DESIGN EVOLUTION AT CHAMPION INTERNATIONAL

Synopsized from:
What Works: A Decade of Change in Champion International
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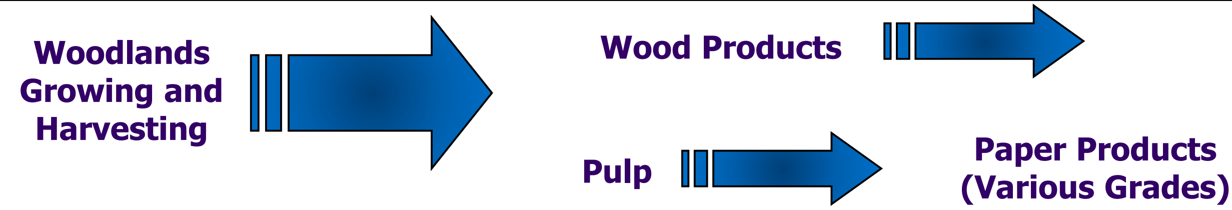
Background

<u>Forest Product and Paper Industry Context:</u>

1997: $600B sales globally
$200B sales by U.S. companies

<u>High Level Value Chain and information about the industry:</u>

Figure A – (Simplified) Value Chain Forest Products & Paper Industry



Most Products are commodities, and prices are market determined.

Cyclic demand; large fluctuations in price. Very hard to make money during down periods.

Capacity management and cost structure are critical; paper mills are profitable only when operating at near or full capacity. Global industry over-capacity has dogged the industry.

Historically the industry has been characterized by very strong union power, in large part because running a paper mill was more of an acquired art than a science. When the operators went out on strike, managers could not run the mill effectively or safely. This had led to very narrow job descriptions and "featherbedding"—a practice whereby any particular operator was only certified to do a narrow range of tasks, increasing the number of union members who were employed, and resulting in particular employees being idle for some part of each day. In the Pacific Northwest, the paper industry was the home of the "Wobblies"—a particularly militant union group, known for using violence and vandalism during periods of difficult labor negotiations or strikes.

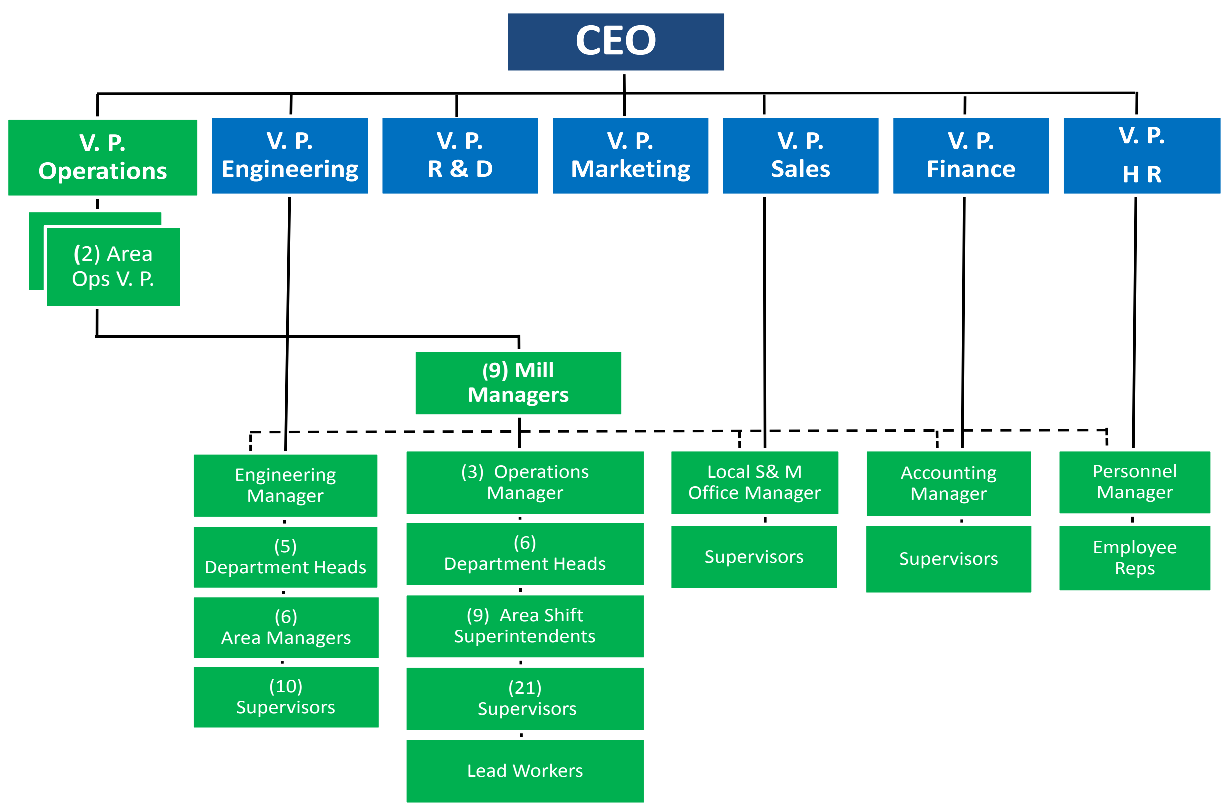
Around 1980 this operator power began to be eroded by computerized process controls, reducing the extent to which running paper machines is an acquired "art", and making it possible for management to continue to run a mill even during a strike. Across the industry, this readjustment involved rancorous and difficult period of readjustment of relations between unions and management. A number of companies, including Champion, started union/management collaborative efforts to work together to establish a better working environment and a higher performing work system.

Champion International:
Early 80's: a large industry player with mediocre financial performance. It operated in most segments of the value chain. (woodlands, lumber mills, pulp, and paper mills), but the pulp and paper business constituted the majority of its operations. It had woodlands and paper mills in the Southeast of the U.S. and in the Northwest. It was at best a mediocre player in the industry from a financial perspective. In the early 1980's it began an aggressive effort to work with its unions to restructure its paper business, and most particularly its paper mills.

Initial state:
Champion started off as a large functional organization, with all functions in its paper mills reporting directly to the company HQ in Stamford, CT. It's paper operations were divided into two areas (east and west). Each area had 9 mills. With only two exceptions, mills were tooled to product one grade of paper: glossy (coated) paper, household paper (napkins, toilet paper, paper towels), newsprint, and specialty paper. Switching from one grade of paper to another was almost impossible, as it involved a fundamental switch out of very expensive technology. These grades of paper sold to different customer sets, so a particular mill was aligned with only one of the customer sets.

Paper is bulky and in some cases heavy, and expensive to transport. Therefore, much paper is sold in the immediate areas surrounding a mill. Each mill manager had a multi-functional leadership "team". Only the operations function reported directly to the mill manager. The other members were hard-lined back to their corporate function. The job of this team was to run the mill as a little business, producing efficiently, forecasting accurately, and building as large a local business as possible. The operations group was rewarded primarily for operational indicators such as quality, utilization, cost, and safety. The cross-functional team members were rewarded for functional performance and for the profitability of the local business. Unionized employees received hourly wages.

Figure B – Initial Structure (Partial)

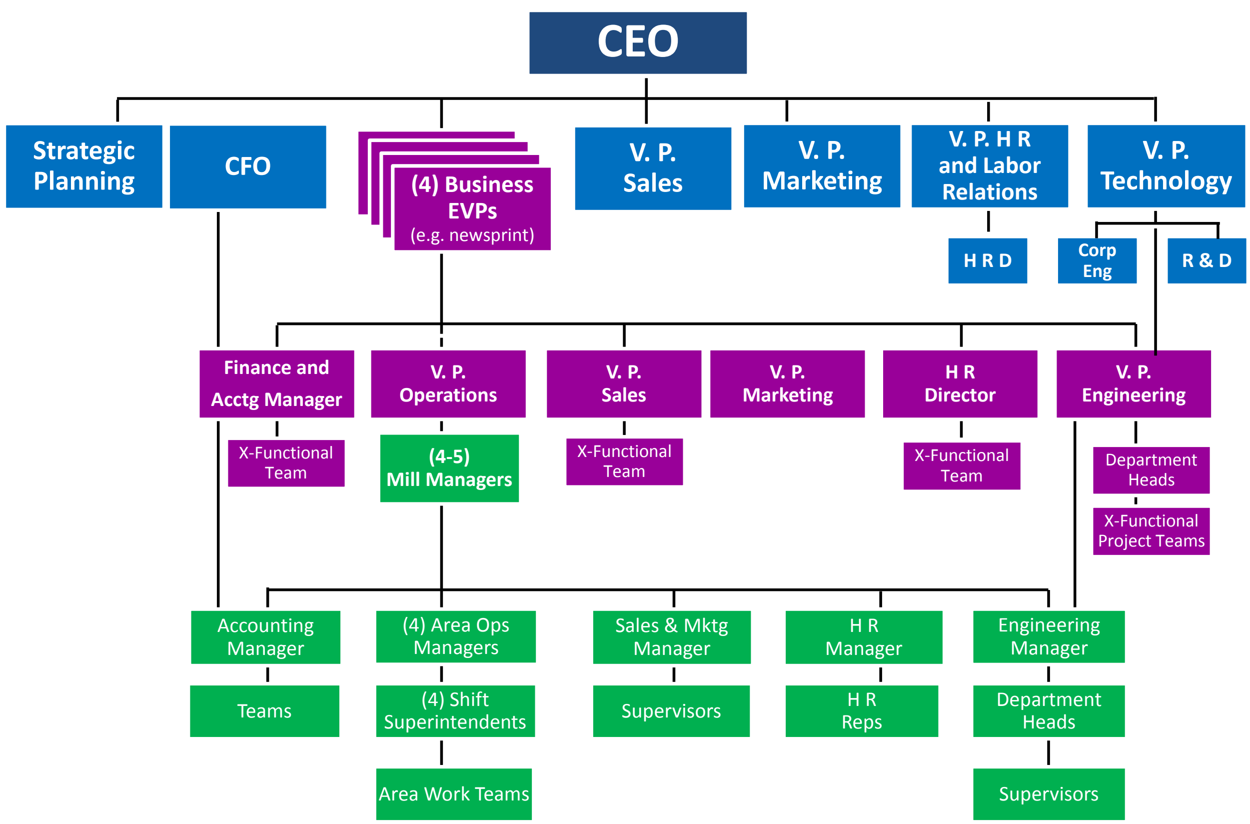


CHAMPION INTERNATIONAL RESTRUCTURING (1980's)

In the early '80's, Champion International started an extensive change process and restructuring. The elements of this transformation included:

- A rationalization of the portfolio of mills and products, with a focus on profitable mills and profitable product families, and on market share growth. This included several mill acquisitions the divestiture of unprofitable facilities, and the introduction of new technology into many of the mills.
- New Business Unit Structure: The integrated functional organization was decentralized and broken into 4 product-oriented businesses (e.g., household paper, newsprint, coated (glossy) paper, specialty paper). This resulted in businesses that were technology and market oriented. P&L accountability moved to the business unit level.
- Corporate level functional leaders were bonused based on company performance. For the most part these had skeleton staff. The technology and finance VP's retained matrix reporting control over the functional leaders in the businesses, and retained a significant corporate staff. But the executive bonuses of all the functional leaders in the businesses were tied to business unit performance.

Figure C – Phase One Restructuring (1980's)



- The transformation was guided by a vision that included a commitment to an employee involvement philosophy and following a socio-technical systems design process:
  - Characterized by high levels of top management leadership and involvement, and broad involvement throughout the company in visioning the future, planning, and leading the change process.
  - Followed the principle that "those whose jobs are being changed should be involved in planning the changes".
  - Broad Union/Management cooperative leadership and planning through a series of transformation committees.
  - High level transition teams were set up at each mill for coordination and learning: local changes planned by local teams. The company provided external consultants to work with each local union/management transition team.
- Participative socio-technical design efforts (aimed at jointly optimizing technical processes and people outcomes) were first put in place in several pilot mills. After initial trust had been established in these pilot efforts, the approach was then rolled out rapidly to other plants.
  - In each mill, designing was carried out by representative teams of employees.
  - Based on process flow analysis: workers broken into self-managing teams that were responsible for running the production process and controlling variances and optimizing performance in each major work process.
  - In many mills, large capital investment in new machines.
  - Lean and flat management structure (at least two levels of management removed).
  - Emphasis on meeting internal and external customer requirements.
  - Quality methodology introduced and quality measures, standards and improvement projects became institutionalized.
  - Pay for skills—operators were paid more for mastering multiple skills and carrying out broad job responsibilities.
  - Coordinator roles were systematically used to integrate across the parts of the mill and to expose managers to different parts of mill as part of planned career development.
- Similar participative redesign was carried out in various staff units, although these groups were not unionized :
  - 2-3 layers were removed; multi-functional teams were organized to service each business unit
  - Cross functional career paths were emphasized
  - Corporate finance and R&D groups were participatively restructured along similar lines, with teams established and multiple skilling encouraged and enabled
- Extensive training and development was carried out throughout the company. There was a commitment to support employees in developing the new needed skills to enable them to advance in salary grade and contribute more. And there was a recognition that a new management style and capabilities would be required for this new work system and organization design to work effectively.
- Team skills, business skills, quality, leadership, and other technical training were set up as ongoing processes.

- The new management style gradually articulated – and there was an extensive but gradual change-out of managers who could not, or did not want to adapt.

Diagnostic questions for analysis:

1) **What strategy (explicit or implicit) do you think drove this restructuring?**
2) **What changes did Champion make in each of the "star points?"**
3) **What results do you anticipate, and why?**

NOTES: ____

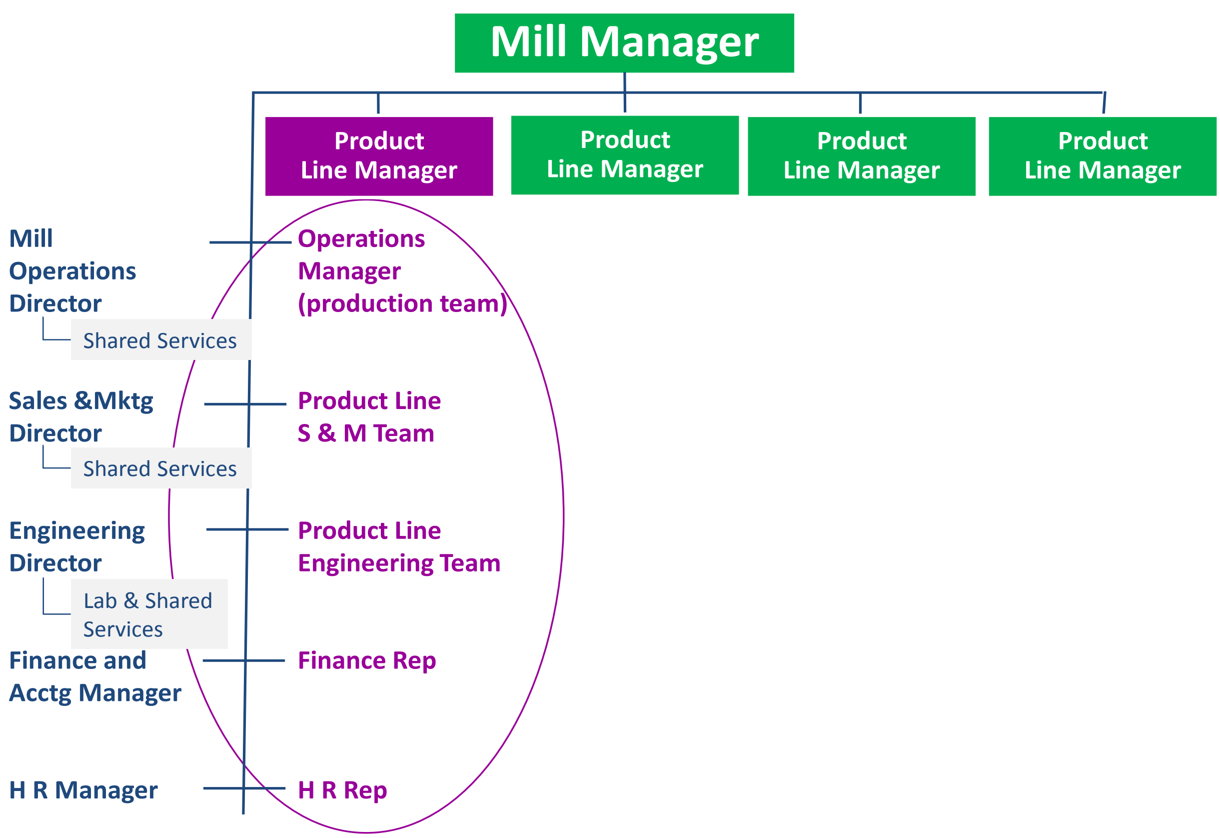
PHASE TWO RESTRUCTURING (1990-1996)

"Phase One" of the restructuring led to large but uneven improvements in mill efficiency, quality and productivity. Manufacturing costs fell below industry average for the first time in two decades. The company was beginning to have a reputation as a high quality low cost producer. Because of its increased capacity for efficient production and improved reputation among customers, it was able to increase output during down cycles and to somewhat blunt the financial impact of the down cycles. Due to its investment in new machines and the resulting increased capacity, it was able to take advantage of the up-cycles and their higher prices. The first phase also created a foundation of trust between management and employees, and for ongoing collaborative redesign activities:

Nevertheless, down cycles still brought losses and the company and employees felt they had to redouble efforts in order to improve financial performance and ensure job security.

- Although the concept of focus on internal customers was well ingrained, the ultimate customer was still far from the minds of those working in the mills. Further restructuring was initiated in the more advanced mills to move to product-focused systems groups ("mini-enterprises") and to increase focus on the needs of the end customer.

Figure D



- The culture among mills had remained quite competitive, and there was little sharing and quite a bit of resistance to adopting approaches that were "invented" in another mill. To address the disparity across mills in the adoption of new practices and accomplishment of performance improvements, the company started to focus on lateral mechanisms to help in the sharing of ideas and practices:
  - Cross mill discipline best practice teams were set up so that managers in areas such as pulp, engineering, and maintenance would regularly meet and share approaches and problems.
  - These made little progress, but ultimately the company invested in electronically connecting its employees to promote rapid learning. A significant amount of employee-to-employee on-line interaction and problem-solving emerged, and a "new sense of community" and collaboration was evident across mills.

- Early emphasis on intrinsic satisfaction of new work systems had been complemented by skill based pay. This was supplemented by a number of new approaches to link compensation to performance:
  - Gainsharing: each mill could develop its own gainsharing program within company guidelines that the plans be crafted to improve business performance, promote teamwork, ensure continuous improvement and build a culture of pay for performance. Payouts depended on local operating performance and accrued equally to managers, staff groups and operators.
  - Special Incentive Programs: crafted company-wide to provide a greater stake in achieving extraordinary performance targets during difficult times in the cycle or to support strategic shifts.

- Career paths were recast to: place less emphasis on hierarchical movement; fit more with the new work design; promote the lateral movement and cross functional team and integrated business unit leadership capability that were required to make it work.

Results as of 1996:

Rate of improvement and levels attained significantly outpaced industry averages in the following performance areas:

- Tons of paper produced per employee
- Manufacturing costs per ton in all segments
- Productivity improvement as a function of capital investment
- Decrease in SG&A as a percentage of cost of sales
- Accident rate reduction

Industry analysts rated all but a few of Champion International's mills as among the best in the world both technically and in terms of work systems and operating performance.

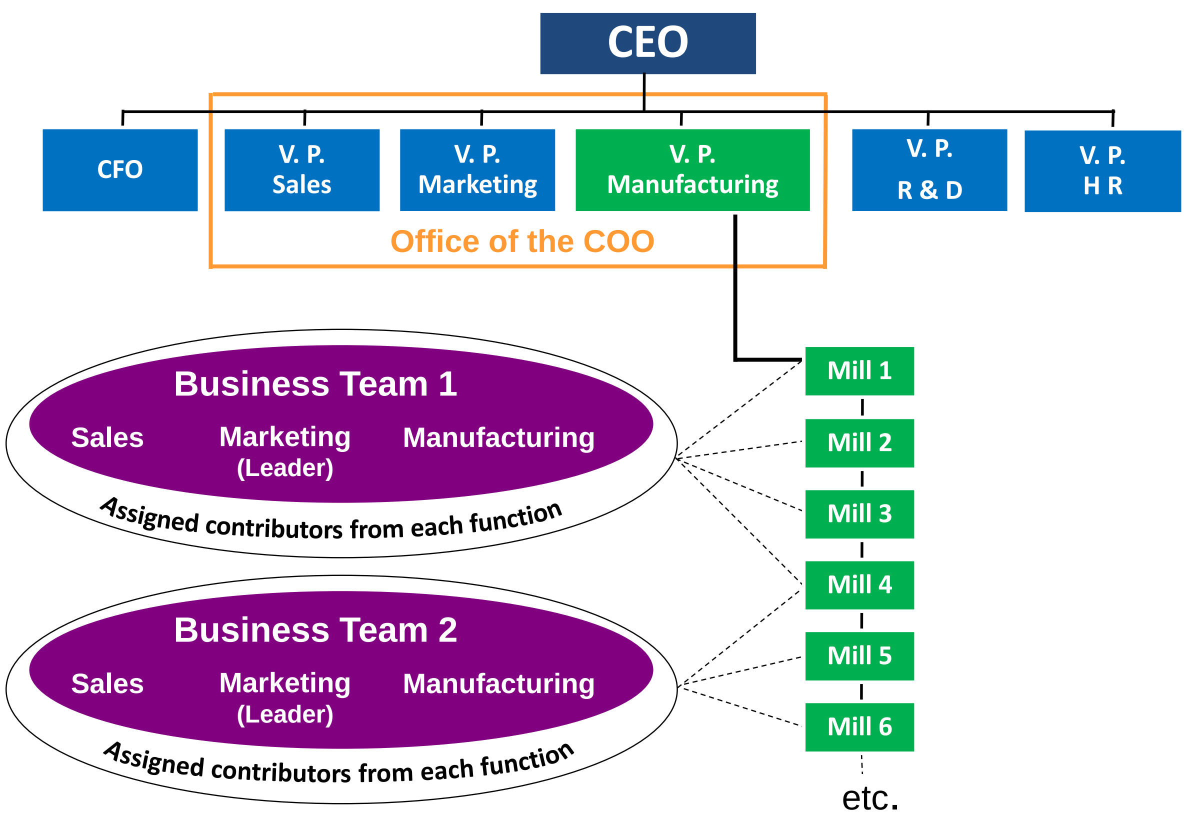
PHASE THREE RESTRUCTURING (1996 ONWARD)
(STILL BEING DEFINED)

Champion International had discovered that simply focusing on operating efficiency and business unit effectiveness were not adequate to significantly impact financial performance given the industry context. The next stage would be driven by explicit focus on financial performance, and in particular on shareholder value. There was a belief that the four business units had shifted influence from headquarters staff functions to product and customer focused business units and that operational performance and cross functional collaboration was excellent within those units. On the other hand, the company was not poised to explore synergies and optimization across products and common customers that transcended business units, nor to rethink the way it approached the market and optimized its overall portfolio.

Although not yet fully defined, the phase includes:

- Primary focus on shareholder value.
- An options program for managers based on stock price targets. Bonus programs at all levels, that are to different degrees, based on company-wide return on capital in addition to business team or local unit performance. Executives required to own designated amounts of stock.
- The reconfiguration of the company into a functional and product matrix.

Figure E



  - The three corporate-wide functions of sales, marketing and manufacturing were re-established in order to strengthen functional excellence. There was a sense that the company may have been slipping in this arena.
  - Further segmentation of the market resulted in eight potentially dynamic business teams being set up to overlay the three corporate wide functions. These teams were responsible for strategy and profit in the business segment. They were staffed by mid-level executives from each of the functions and led by the marketing manager. The majority of their bonuses depended on how well these businesses performed.
  - The business teams reported to the office of the COO, which included the executive vice presidents of the same functions. These teams were co-located, and the majority of headquarters personnel were attached to and located with the teams, not their functions.
  - Mills, some of which produced product for multiple business segments, might have representation on multiple business teams.

- The company executives undertook an intense examination of assets and strategy, leading to another wave of divestiture and acquisition based on present and future profit potential and on fit with an emerging market strategy based on optimizing across the value chain.

- Another wave of cost cutting and layoffs was beginning, including 2,000 layoffs, the first significant layoffs in a decade.