below, with answers.

Q. 1. What is CanCel's corporate strategy?

A. 1 To be a non-integrated producer of bleached softwood kraft pulp and to market this product in several foreign countries. Note: Decisions relating to capital improvements and plant closures or expansion are matters of strategy implementation.

Q. 2. What corporate policies had to be developed to implement this strategy?

A. 2. Policy towards threats of government interference. Develop marketing approaches. Formulate and implement program to improve efficiency. Approach to responding to environmental pressures; i.e., hostile industry attitude, industrial relations, plant closures, pollution.

Q. 3. Why was CanCel successful in accomplishing its strategy?

A. 3. Some would argue that it was luck! More substantive reasons are: change in the market conditions for pulp; management's correct identification of problems and its ability to make decisions; and the decision to expand just as markets were recovering.

Q. 4 What dangers are there in this strategy?

A. 4 The strategy is basically one product, and one type of market, foreign. To some extent this leaves CanCel vulnerable when weak pulp markets exist. Markets in the pulp and paper industry tend to be cyclical and weak markets occur fairly regularly; for example, weak markets existed for Cancel in 1973 and 1978. Note that CanCel management is sensitive to vulnerability in foreign markets by selling in several countries.

A good question to conclude on would be "What strategy should CanCel follow now?" There are several possibilities:

1. Status quo – That is, do nothing. The company is profitable and one could argue that there is little need to change strategies.
2. Expand upon the existing strategy. This would argue that the company do more of the same. The logic is that CanCel should continue to do what it knows best and not venture into unfamiliar areas. This is referred to as horizontal integration. It could be accomplished by building additional plants, or purchasing other companies (or parts of them) and operating in the same industry.
3. Vertical integration – The company could decide to depart from its present strategy and diversify forward into the production of finished products. Again, this could be done by plant expansion or by purchasing an existing plant or company. This strategy requires the company getting into less familiar areas; therefore, higher risk activities.
4. Joint ventures – The company could get into other pulp and paper industry operations by entering into joint ventures with other companies. For example, establishing a pulp mill with a newspaper chain.
5. Takeover – The company could use its excess cash and invest in another company in the paper/wood industry, or any other industry. This type of diversification would be more risky and more unrelated to the pulp and paper industry.

There are several other matters that might be considered:

1. Should expansion occur outside the Province of British Columbia? Should the Government discourage or encourage expansion outside the Province?
2. What about the minority shareholders? Do they have a case for their complaint? Should the Government give special consideration (protection) to these shareholders?
3. At what price should the Government sell the company? (Instructor may want to review the BCRIC situation).

CONCLUDING COMMENT

It should be pointed out that CanCel was not a Crown corporation, but instead, a private sector corporation whose majority shareholder (81%) happened to be the Government of British Columbia.

The case illustrates a government's successful rescue of a troubled enterprise. Because a success story is illustrated, the point can be made that government involvement does not always lead to failure or expensive financial support from government revenues (that is, taxpayers).

ADDITIONAL READING

Gordon, Marsha. *Government in Business*. Montreal. C. D. Howe Institute 1981.

Sexty, Robert W. "Autonomy Strategies of Government Owned Business in Canada," *Strategic Management Journal*. Vol. 1, No. 4, Oct. – Dec. 1980, pp. 371-384.

Tupper, Allan. "The State in Business," *Canadian Public Administration*, Spring 1979 (Vol. 22, No. 1), pp. 124-150.

Comments

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