

Growth in a Crisis: COI Debate

As the first item on Friday morning's agenda of Afera's 52nd Annual Conference, Eric Pass, Afera's outgoing Marketing Chairman and Director of Corporate Planning & Communications at Nitto Europe N.V. (B), moderated a 55-minute 'Interactive Session with Captains of Industry' focusing on 'Growth in a Crisis'. This was a very successful interactive debate among six 'captains' of the self adhesive tape industry and the other 100 attendees of the Conference. COIs included Jef Smets of Avery Dennison; Hubertus von Voithenberg, formerly of tesa and currently a consultant at ChemQuest Group and Afera TC Member; Mike Punter of Parafix Tapes & Conversions, Ltd. and Chairman of Afera's SDC Group; Lutz Jacob, formerly of ExxonMobil and outgoing Afera TC Chairman and consultant; Glen Anderson of the PSTC; and Mike Ayres of Advance Tapes International Ltd. and Afera SC Member.

Mr. Pass: We have 190 years of experience in our industry sitting on this panel. Over the next hour, we will be talking with people who are very familiar with our industry about their views on the current crisis and what we should be doing about it, and about some industry-specific topics.

We are coming out of the Lehman shock of the last year, and we are all facing tough economic times. It has been said that this is not a simple economic crisis. It is a problematic one which is touching some of the fundamentals of our economy and society. How long will it last, and what kind of recovery will we see? Once we emerge from this crisis, what kind of world order will there be? The same as before? Or will we see major changes?

I derived today's theme from a popular book in Belgium, *Econoshock*, written by Belgian economist Geert Noels, who summarises the major trends that we are faced with in our society, industry and company by identifying six 'econoshocks':

1. Demographic changes
2. BRICs
3. IT (network economy)
4. The end of oil
5. Increasing regulation
6. The green economy.

How did your company experience this crisis? How has it been affected in terms of product range, customer base, number of personnel, and/or any other relevant aspects which you would like to mention?

Mr. Smets: (*Avery Dennison for 32 years, specialty tape business, retiring next year*) Just like many other companies, Avery Dennison was affected early in the crisis, especially within the automotive sector. The first thing we did was look at our product and customer portfolios, focussing on their complexities. As many of us did, we conducted an ABC Group study of our customer, product and raw materials bases over a very short period of time. We then took direct action. Once we knew what the impact was going to be on our operations and productivity, we started looking at our cost structure and adapted the organisation accordingly.

What is critical in this crisis phase is that you take action right at the beginning. We as a company were in a very difficult situation. We did not see the crisis coming, and when it did, we had just finalised an acquisition of \$1.3 billion. Avery is a \$6.5 billion company, so this was a big position for us, driving our debt ratio up from 47% to 53%. So just as the hard times set in, we needed the banks to give us money, but they were deep in crisis. It was very hard for us to get credit while the financial analysts were distributing negative information about Avery Dennison because of the debt ratio of the company following the acquisition.

What we then did was look at the parts of the world where we could restructure less expensively, such as in the U.S. If you restructure at particular higher levels, you may talk about a payback over 6 to 9 months. If you do the same thing in Holland, Belgium or Germany, it may take 3 years' payback time. We started there and then looked at our cash flow—our working capital—and we spent a lot of energy generating our own cash. Finally we were in a position to adapt our costs within European countries, and we did that. So we were a bit later when it came to taking action, which is very crucial in these situations.

Mr. Ayres: *(20 years with Advance Tapes, U.K., a specialty tape manufacturer operating for just over 40 years)* We also didn't see, as I imagine many of the people in this room didn't, the depth of the problems that were approaching towards the end of 2008. But we did start to feel some adverse effects earlier in the year, and we decided to take some steps to reduce indirect costs. For us, the impact of serious destocking by customers was felt in October and November of 2008. That's when we had to take steps to lower capacity by reducing direct labour in the business.

In the same period that was mentioned by Avery Dennison, we had to take steps to preserve cash within the business. This reminds me of the A.T. Kearney presentation at the Annual Conference with the triangle of managing costs, service and working capital within the business. We focussed a lot of attention there, where the balance becomes extremely difficult to try and maintain the right level of service for customers whilst controlling costs and preserving cash during a very difficult time. It is also a challenge to maintain that balance once recovery begins.

Mr. Punter: *(Adhesive tape business for 31 years, Parafix Tapes & Conversions, Ltd. for 7 years)* Parafix is a medium-sized, turnaround company which shot up very quickly. In 2007, we saw a great result. In 2008, we were really going for it until about June, and then we flattened out. I remember a year ago, I was away in the Far East when the crisis hit. I returned to find men in the factory were painting the walls. We had no work. That was a shock. We employ a hundred-odd people and had to take action there and then. My partner, Colin, and I went away over the Christmas period and tore up all our business plans that had been given to us by our managers. We reset the cycle of business and reduced the number of employees by 30%. That's how dramatic it was at Parafix. Our objective for the year had changed from being the best at what we did to mere survival.

We survived, the business has come back and we're back in the profits. We're reemploying some of the talent we let go. Because the people we had to let go were good people, not wasters. But we had to survive, and we did. 'Cash is king' is an important phrase. Because when you don't have any or very little cash, to try and maintain your credit is very difficult when the banks aren't supportive. I have no complaints about the banks we used, however. We ran a little bit short, but our banks supported us. It was tough, but you can get through it. You've got to be pragmatic and early in acting.

Mr. Pass: Yes, it is very difficult when talking about reducing headcount. I would also like to hear the opinion of our American counterpart.

Mr. Anderson: *(PSTC for 30 years, attended Afera Annual Conference for last 10 years)* Speaking for a number of the manufacturers in the U.S., the phrase 'cash is king' is indeed key. Those companies that were struggling with cash are now struggling to determine if they're going to continue to exist. Any downturn immediately gives management the opportunity to eliminate the laggards in their companies. The difficulty was that once they got rid of those lacking in performance, they had to dig deeper. So in the U.S., the average reduction in the tape companies was between 20% and 30%.

Now, when business is recovering a little bit, they're being very cautious by not hiring back. They're concentrating on overtime work or bringing in part-timers. There is a great concern in the U.S. that we do not see this economy continuing growth for more than 30-45 days. We think the first quarter of 2010, as we've shown yesterday, will see a 'W effect'. We're also very cautious. We think in the U.S. that we're going to crawl out of this through 2012. So from this standpoint, we see 2010 to be about the same as what we've experienced since June, and we think in '11 we'll start to gain, but it's

not going to be to the point that we're going to be where we were in '08 or '07. We just don't see this coming back at this point.

Mr. Pass: We have been hearing some views on how companies have been dealing with the crisis. How long do the rest of the panel think the crisis will last, and how will we get out of it? Do you subscribe to the W-curve theory?

Mr. Jacob: *(10 years in tape industry followed by ExxonMobil Chemical for 27 years dealing with the tape industry globally)* Most people believe that the upturn right now may be due simply to a short-lived restocking factor. The question is, is this upturn sustainable over the next year? In Germany, they expect the highest unemployment rate in 2010. This means that private consumption will decrease. This has held up the economy quite well so far, and its decline could start another downward spiral, which may show 2010 as more difficult than 2009.

Mr. Von Voithenberg: *(20 years with tesa, more than 30 years in tape adhesives sealants and tape industry, retired last year and still working as a consultant at ChemQuest Group based in Cincinnati, Ohio, U.S.)* Of course it is difficult to predict the future, but now we are seeing an upswing, and I think this will continue but not at a very fast rate. Perhaps we will see the W effect. There's a famous saying by John Thomas Sladek: "The future, according to some scientists, will be exactly like the past, only far more expensive."

I think you will probably see some hiccups. You deal with many partners in the total supply chain. What happened, which affected most of the industry, is that many raw materials suppliers reduced their capacities along with decreasing demand. Because raw materials were suddenly not available on a previous scale, many had to work on new formulations. There are so many variables in keeping up with the business. I think therefore it will take quite some time until businesses are back functioning properly—perhaps two years before businesses are back at or close to a level at which they were in the past.

Mr. Pass: Most answers seem to point toward facing a difficult year ahead. Assuming those circumstances, what priority should be given to recruitment? Which functions should be strengthened first? Sales, R&D, operations, manufacturing?

Mr. Ayres: I think there is a general consensus here that there had to be some reduction in headcount. Within my business, that was around 10% of direct labour so not quite as severe as some of the other examples. But I think before recruiting, we've been looking at what opportunities there are to mechanise some of our processes. So we're trying to keep the balance of maintaining flexibility but reducing the demand for direct labour.

After this experience, I'm sure everyone here has come to appreciate the costs of employing direct labour. Not just in terms of salary costs but labour requirements which are increasingly strict in ensuring all employees work in a health- and safety-compliant environment. In terms of tactically where we can invest for the future: sales and marketing is certainly an area that we've looked at and where I expect there to be some growth in headcount over the coming months.

Mr. Punter: We've had an interesting time actually. Whilst our customers' engineers have been so quiet, they've been looking at better ways of improving their processes. So we've received an unprecedented number of inquiries for new designs. They are on hold currently, because the projects haven't been released yet. The activity hasn't come back. I suspect we'll see a number of them released soon, followed by our investment more in direct manufacturing employees.

I actually don't think we'll see the depth of challenge next year as we've seen this year. The last twelve months have been an enormous shock to the system. Not just in terms of the functionality of the market dropping, but the lack of confidence. I think what you're now going to see is operating at a level of cautious confidence. Thus I am not with the school of the W bounce. I think there will be a

slow climb up. I don't think the shock and trauma we saw will repeat itself. I don't expect a deep fall again.

Mr. Smets: I think it all depends on what you have done during the restructuring period of companies. Based on my experience, my advice would be: If your goal is to restructure—whether it's 10% or 30% of your workforce—keep your best personnel who have been through this type of crisis before. Lay off the less experienced. The problem is that in an upswing, personnel must be rehired, and this generates issues of trust and loyalty, or the lack thereof, within the company culture. This will continue to be a dilemma for many companies and personnel in the industry.

I strongly subscribe to the U-curve and not the W-. If the economy picks up a little bit, all companies including our suppliers and our customers will build up the capacities. So then everyone will want to benefit from the upturn, however slight, and they will invest immediately in capacity. If we're not careful, we're going to open up the economy again, for those who have capital, and then the second half of the W will be even deeper than the first half. So we have to be careful in spending our money during the upturn. Don't go too fast. Don't overheat the economy. Then we may be able to create a U- instead of diving straight into a deeper second W-.

Mr. Pass: That sounds fairly encouraging. What about the labour market in the U.S.? What sort of emphasis will be put on recruitment? What is your outlook for tape-related companies?

Mr. Anderson: As I visited recently with my members by telephone, two things came up: They are really focussing on growth, and therefore investment in employees is going to be in R&D and scientists. So they have already accepted that they are in an economic downturn, and they are not looking so much to fight over the same piece of the pie. They are looking at how they can grow their companies within the next 30 months. So their recruitment and struggling is centred on finding the R&D, the scientists, the developers. They're also spending a tremendous amount of time and training on their sales force to search out new opportunities. They are not hiring more salespeople; they're just retraining. Their investment is therefore in the labs and determining how they can develop new applications.

Regarding the W effect: Unlike the bar we saw yesterday, with the second half of the W- coming down deeper in '10, the U.S. predicts that the second U- is going to be shallower than what we just experienced. However, what we're concerned about in the U.S. is the first quarter of '10. There are going to be a tremendous number of 5-year loans coming through on commercial buildings. The question that is coming to everyone's mind is, will the banks prevail when businesses cannot pay the loans off on the 5-year terms? Will the small banks collapse, and will the federal government offer support? How will the resulting data and the news media coverage affect the consumer market? What is that going to do to the all of the end-users of tape in the U.S.? How are they going to manage their inventory if we're deluged with the same media coverage and negative thinking as in September/October 2008?

In the U.S., we still see ourselves crawling out of the worst of the economy with experience. But when these loans come due, we do not know what will happen to the banks and how the federal government will handle it.

Mr. Pass: Assuming we're going to emerge from this economic crisis in a few years, will we find the world to be different or the same as before? What is your view on the econoshocks theory? Which one of the econoshocks do you think will have the greatest impact in the coming years?

Mr. Jacob: I think we all hope that something will change in the future, at least in the financial sector, but I don't think that the economy of the world will change for the best. You have the huge countries, the big successes, which will be growing at the same pace or faster in the future. And fortunately, due to the global economy, these will pull the rest of the world out of the shock. I think there will not be a change in the way business is done and the way business will grow. My only hope

is that the financial system will be more controlled so that this kind of crisis cannot hit with the same severity as it did this last time.

Mr. Pass: So except for a modified financial system, it will be business as usual?

Mr. Ayres: I think things will be different from how they were before this crisis, particularly in the financial area. Anybody who is trying to expand their business, particularly if they're not generating sufficient cash internally and must fund future investments, is going to find life very difficult. Certainly in the E.U. with the additional controls being put on banks in terms of capital which has to be held and therefore cannot be lent. So I think things will be extremely difficult for companies which want to invest in their future.

Looking down the list of econoshocks trends, I think some of them certainly are already in full swing and are going to continue. I think one particular challenge for our industry is the fifth one: more regulation. We've had some relevant examples presented at this Conference, such as REACH. In all areas of work, the issue of regulation is only going to grow and make life extremely difficult for our industry. Obviously for those companies which can respond by running efficient, well-regulated businesses, there will be good opportunities.

Mr. Punter: Where there are challenges, there are opportunities. I think what we've got to do is chase the gazelles. We've got to go and find where the business is rather than just sitting back and talking about what happened in the past. The business will change undoubtedly and continue to change. We'll have to train in different parts of the world. SMEs have got that flexibility. They've just got to go and do business somewhere else. There's plenty out there. Don't lose sight of the power of the medium-sized company, because it can react very quickly. If you add up the total creation of wealth of medium-sized companies in the world, it can have a dramatic affect on the business economy.

Mr. Smets: With the Third World relying upon us and Asian business increasingly competing with us, how are we going to deal with the strengthening of our corporate governance and the vulnerability of our banks? Look at what happened and how they affected the economy, the industry and us as individual companies. The outcome could be unpredictable if on one side of the world corporate governance is increasing and on the other side, the Asian world is less regulated and interfering in our markets. If this happens, how are we going to deal with this?

I agree with Mr. Ayres that regularisation is becoming an issue and I am deeply concerned. I lived in the U.S. for ten years, having just returned in November 2008. When I saw the REACH presentation at the Annual Conference, I was shaking, because Mr. Verspoor was painting a doomsday picture. That's what I would expect from a consultant of course, but if only 10% of what he said is true, think about those products which are less than 1,000 tons. What are we going to do with them? Think about adhesive formulations. What are we going to do with the hundreds of components which are in them? On an individual basis, how are we going to deal with these challenges? Will it cost us \$100,000 per regulation, or where are they going?

Having nothing to do with the crisis in my opinion, these two things are going to affect the future of the tape industry. There are opportunities out there. It's the underlying control systems I think which are going to be difficult to deal with.

Mr. Von Voithenberg: I do not have great trust in what is happening with the banking system. I think the regulations put into place by the government are trials. Nobody knows if they will be really effective, and some gains are still being taken, so cash management will remain the name of the game for companies in the years to come.

Globalisation is a real, larger opportunity rather than a threat. Of course you will increase your competitiveness in local markets. You will probably find yourself on the slippery slope of

commoditisation of commodity products, but on the other hand, you have a large opportunity to expand in other countries like the BRIC states. I think the better companies can manage their processes, keep their costs down and invest this money in order to develop in these countries, the more they will benefit. Many companies are building up organisations in Asian countries, India and Brazil, so they need many technical application engineers to handle the speciality products in these countries. So there are big opportunities out there.

Regulatory matters I don't see as that critical. Of course, now there is a big basket of regulation, but I think most of the people are overwhelmed. They see a thick booklet with lots of words and paragraphs, and it's just too cumbersome to go through. That's what's going on now. You have to deal with a lot of bureaucracy, a lot of pre-registering of products, but I don't think at the end of the day so many products will be killed off. Perhaps see it as an opportunity to optimise your raw materials portfolio in some cases. But I don't see a big problem occurring with raw materials. I agree that the effects of REACH and other regulations will only be clear in 5, 6, maybe even 10 years from now.

Mr. Anderson: In the U.S., we're talking about a correction, not an economic downturn. From the way people are doing business and how consumers are spending, this entire economy has been a correction. 100% of my members say they have not lost market share to competing fastening systems.

So understanding that, and the way that people are thinking in North America and operating their businesses, is brand new. They've got to think sourcing; they've got to think cash; and they've got to think, how do they operate their company? If they are not losing market share, they are spending an abnormal amount of time with their customers. They are even trying to get ahead of their customers, trying to understand what's going to occur with their customers, so that they can manage their downstream of suppliers and stay very close to the network.

So I believe the old modelling of how you manage business doesn't apply. Unfortunately for those of us who are older, we cannot look at history. We have to become innovative and creative. We've got to think differently about how we manage our businesses. And we've got to think, if we cannot manufacture it, where do we get our product so that we can sell the products and keep the customers we want? So globalisation, sourcing, alternative methods, and close proximity to the customer are critical to staying alive.

A cultural change in the U.S. has occurred: People are spending money differently, moving to a more savings economy. I enjoy the way you folks in Europe live; you're so conservative. I wish that spending culture would move more quickly into the U.S. so we could balance ourselves and our lifestyles appropriately.

Mr. Pass: There are many opinions on this panel about REACH. What are your views on its content, purpose, importance and implementation?

Mr. Ayres: Most reasonable people would probably accept that the premise on which REACH is based is sensible. Where it starts to become a problem is where we're all involved in running businesses. It's how these principles get converted into actions which we can sensibly apply. And that's where the difficulties arise. When you've got so many governments with their fingers in the pie, with different interests, trying to come up with a common set of rules for how this will be put into practise—that's when you step into serious problems.

Furthermore, when we're listening to Mr. Verspoor, what we want to hear is concrete information about what we in this business should do. Sometimes that can be given, but in many cases it can't. It's still 'let's see how this thing shakes down, and we'll let you know what you need to do.' So that's very difficult to work with. You want a little more certainty in things you can control, and the number of question marks just makes REACH a big problem.

Mr. Smets: It is a great initiative if you talk about health and the environment and the future and our children. I believe that, but I haven't seen any successful regulatory implementation where the government is heavily involved. I do hope that it is not only the government, but some experts, who are going to review this. If you leave it to the government, I expect a lot of bureaucracy. What I also learned yesterday during the presentation on REACH is that I have to learn a new language, because many of the acronyms I don't understand at all.

Another concern: What about competition in the supply chain between the different regions, such as the U.S., Asia, and Latin America? How can they come into Europe with all those regulations we've put into place? So I hope that common sense will prevail.

Within our organisation in Belgium, where we have about 450 people, we have one, full-time regulatory consultant who will stay on one more year. Hopefully we will not have to engage more people to support us on REACH within our organisation. Otherwise this may have a negative impact on our costs. Hopefully over time what we learn from the regulatory implementation process will become a positive opportunity instead of a negative threat as I see it today.

Mr. Anderson: If those of you in Europe are confused by REACH, I can say that in the U.S. the confusion is horrendous, particularly among our tape producers. It is the multinational tape producers which have applied the resources, so they understand REACH. Those that are not multinational and supplying tape products, I suspect, will lose market share in those areas. From the calls that come into my office, it is obvious that the smaller tape producers have not invested in understanding or complying with REACH, and certainly the PSTC cannot give them the answers.

Once the healthcare issue is resolved in the U.S. with our new president, we anticipate that REACH will be put on the legislative agenda in the next two years. Overall we cannot fight the concept, which is a correct one. It's the confusion around the implementation that it brings. We will be facing this in the next 5 years in the U.S.

Mr. Punter: I wish you hadn't asked me this question. It's a total cost. It's a pain in the ass, and I see no value in it for my business.

Mr. Jacob: I think REACH is basically a good thing. The only problem is that as it currently exists, like much of E.U. legislation, it has become a bureaucratic monster, so there are a lot of costs involved. I hope that in the future, it will not be used as a sort of trade barrier between the regions. Creating trade wars based on REACH, such as with the U.S., would be an unfortunately effect of the legislation. People may play on REACH's limitations in order to protect their economies.

Mr. Von Voithenberg: The future of the tape industry is inevitably linked to REACH and similar legislation. REACH is a bureaucratic monster, caused by a lack of knowledge within the government. That's why industry associations such as Afera are vitally important in taking action with key government players and industry consultants and participating in the legislative process in order to ensure that the content of these regulations is accurate. Afera has greatly succeeded in representing the interests of the tape industry in these processes.

If you talk of substances of very high concern: Nobody wants to have products labelled with skull and crossbones, of course. In the past, companies have worked on formulations to find other raw materials and products. So it's an opportunity, albeit an expensive one. But you'll probably have to do this if you want to survive in various areas. So I think REACH's effect is not really easy to predict, but I do believe that we can do a lot individually to prevent the worst of outcomes for ourselves.

Mr. Pass: So there are mixed opinions on this panel about REACH, ranging from seeing it as a burden to treating it as an opportunity over the long-term. I am confident that our audience has learned a great deal from listening to the opinions of these notable tape COIs.

Before this and all Afera's events, the Association's policy for Member compliance with competition law was reviewed and acknowledged by the participants.