

C A S E S T U D Y

From Anson's Folly to  
Bowater's Blunder:  
A History of Abitibi  
Paper, 1912–2011

Canadian Business History

This case study has been prepared by Darren Karn under the direction of Professor Joe Martin as the basis for class discussion rather than to illustrate either effective or ineffective handling of a managerial situation.

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# From Anson's Folly to Bowater's Blunder: A History of Abitibi Paper, 1912–2011

## Introduction

In 2009, Montreal-based AbitibiBowater — the world's largest producer of newsprint — slipped into bankruptcy, burdened by the weight of massive debt, waning North American demand and falling prices. This bankruptcy was but the most recent chapter in the tumultuous story of a venerable firm — the only survivor among many Canadian newsprint companies from the time of its founding early in the 20th Century. (See Appendix 1.)

In the digital age, it may seem nostalgic to examine newsprint and paper production. Our most important natural resources are oil, gas and minerals — rarely do paper companies make national headlines, but this was not always the case. The vast stands of black spruce (the preferred species for newsprint in the first half of the 1900s) in northern Ontario and Quebec made Canada a fertile ground for a vibrant newsprint industry.

Although the technology to develop newsprint had existed for years, Canada's newsprint industry did not take off until 1913 with the passage of the Underwood Tariff Act in the United States. The act permitted free trade in newsprint, and U.S. publishers immediately rushed to secure cheap supply from the north: Canada's golden age of newsprint had arrived.

In 1920, newsprint accounted for approximately 5% of Canada's exports, lagging well behind wheat, the largest commodity, which garnered 17%. But newsprint's importance subsequently increased, nearly tripling to 14% by 1930. It became Canada's most valuable export commodity by 1939, accounting for 16% of total exports (a position it held for the next 20+ years).<sup>1</sup> Indeed, newsprint was an important source of trade with the U.S., and throughout these years, Abitibi both prospered and failed — but it consistently ranked among the largest newsprint producers.

This case examines the full scope of Abitibi's corporate history — from the early 1900s to the present. It reveals many of the strategic decisions made by the firm's management, tracing one of Canada's more successful companies across four time periods, ending with AbitibiBowater's emergence from bankruptcy in 2011.

## Company Founding and Boom to Bust – 1912 to 1932

The Abitibi Pulp and Paper Company was formed on December 4, 1912 in Iroquois Falls, Ontario. (See Appendix 2 for a company timeline.) Its founder, Frank Harris Anson, initially sought to exploit Northern Ontario's gold and mineral riches, but his decision to found a pulp and paper firm reveals a stroke of entrepreneurial serendipity.

Born in Niles, Michigan in 1859, Anson worked as a U.S. railway employee, a rubber prospector in South America, and later back in the U.S. milling and selling flour. After establishing business connections with a Montreal firm — Ogilvie Flour Mills, one of Canada's largest manufacturing companies in 1905<sup>2</sup> — Anson was lured back to Canada and specifically to Montreal, where he was regarded as an able business leader.

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<sup>1</sup> Canada Year Book.

<sup>2</sup> Martin, 2010, p 16.

In 1909, two McGill University students persuaded Anson to fund their prospecting trip to Northern Ontario. Although the students did not discover any minerals, they advised Anson that the area was well-suited for a paper mill given its vast forests and rivers.<sup>3</sup>

Anson set off on what the Montreal business community derided as “Anson’s Folly” — a mission to build a paper mill on the Abitibi River at Iroquois Falls. With financing from Shirley Ogilvie (an heir to the Ogilvie Flour Mills fortune), construction of the new mill began in December 1912, and the first pulp was produced on August 4, 1914.<sup>4</sup> The firm was renamed the Abitibi Power and Paper Company to better reflect the firm’s wider scope as it<sup>5</sup> began to produce newsprint for a growing domestic and international (U.S.) market that demanded paper products.

Although Anson may have been eager to start a new enterprise following his success in the flour business,<sup>6</sup> tariff changes to pulp and paper at this time may have further enticed him to build a paper mill.

In 1897, the U.S. applied a tariff to all paper imported from Canada, which priced Canadian newsprint out of the U.S. market.<sup>7</sup> This tariff had several effects, one of which was the subsequent rapid depletion of U.S. softwood supplies in its primary newsprint-producing regions, which contributed to the inability of U.S. producers to meet growing domestic newsprint demand.<sup>8</sup> With supply constrained, quickly-rising newsprint prices concerned U.S. newspaper publishers, who could not pass on their increased costs to readers due to price resistance. Through the power of the press and the publication of many editorials, the publishers successfully lobbied the U.S. government for the removal of the Canadian newsprint tariff, which became a key feature of the Underwood Tariff Act of 1913.<sup>9</sup> Free trade in newsprint precipitated a flow of both Canadian and U.S. capital into Ontario and Quebec and facilitated the construction of new pulp and paper mills.

As Anson expanded his operations, his business associate, Alexander Smith, a Chicago-based investment banker<sup>10</sup> and member of Abitibi’s board of directors, encouraged vertical integration (transferring wood pulp to paper mills within the same organization) of the firm. Following Anson’s death in 1923, Smith became president.<sup>11</sup>

Although Abitibi was vertically-integrated in production, the firm did not maintain its own sales force. Smith relied on a close business associate, George H. Mead of The Mead Corporation of Dayton, Ohio, to handle all marketing initiatives for Abitibi paper in the U.S.<sup>12</sup> Smith also handled finances for the Mead and Backus<sup>13</sup> groups of pulp and paper companies, and had Abitibi invest in new Mead initiatives.<sup>14</sup> In the nascent Canadian newsprint industry, competition among certain firms was not always fierce — sometimes more collaboration than competition occurred.

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<sup>3</sup> Ambridge, 1952.

<sup>4</sup> Ambridge, 1952.

<sup>5</sup> Pulp and paper production required significant electrical supply, and as a result pulp and paper mills were almost always co-located with hydroelectric installations.

<sup>6</sup> Ambridge, 1952.

<sup>7</sup> Roach, 1994, p 2.

<sup>8</sup> Heinrich, 2001, p 476, Roach, 1994, p 2.

<sup>9</sup> Guthrie, 1941, p 43.

<sup>10</sup> Smith worked for the Chicago-based investment banking firm Peabody Houghteling.

<sup>11</sup> Boothman, 2002, p 622.

<sup>12</sup> The Mead Corporation is one of the world’s largest paper and paperboard manufacturers in addition to being a leading producer and distributor of school supplies in North America. Founded in 1846 by Colonel Daniel Mead, the company prospered until 1891, the year of his death. After 15 years of mismanagement by his sons, his grandson, George H. Mead took over the firm and guided the firm for the next 43 years. Mead’s newsprint businesses (of dubious quality) of the 1920s were merged into Abitibi’s at the end of the decade.

<sup>13</sup> E.W. Backus was a Minnesota-based entrepreneur of the day who built lumber and paper companies in both the northern United States and Ontario.

<sup>14</sup> Boothman, 1994, p 23.

This arrangement produced strong returns for the firm during the early and mid-1920s. Abitibi averaged an 8% return on assets from 1922 to 1927 (see Figure 1). While Abitibi shares traded at a low of CAD\$22 in 1921 (after a 5-1 split), the stock price rose to a peak of CAD\$149 in 1927, before splitting again. The company had enjoyed a profitable trend, with its share price increasing seven-fold from 1917 to 1920.

**Figure 1**  
Abitibi Return on Assets, 1922 to 2006



Widespread industry overcapacity in newsprint occurred in 1926, pushing prices down to CAD\$70 per tonne from a peak of CAD\$112.60 in 1920.<sup>15</sup> (It turns out that this circumstance would become a trend for the next 85 years.) This overcapacity and dramatic drop in prices led to several ill-fated attempts to create newsprint cartels as well as mergers and acquisitions aimed at rationalizing operations.

In 1927, Smith acquired from the Mead group five newsprint companies, the largest being the Spanish River Pulp and Paper Mills.<sup>16</sup> This deal, which catapulted Abitibi's assets from CAD\$44 million in 1927 up to CAD\$178 million in 1928, rendered the company one of Canada's "Big Three" in newsprint, including Consolidated Paper (Canada Pulp and Paper) and Canadian International Paper.<sup>17</sup>

The Mead acquisition was a crucial strategic move for Abitibi, but the deal deserves more examination. Smith and Mead collaborated on many projects, with Smith's firm acting as the investment bank. Abitibi's acquisition of Spanish River Pulp and Paper is highly suggestive of a conflict of interest that was ultimately detrimental to Abitibi's shareholders.

<sup>15</sup> *Financial Post* Information Card, Price Brothers, 1942.

<sup>16</sup> The five companies acquired were Spanish River Pulp and Paper, Manitoba Paper, St. Anne Paper, Murray Bay Paper, Fort William Paper, as well as the associated hydro and timber concessions.

<sup>17</sup> Guthrie, 1941, p 62.

The value of Spanish River Pulp and Paper was never verified by independent financial analysts, and, by several accounts, it was grossly overvalued.<sup>18</sup> After being appointed chairman of Abitibi in 1929, Mead estimated the consolidated firm's worth at CAD\$94 million — about half of the CAD\$178 million declared in the annual report.<sup>19</sup> Further, the production costs of Spanish River's three mills were out of line with industry leaders. Two of those mills (at Espanola and Sturgeon Falls) stopped newsprint production in 1930 due to high production costs.

Fictitious accounting and insider dealing aside, the consolidation of the five Mead mills into Abitibi transformed it into one of the largest industry players. Greater size increased economies of scale in production, with higher capacity resulting in lower unit costs of production, and enhanced bargaining power on price.

In newsprint production — a capital-intensive industry — economies of scale were vital as producers competed primarily on price.<sup>20</sup> For example, International Paper, the first company to consolidate newsprint production across many mills at the turn of the 20<sup>th</sup> Century, exploited its economies of scale to obtain the largest contracts (often with the Hearst Corporation)<sup>21</sup> and set the newsprint market price.

The biggest contract announcement negotiated by one of the three largest newsprint producers would then set the industry price for about six months. The average contract price struck by each of the “Big Three” was commonly considered the set price for the rest of the industry. The importance of having a company large enough to be a price-setter cannot therefore be overstated. Despite the fact that Abitibi was one of the largest newsprint firms, it was often International Paper (the newsprint division) that served as price leader from 1923 to 1928, after which the latter's position was challenged and other companies became successful in setting prices.<sup>22</sup>

Shortly after Abitibi emerged as one of the largest producers, newsprint prices declined sharply. As prices slid from CAD\$70 a tonne in 1927, to CAD\$62 in 1929 and to a low of CAD\$40 in 1934, Abitibi's production was heavily affected, particularly during the depths of the Depression. Abitibi ran its mills at just 28.4% of capacity in 1932 and 26.8% in 1933.<sup>23</sup>

Abitibi defaulted on its mortgage bond interest payments on June 1, 1932, and was placed in receivership.<sup>24</sup> This bankruptcy lasted 14 years and became the longest in Canadian history (the firm exited receivership on April 30, 1946). The bankruptcy was precipitated by the combination of a significant drop in U.S. demand for newsprint and oversupply among Canadian producers, which pushed newsprint prices to levels below the firm's operating costs.

Abitibi had financed most of its growth through a large bond offering of CAD\$55 million (rather than cash) to cover the redemptions of the securities of the firms acquired in 1927 and 1928 — which required Abitibi to meet the scheduled interest payments.<sup>25</sup> In 1928, Alexander Smith also promised a CAD\$4 annual dividend to common shareholders, despite operating in a price-declining environment with aging mills and high production costs. This dividend could not be maintained, and was soon suspended.

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<sup>18</sup> Boothman, 2002, p 643.

<sup>19</sup> Boothman, 2002, p 644.

<sup>20</sup> Chandler, 1990, p 17, 140.

<sup>21</sup> The Hearst Corporation was owned by William Randolph Hearst and starting from a San Francisco base expanded into the major American newspaper chain of the era.

<sup>22</sup> Guthrie, 1941, p 107.

<sup>23</sup> *Financial Post* Information Card, Abitibi Power and Paper Company, 1936, Boothman, 1994, p 24.

<sup>24</sup> *Financial Post* Information Card, Abitibi-Consolidated, 2007. Abitibi was not alone — Canadian Pulp & Paper share prices declined by 97.5% in the stock market crash and other prestigious companies like Price Brothers also went into bankruptcy.

<sup>25</sup> Boothman, 1994, p 31.

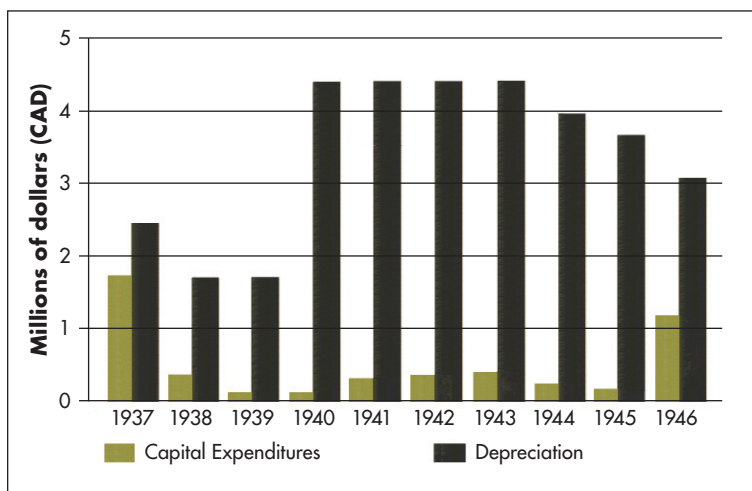
## Bankruptcy – 1932 to 1946<sup>26</sup>

The lengthy receivership appears due partly to the opposition of preferred and common shareholders to various plans put forward by the firm's bondholders. Numerous plans for reorganization were suggested, including bonds, preferred shares, and common shares) but each was defeated by one of the stakeholder groups. These defeats were often due to a convoluted legal system, where aspects of bankruptcies under one of either federal or provincial jurisdictions were exploited to the detriment of the proposed reorganizations.<sup>27</sup> Indeed, the Ontario government's actions also extended the bankruptcy by ensuring job protection at high-cost mills throughout northern communities and for common shareholders.

It was not until 1943, however, when the Ontario government — under the newly elected premier, George Drew — appointed one last committee charged with mediating stakeholder conflicts, lest a legislated reorganization take place. Although a resolution was proposed in the spring of 1944, it was not until March 1946 that all stakeholders voted to approve the reorganization and the firm finally emerged from 14 years of receivership.

The company's 1946 annual report signalled many changes for Abitibi, in particular a return to capital spending. As shown in Figure 2, capital expenditures had been reduced to a minimum after 1938, and represented a significant deficit compared to depreciation of the firm's assets. To modernize its physical plant, Abitibi increased capital expenditures, which about equalled or exceeded depreciation for the next several years. The unusually long bankruptcy, however, and the more significant decade of neglect, may have jointly affected earnings in the postwar years, when industry profits were generally strong.

**Figure 2**  
Capital Expenditures and Depreciation – 1937 to 1946



A comparison of capital expenditures and depreciation. Of note is the negligible capital spending in the 8 years preceding the end of the firm's bankruptcy.

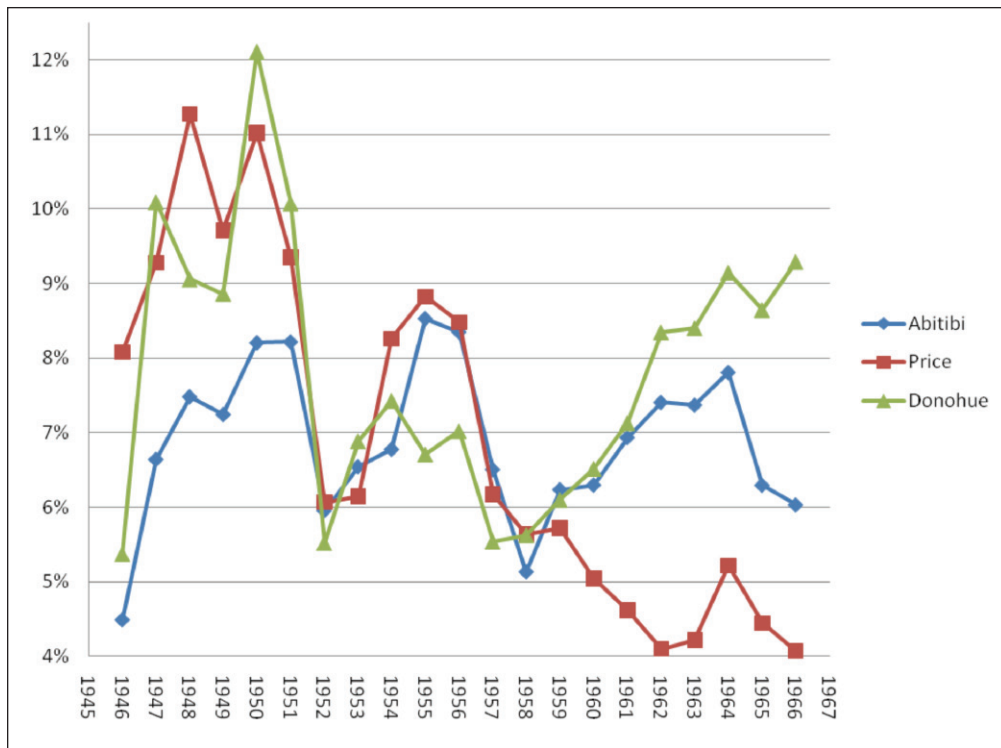
<sup>26</sup> More thorough treatments are provided by Boothman, 1994, and Horne, 1954.

<sup>27</sup> Boothman, 1994.

Compared to other newsprint firms such as The Price Company or The Donohue Company, Abitibi did not enjoy the same strong returns on assets as its competitors. Particularly between 1946 and 1952, Abitibi underperformed its peers by up to 4%, as shown in Figure 3.

**Figure 3**

**Return on Assets for Abitibi, Price and Donohue – 1946 to 1966**



Note the relatively poor performance for the first five post-war years.

### **Southern U.S. Newsprint Development and Lead-Up to the Price Takeover – 1946 to 1974**

The rise of the newsprint industry in the Southern U.S. was noted in several Abitibi annual reports, although reference to this new source of low-cost competition first appeared in 1958. Abitibi President D. W. Ambridge stated that “it is strikingly evident that Canada has no monopoly on world forest resources or on the ability to utilize forest crops.”<sup>28</sup> Subsequent annual reports mention that increasing demands for newsprint in the U.S. were not met by growth in Canadian production, but rather by the establishment of mills in the Southern U.S. The growth of U.S. newsprint production is indeed relevant to the strategic context of Abitibi, since the company also entered this geographic market through the acquisition in 1968 of Atlanta-based Cox Newsprint and later joint ventures.

Newsprint production exploded in the region after the 1950s. By 1955, three mills in the Southern U.S. provided 29% of U.S. newsprint demand — a development occurring in less than 10 years.<sup>29</sup>

<sup>28</sup> Abitibi Annual Report, 1958, p 10.

<sup>29</sup> Oden, 1977, p 89.



Earlier in the 20th Century, many believed that the southern pine species indigenous to the region could not produce high-quality newsprint. However, in the 1930s Dr. Charles Holmes Herty<sup>30</sup> had discovered new chemical processes to overcome technological hurdles, facilitating the industry's development in the Southern U.S.<sup>31</sup>

Although the U.S. South had several cost advantages over northern and Canadian producers, the nascent Southern newsprint sector faced other economic challenges. Fast-growing pine — situated on large, flat expanses of land — was abundant in the U.S. south, and it was easier and cheaper to harvest trees there than it was in much of Northern Ontario and Quebec. Southern U.S. producers had access to cheaper wood and other raw materials and were positioned closer to key newsprint markets than their northern competitors. Free trade in newsprint, however, kept returns on investment low. Prices did not rise in the 1930s to levels necessary to drive significant investment, since northern and Canadian producers possessed significant overcapacity, built up through the 1920s prior to the Depression.<sup>32</sup>

Even if a firm had been willing to develop large-scale newsprint facilities in the U.S. South, political barriers prevented it for many years. The U.S. industry was controlled by northern interests, which used the American Paper and Pulp Association to lobby successfully for policies requiring that the association approve the construction of any newsprint capacity.<sup>33</sup> Given the volume of idled capacity prior to the end of WWII, industry politics controlled by northern producers prevented southern development.

Higher prices in the late 1930s swept aside these economic and political obstacles. The Southland Paper Mills began operations in 1940 near Luftkin, Texas, and produced 30,000 tonnes of newsprint.<sup>34</sup> After WWII, growth in the newsprint industry in the U.S. South proceeded rapidly. With burgeoning U.S. demand for newsprint and much idled capacity from the interwar period, newsprint shortages ensued. The depletion of easily-harvested timber from Canadian mills contributed to this shortage, shrinking any remaining cost advantages Canadian producers may have had.<sup>35</sup> These events marked the entrance of the U.S. South into the North American pulp and paper market, and presented Canadian producers with the first North American challenge to their low-cost position and domination of the U.S. newsprint market.

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<sup>30</sup> Herty was a chemistry professor at the University of Georgia, an executive and the first coach of the university's Bulldogs football team.

<sup>31</sup> Oden, 1977, p 88.

<sup>32</sup> Oden, 1977, p 88.

<sup>33</sup> Oden, 1977, p 85.

<sup>34</sup> Oden, 1977, p 88.

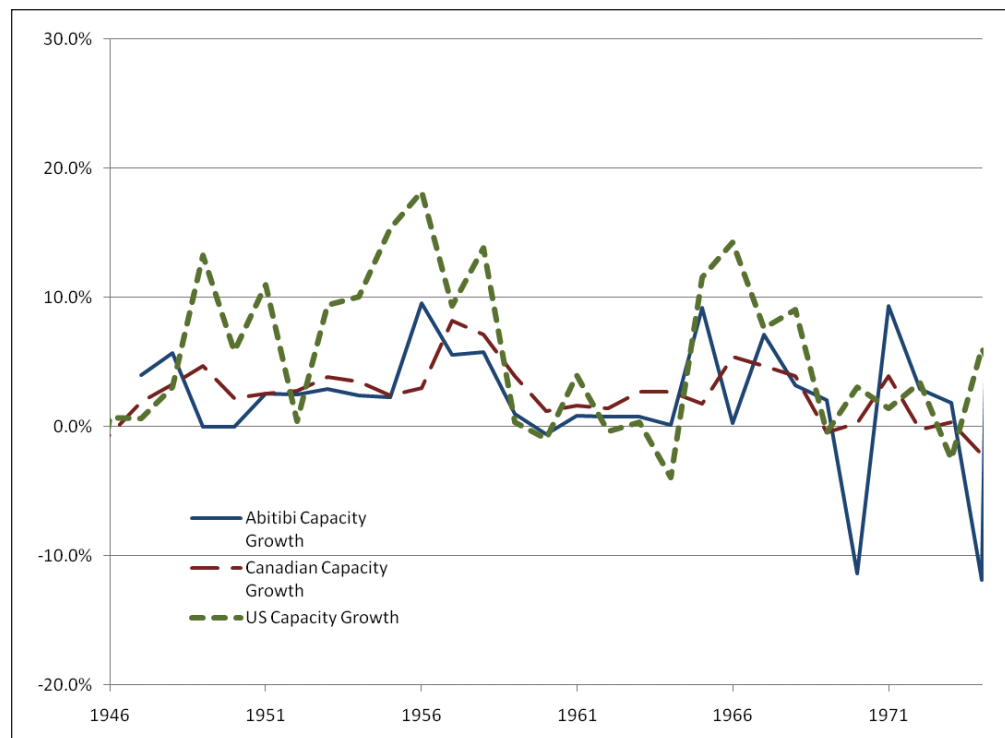
<sup>35</sup> Oden, 1977, p 88.



Figure 4 illustrates newsprint capacity growth between Canada, the U.S., and Abitibi during this period, with significant U.S. capacity growth in the 1940s and 1950s.

**Figure 4**

**Newsprint Capacity Growth of Abitibi, Canada and the United States – 1946 to 1974**



U.S. capacity growth greatly exceeded that of Abitibi’s and Canada’s during the late 1940s and 1950s as capacity was added in the U.S. South.

Below is an analysis of the firm’s actions in the years following 1946 and its efforts to return to a competitive position, both in Canada and the U.S.

Following completion of the postwar “catch-up” capital expenditure program, Abitibi endeavoured to lessen its dependence on newsprint sales, which had been the company’s main driver of profits. Beginning in 1950, with the acquisition of the British Columbia Pulp and Paper Company, Abitibi pursued a series of moves to build a bigger lumber and hardboard portfolio. President Ambridge announced that this acquisition matched well with the corporate strategy and that the board of directors “has pursued a policy of diversification” in recent years.<sup>36</sup> Abitibi managed this acquisition jointly with the Koerner brothers, who operated the Alaska Pine Company — a British Columbia lumber interest — and made significant contributions to improve these mills.<sup>37</sup>

In 1954, newsprint as a percentage of all company production peaked at 80.9% (including tonnes of fine paper, pulps, and building materials). This precipitated a distinct trend in 1955 that saw Abitibi striving to reduce product dependency on newsprint, shown in Figure 5 (see page 10). Despite a decline in newsprint production in 1957 from the record high of 1956, a small decrease in produced total tonnage occurred, due “in good measure” to diversification efforts into fine paper and building materials.<sup>38</sup>

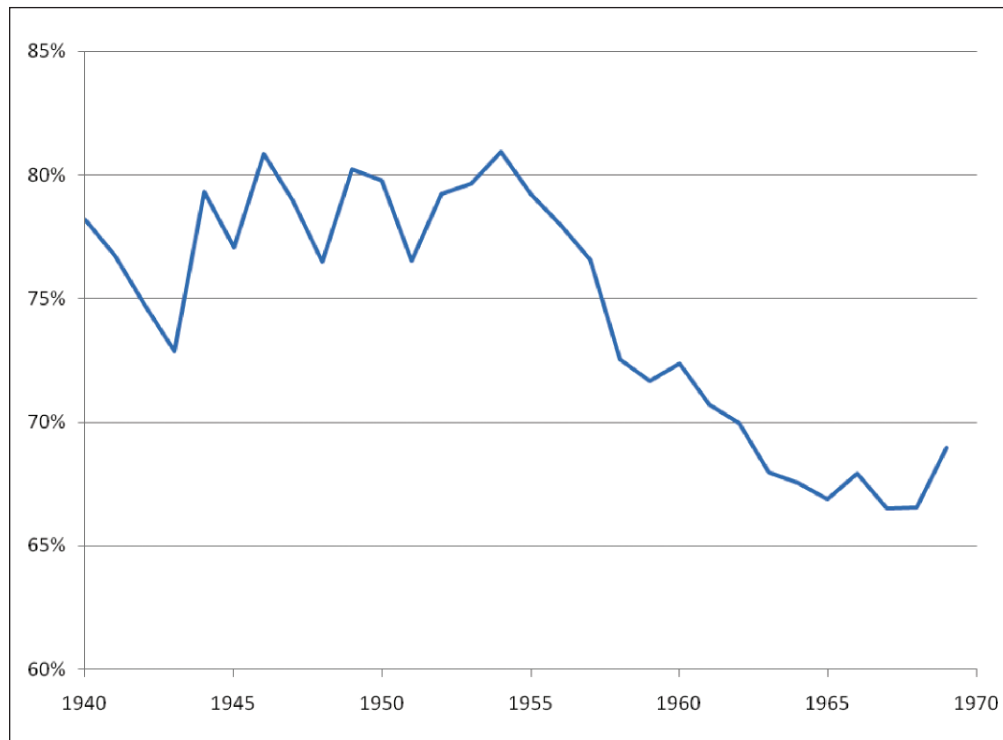
<sup>36</sup> Abitibi Annual Report, 1950, p 5.

<sup>37</sup> Abitibi Annual Report, 1950, p 5.

<sup>38</sup> Abitibi Annual Report, 1957, p 4.

**Figure 5**

**Abitibi Newsprint Production as a Percentage of Total Production  
(tonnes of all products) – 1940 to 1970**



Following the peak of newsprint production (representing 81% of all products produced), Abitibi steadily increased the production of its non-newsprint divisions in an attempt to better diversify its portfolio.

In the late 1950s, Abitibi lost certain cost advantages it had over U.S. producers because the higher Canadian dollar (above par) hindered exports. Several annual reports indicated the company's dissatisfaction with government inaction on its requests to devalue the Canadian dollar, which would have helped the domestic pulp and paper industry compete in the U.S. Although Abitibi (and other Canadian producers, for that matter) had to cede some of the American newsprint market to the upstart U.S. South, Abitibi did not hold back on its fine paper and building materials businesses, which were less sensitive to exchange rate fluctuations.

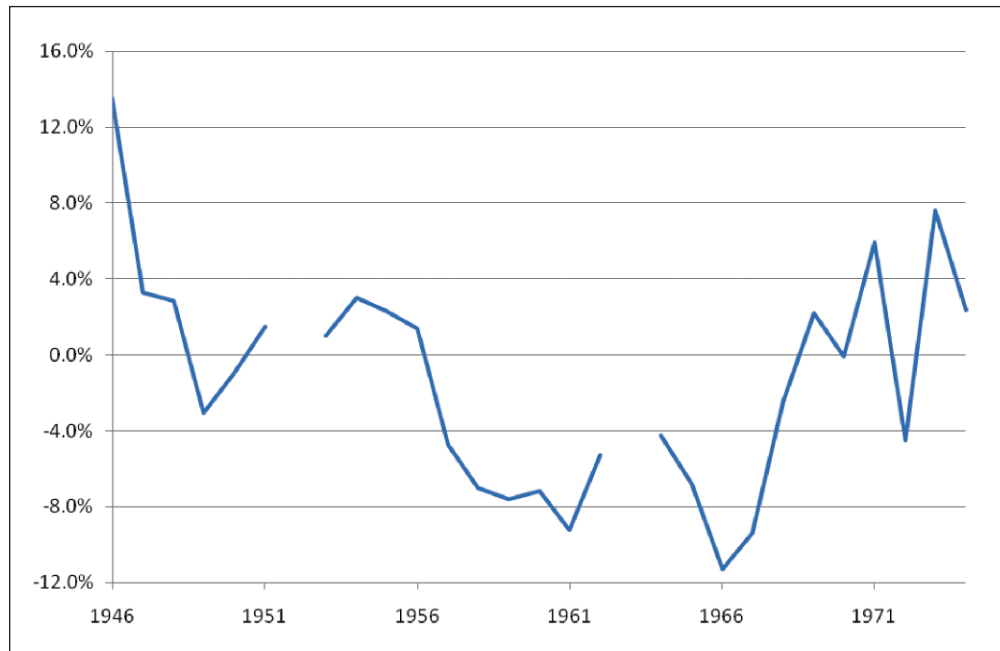
The company continued to diversify by acquiring two more building material firms in 1963, along with Hilroy, the Toronto-based stationary company. In fact, except for the acquisition of Cox Newsprint<sup>39</sup> in 1968, the areas of most significant growth for the company were in building materials and fine papers.

These capital expenditures excluded anything beyond minor improvements to newsprint operations. As noted on Figure 6 (on the following page), Abitibi's newsprint capacity utilization rate trailed the Canadian industry average by several percentage points between 1956 and 1970. This indicates that Abitibi's newsprint capacity ran at a higher cost than that of the Canadian industry, since pricing pressures forced Abitibi to curtail more of its production than its competitors. (If Abitibi were a low-cost producer, it would have been able to run its mills at a higher rate.) Given that newsprint was its core business — newsprint still represented more than two-thirds of company production after the

<sup>39</sup> Cox Newsprint was a pulp and paper company based in Georgia and South Carolina.

firm's diversification strategy of the late 1960s — and that other players in the industry were adding modern capacity (1.5 million tonnes of new capacity was added in North America in the late 1950s), Abitibi neglected to manage its core assets properly in the post-war years.

**Figure 6**  
**Difference Between Abitibi Capacity Utilization and Canadian Capacity Utilization – 1946 to 1974**



The data indicate that for all years where the values fall below zero, capacity utilization at Abitibi trailed the Canadian average, indicating higher-than-average operating costs.

In the early 1970s, Abitibi found itself in difficulty. Its capacity was relatively fixed and aging. Meanwhile, newsprint consumption in the U.S. — Abitibi's largest market — grew consistently; U.S. consumption had increased by approximately 3.3% per annum from 1961 to 1973. (See Figure 7 on the following page.) In 1974, a supply shortage led to an increase in prices.<sup>40</sup> Abitibi, the third largest newsprint producer at the time, was aiming to increase its capacity, especially in the U.S. market.<sup>41</sup> The company faced the challenge of how to increase capacity. Its answer was to acquire the Quebec-based Price Company. The Price Company enjoyed lower manufacturing costs, had an almost-equal newsprint capacity and had built five new paper machines since 1962.<sup>42</sup>

In 1974, Abitibi management finally decided that the firm needed to expand its newsprint capacity significantly and that the best way was through acquisition. Company management at the time required returns of approximately 8 to 10% for new investment. In a high inflationary environment, management did not believe that building a new mill would earn a return on investment since it would cost an estimated CAD\$200 million. Growing construction costs, especially in northern Ontario where the new mill would be situated, easily outpaced the expected moderate increases in newsprint prices.<sup>43</sup>

<sup>40</sup> Mathias, 1976, p 6.

<sup>41</sup> Roach, 1994, p 48.

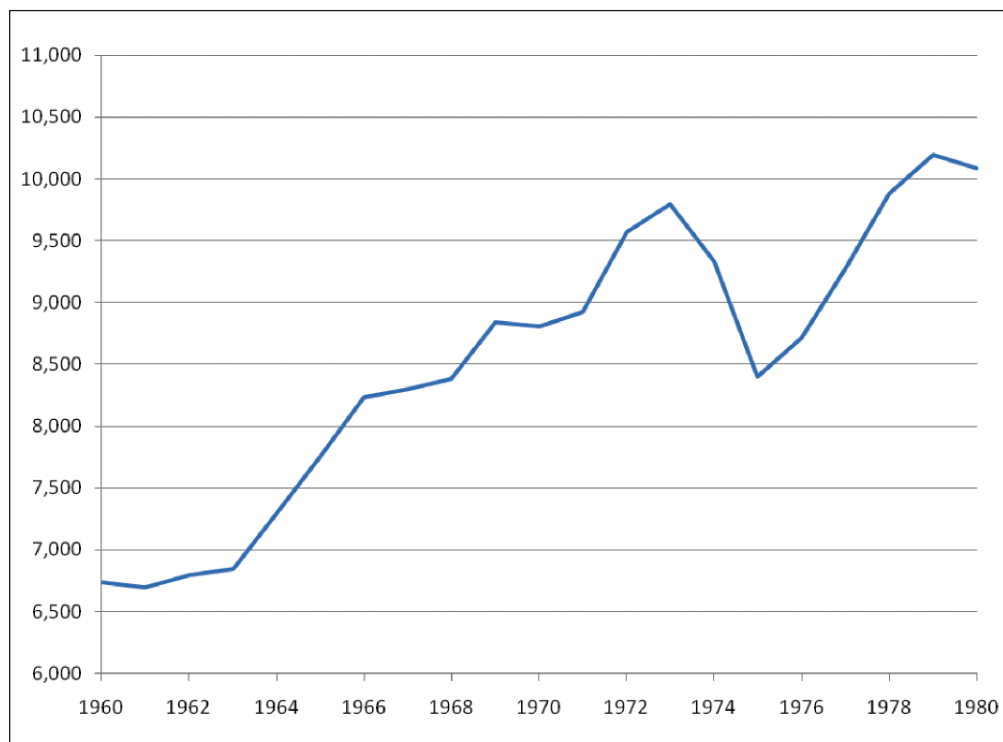
<sup>42</sup> Mathias, 1976, p 190.

<sup>43</sup> Mathias, 1976, p 180, 184.

Acquisition was therefore the next best option. More modern capacity could be achieved at lower costs by purchasing existing facilities rather than building new ones. Moreover, the price was right, since newsprint firm shares in 1974 were undervalued compared to the value of their existing assets due to fears of an impending recession and even higher inflation following OPEC’s manipulation of global oil markets.<sup>44</sup> Although it is not certain which companies Abitibi targeted in its 1974 acquisition strategy, it has been suggested that the company probably focused on three U.S.-based, non-newsprint firms — Federal Paper, Bangor Punta, and Superior Fiber Products. Abitibi wanted greater access to the U.S. markets and these firms operated in that arena.<sup>45</sup> Although Abitibi had considered a takeover of The Price Company in the early 1970s, management had not pushed that strategy. By 1974, however, Price looked attractive because it was considered a Canadian company (various laws on corporate acquisitions made purchases of domestic companies more palatable) with modern mills and a substantial presence in the U.S.

With the acquisition, Abitibi-Price became the world’s largest newsprint producer, and gained greater exposure to the U.S. newsprint market. Following the deal, however, U.S. newsprint consumption dropped by almost 5% in 1974 and again by 10% in 1975 before rebounding moderately in 1976 (see Figure 7). In the years after the acquisition, the company’s Return on Assets (ROA) fell from 7% in 1973 to 1% in 1976. Though the cyclical nature of the newsprint business was difficult to manage, Abitibi once again executed an impressive merger to create a dominant industry player almost 50 years after its early acquisitions from the Mead Group.

**Figure 7**  
**Newsprint Consumption in the United States (in tonnes) – 1960 to 1980**



<sup>44</sup> Roach, 1994, p 48.

<sup>45</sup> Mathias, 1976, p 4.

## The Global Challenge – 1980 to the Present

The 1980s were characterized by Abitibi's desire to again focus on the profitability of its newsprint operations. In its 1979 director's report, Abitibi announced an enhanced capital expenditures program, with more than 70% of the funds directed to the newsprint division to "mainly improve quality and reduce costs."<sup>46</sup> The firm also reported that in 1979 alone, it disposed of its packaging operations, its Canadian building products division, a plywood facility in California and a sawmill in British Columbia. It was headed in a decidedly fresh direction as management focused (once again) on the core business.

Management's strategy to improve existing mills and equipment rather than to construct new ones deserves deeper analysis. It also reflects the policy environment of the day. From 1979 to 1984 — coincidentally the same period as Abitibi's five-year capital spending program — the Canadian government announced a pulp and paper modernization plan. This provided firms with incentives to improve outdated equipment. However, it did not give the necessary incentives for firms to build new paper machines or mills and is now criticized for impeding industry rationalization at a crucial point when the pulp and paper industry began to witness a global expansion in low-cost production.<sup>47</sup>

Industry surveys from the late 1980s compared the cost structures and performance of newsprint firms in Canada, the U.S. South, the U.S. West, Sweden and Finland. Two metrics indicate the level of innovation and modernization of newsprint technology among the leading producers of the world. Firstly, between 1985 and 1989, average capital expenditures per tonne of newsprint capacity were CAD\$546 in Sweden, CAD\$451 in the U.S. South, and CAD\$407 in Canada.<sup>48</sup> Although Abitibi's management announced a more robust capital expenditure program for the early 1980s, the company only invested between CAD\$40 and CAD\$80 of capital dollars devoted to newsprint per tonne of capacity in this period. In this respect, it lagged behind competitors due to a lack of new mill construction.

Secondly, another performance measure from the late 1980s is average machine size/capacity. Because pulp and paper is one of the most capital-intensive industries, companies in the field often strive for the largest machines to drive economies of scale. In 1989, the average newsprint machine in Canada only produced 104,000 tonnes a year, compared to Sweden at 175,000, Finland at 178,000, and the U.S. South at 146,000. These figures represented, on average, about a 12% increase in machine size in Canada from 1985. In addition, the minimum efficient scale of newsprint machines had also risen to about 220,000 tonnes in the late 1980s.<sup>49</sup> During this same period, Abitibi average machine capacity was 107,000 tonnes — ahead of the Canadian industry average, but well behind global competitors. Abitibi's average machine capacity remained steady at 107,000 tonnes over this period instead of growing. Considering that Abitibi noted that it was losing U.S. market share to the U.S. South producers as early as the late 1950s, it is surprising that it failed to take bolder steps to invest in capital to improve equipment to compete with such a direct market threat.

Abitibi's domestic modernization of the late 1970s and 1980s, referenced above, produced strong returns. From 1979 to 1988, Abitibi enjoyed buoyant returns on assets, averaging 5.6% per annum, with a 10% return on assets in 1979, as shown on Figure 1 (see page 4). This success, however, can also be linked (and most likely entirely linked) to the weakening value of the Canadian dollar over the same period. Abitibi commented frequently in its annual letter to shareholders that the Canadian dollar's

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<sup>46</sup> Abitibi Annual Report, 1979, p 3.

<sup>47</sup> Porter, 1991, p 101, Clancy, 2004, p 127.

<sup>48</sup> Porter, 1991, p 97.

<sup>49</sup> Porter, 1991, p 97.

high value vis-à-vis the U.S. dollar hindered exporters and Abitibi in particular. Illustrated on Figure 8, in the mid-1970s, the Canadian dollar's value decreased against the U.S. This devaluing allowed U.S. publishers — Abitibi's most important customers — to purchase newsprint at a comparative discount to U.S. sources. Although U.S. (and Scandinavian) newsprint was produced at a lower cost than that of Abitibi (and most Canadian producers), the declining value of the Canadian dollar during this period allowed the firm to remain competitive, despite higher production costs.<sup>50</sup>

**Figure 8**

**Canada–U.S. Exchange Rate (monthly averages) – 1954 to 2010**



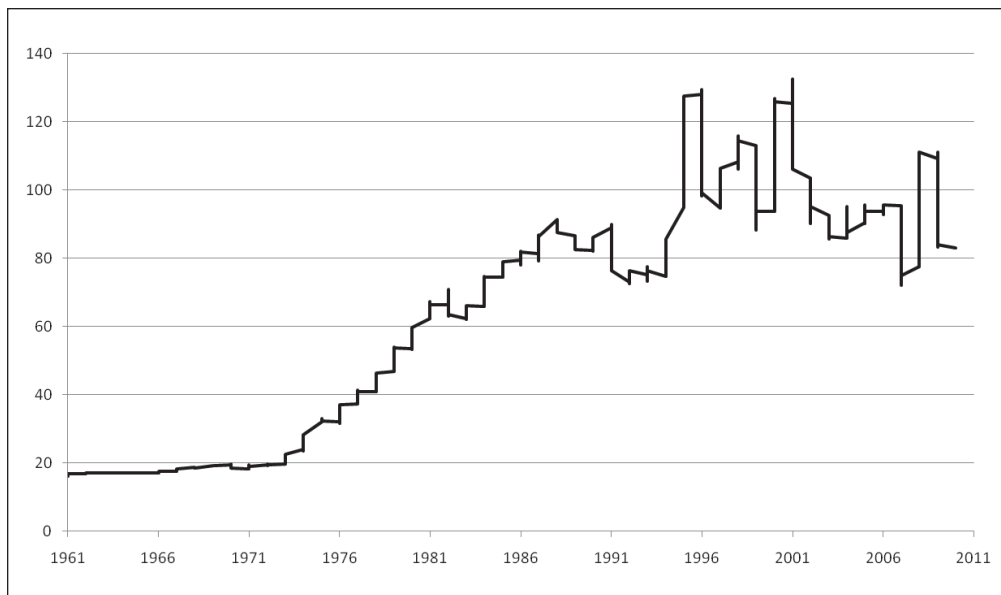
A similar pattern was repeated in the 1990s, when Abitibi again showed relatively strong returns averaging 7% from 1995 to 1999. However, steady increases in the value of the Canadian dollar, in addition to increased global competition from new pulp and paper sources (Latin America and Asia), tempered the firm's financial success after this period. (See Figure 1 on page 4, and Figure 8.) The text below outlines Abitibi's key acquisitions of the Consolidated and Donohue firms, as well as its entry into the Asian pulp and paper market.

In 1996 and early 1997, Abitibi did not perform as well as management had hoped — returns on assets remained strong by historical standards at 4% and 6%, respectively. However these were a significant decrease from 12% in 1995 (See Figure 1 on page 4). The reversal of the efforts of the early 1980s to focus on the “core business” in favour of pursuing a new diversification strategy met with mixed results, and non-newsprint operations were sold or shut down. As in the post-war years, Abitibi was operating obsolete mills that required major overhauls or faced high input and transportation costs,<sup>51</sup> a difficult combination given that newsprint prices declined by an average of 1.1% a year from 1991 to 2001.<sup>52</sup> (See Figure 9 on the following page.)

<sup>50</sup> Roach, 1994, p 49.

<sup>51</sup> Andre et al, 2004, p 1.

<sup>52</sup> Andre et al, 2004, p 1, Porter and Martin, 2001, p 14.

**Figure 9****Newsprint Price Index – 1961 to 2010**

1997 = 100. Note the downward trend from a peak in 2001.

While Abitibi struggled to remain competitive on a production cost basis with an aging physical plant, one of its contemporaries, the Stone Container Company of Chicago, (which owned Stone-Consolidated, formerly Consolidated-Bathurst (see Appendix 1) experienced financial troubles in other areas of the conglomerate's business. Stone was conversely exploring options to divest certain business units. The firm's newsprint and forest products division, Stone-Consolidated, was offered for sale to Abitibi.<sup>53</sup> The deal rendered Abitibi the world's largest producer of newsprint once again.

In 2000, Abitibi decided to purchase Donohue, a large, Quebec-based pulp and paper company with extensive newsprint operations. At the time, Abitibi's production was spread across 17 facilities, whereas Donohue's involved only 7. Donohue reported an annual production capacity of approximately 2.4 million tonnes of paper products, while Abitibi enjoyed approximately 3 million.<sup>54</sup> Donohue's greater economies of scale in its concentrated production base partly explain its superior financial performance to that of Abitibi in the years preceding its acquisition.

Throughout the 1990s, Abitibi's financial performance was inferior to Donohue's in almost every category. Underlining Abitibi's struggles to invest more heavily in its high-cost domestic mills, the firm generated negative CAD\$676 million in cash, as compared to a positive CAD\$1.1 billion by Donohue in the 10 years before the acquisition.<sup>55</sup> Over the same period, Donohue grew net sales by 17%, while Abitibi managed growth of only 11%.<sup>56</sup> Donohue's management demonstrated commitment to a low-cost production system. In 1999, its average direct production cost per tonne sold was approximately CAD\$50 less than that of Abitibi.<sup>57</sup>

<sup>53</sup> Andre et al, 2004, p 1.

<sup>54</sup> Andre et al, 2004, p 1.

<sup>55</sup> Atkinson, 2000, p 9.

<sup>56</sup> Atkinson, 2000, p 9.

<sup>57</sup> Andre et al, 2004, p 2.



Abitibi did not emulate many of the best practices of its target companies. It removed many members of the Stone management team soon after the deal was completed, despite promises to the contrary. Similarly, following the acquisition of Donohue, Abitibi's pledges to retain key Donohue management were broken.<sup>58</sup>

Donohue, a profitable newsprint manufacturer, was owned by Quebecor — the large media conglomerate controlled by Montreal's Peladeau family. By the end of the 1990s, Quebecor's telecom and media empire was growing and the company sought to divest its newsprint division (thinking the capital could be better deployed in "new" media). Quebecor contacted Abitibi and a deal was soon struck.<sup>59</sup>

In the 1990s, Abitibi shipped more than 250,000 tonnes of paper annually from North America to Asia. The company identified Asia as the best long-term growth market, but wanted to establish a local presence — shipping across the Pacific Ocean left Abitibi at a cost disadvantage. In 1999, Abitibi formed the Pan Asian Paper Company jointly with Norske and Hansol, two large Scandinavian-based newsprint producers.

The venture involved the purchase of existing mills in Asia. Noted in company annual reports was the fact that these mills were among "the newest, most cost-efficient mills anywhere in the world."<sup>60</sup> Unlike Abitibi's earlier acquisitions, this purchase made the venture the lowest cost producer in Asia, save for mills in Japan.<sup>61</sup> Although Abitibi exited this joint venture in 2005 by selling its share to Norske (to reduce company debt and focus on the firm's North American resources), its entry into the Asian market with world-class calibre mills marks one of the few instances in company history when it was a low-cost producer in an emerging global market.

In the middle of the new millennium's first decade, the newsprint industry continued to experience expansion in global markets. In 2006, Chinese producers were positioned to export newsprint for the first time in the country's history, with modern mills and lower production costs than Abitibi. This new capacity was also expected to push global paper prices down<sup>62</sup> (as was the case; see price decline in 2007 on Figure 9 on the previous page) — a difficult environment for Abitibi to manage with its higher cost production capacity. Rising fuel and transportation costs, as well as an appreciating Canadian dollar, placed additional pressures on Abitibi's profitability.<sup>63</sup> Abitibi also reported negative earnings in 2004 and 2005, and was earning returns on assets of less than 3% per year since 2000 (see Figure 1 on page 4). Abitibi needed a partner with which it could rationalize operations to compete better in an increasingly cost-competitive global market.

Bowater, the largest U.S.-based newsprint producer, was, like Abitibi, experiencing cost pressures from global competitors. The 2007 merger between the two firms was thus reported as an attempt by both to rationalize production and reduce the market's newsprint capacity, thereby lowering costs and raising prices. With older and less-efficient capacity, the firms predicted that their newly combined entity could realize cost savings of CAD\$375 million annually — an important sum given the stronger value of the Canadian dollar hindering exports from the Canadian production base.<sup>64</sup>

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<sup>58</sup> Atkinson, 2000, p 5.

<sup>59</sup> Coincidentally, perhaps, Abitibi had performed an in-house evaluation of a potential takeover of Donohue the previous year, but had not taken action.

<sup>60</sup> Abitibi Annual Report, 1998, p 13.

<sup>61</sup> Abitibi Annual Report, 1999, p 7.

<sup>62</sup> Bi, 2006.

<sup>63</sup> Canada Newswire, 2007.

<sup>64</sup> AbitibiBowater Annual Report, 2008, p 1.

The combined firm of AbitibiBowater also announced plans to remove a substantial amount of capacity from production to improve the price environment for newsprint and building materials — stating that the company would close approximately 1 million tonnes of newsprint production facilities and other paper capacity. These closures took place exclusively at facilities incapable of generating positive cash flows.<sup>65</sup>

AbitibiBowater controlled approximately 50% of North American newsprint production. Analysts predicted that, with so much production concentrated to one large player, the balance of bargaining power would shift from newspaper publishers to newsprint producers.<sup>66</sup> It was expected that this larger entity would be able to negotiate better prices, especially after removing so much capacity from the market. Unfortunately, neither this market power nor the cost savings measures generated profits. In an ever-declining newsprint market and as instant digital access to news outlets continued to hammer the newspaper industry,<sup>67</sup> AbitibiBowater filed for bankruptcy protection in April 2009.

This bankruptcy was quite short, and AbitibiBowater emerged from creditor protection in late 2010. The company took the opportunity to restructure and shed much of its debt, cut newsprint production by a third and drastically reduced its fixed costs. Other changes included shifting its product mix from newsprint to a higher paper grade while focusing on expanding export markets beyond North America. These moves were driven by a desire to absorb — and quickly adapt to — marketplace changes, perhaps indicating that future decisions at Abitibi will not be governed by a growth-through-acquisition strategy.

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<sup>65</sup> AbitibiBowater Annual Report, 2008, p 2.

<sup>66</sup> Marowits, 2007.

<sup>67</sup> Crovitz, 2009, A13.

## Appendix 1

### Historical Rankings of Canadian Pulp and Paper Companies by Assets

#### 1930

Company	Assets
Consolidated Paper Corp.	\$212,974,612
Abitibi Power and Paper	\$193,409,283
Price Brothers & Co.*	\$79,409,299
St. Lawrence Corp.	\$68,080,743
Fraser Companies*	\$50,910,672
Spruce Falls Power and Paper	\$43,107,874
St. Lawrence Paper Mills	\$32,035,668
Howard Smith Paper Mills	\$31,105,113
Bathurst Power and Paper	\$25,048,022
Donnacona Paper Co.	\$17,910,918

\*1931

#### 1955

Company	Assets
The Bowater Corp. of North America	\$183,909,734
Abitibi Power and Paper	\$163,339,221
MacMillan & Bloedel Ltd.	\$143,447,344
Consolidated Paper Corp.	\$105,929,554
Price Brothers and Co.	\$103,977,851
St. Lawrence Corp.	\$86,666,954
Howard Smith Paper Mills	\$82,990,363
Powell River Co.	\$70,605,680
Anglo Canadian Pulp and Paper	\$67,776,418
Alaska Pine and Cellulose	\$62,857,093

#### 1980

Company	Assets
MacMillan Bloedel	\$2,075,230,000
Abitibi Price	\$1,393,778,000
Domtar	\$1,203,874,000
Consolidated Bathurst	\$1,136,558,000
British Columbia Forest Products	\$1,018,257,000
Canadian International Paper	\$752,000,000
Crown Zellerbach Canada	\$533,181,000
Great Lakes Forest Products	\$520,455,000
Kruger	\$391,628,000
Fraser	\$376,158,000

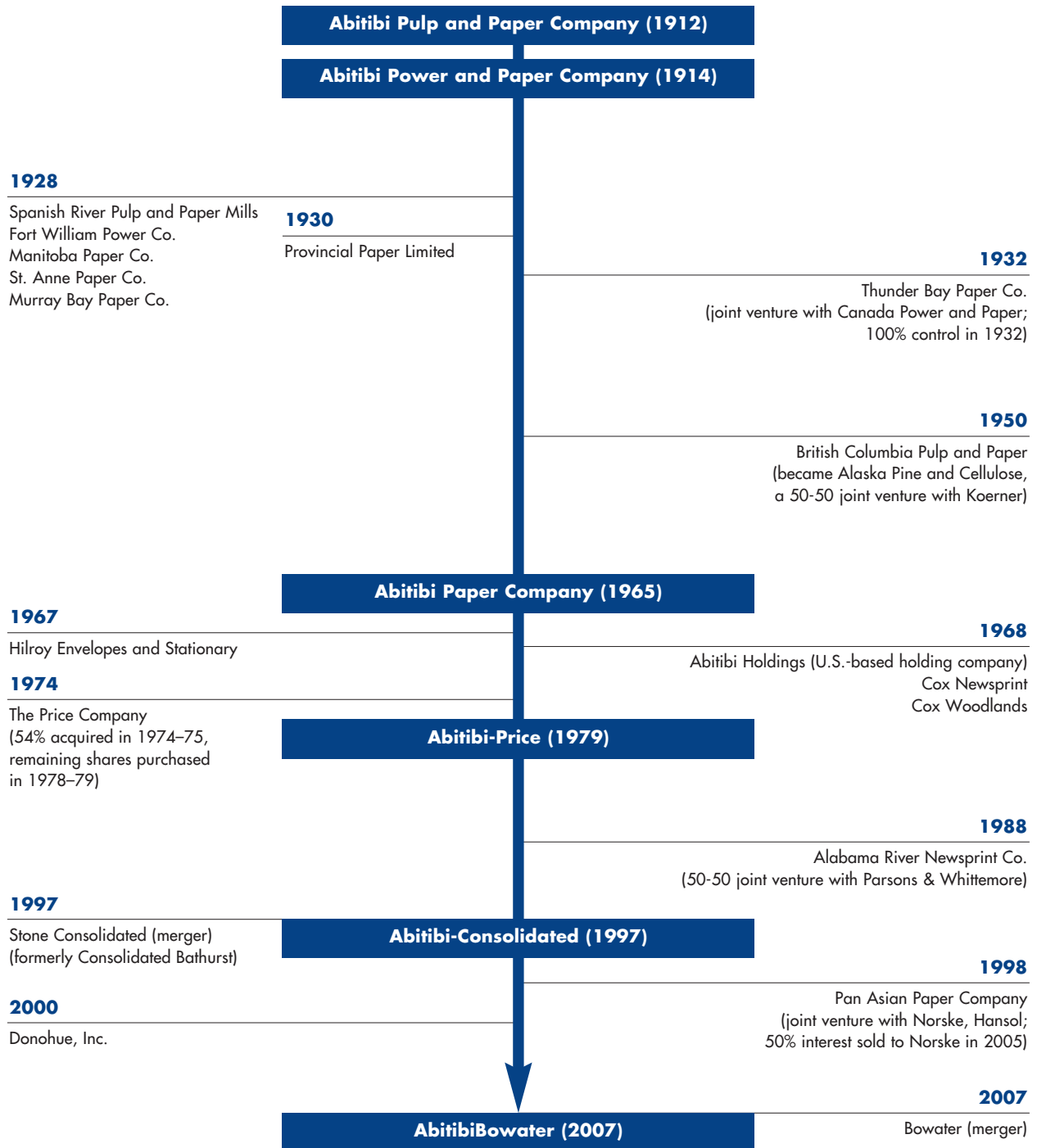
#### 2005

Company	Assets
Abitibi Consolidated	\$8,044,000,000
Domtar	\$5,192,000,000
Canfor	\$3,830,500,000
West Fraser Timber	\$3,633,700,000
Tembec Inc.	\$3,424,700,000
Kruger Inc.	\$3,119,614,000
Cascades Inc.	\$3,046,000,000
Catalyst Paper Corp.	\$2,695,900,000
Norbord Inc.	\$1,544,464,000
Ainsworth Lumber	\$1,513,002,000

(The *Financial Post* ranked Tolco Industries Ltd. as the 10th largest in revenue but listed no assets.)

## Appendix 2

### Timeline of Select Acquisitions and Divestitures in Company History



## Questions

1. In 1928, through a strategy of acquisition, Abitibi became part of the “Big Three” pulp and paper producers in Canada. What is your assessment of the strengths and weaknesses of the newly merged company?
2. From 1932–1946, Abitibi endured the longest bankruptcy in Canadian history. What, if any lessons, did the company learn from this experience, or what should it have learned?
3. In the post-war world, the pulp and paper industry became first more North Americanized and then more global. How well do you think Abitibi reacted to the changing nature of the industry?
4. Abitibi has recently come out of bankruptcy. What do you think of its future prospects? Give reasons for your answer.
5. The Institute for Competitiveness and Prosperity compiles listings of Canadian companies with revenues in excess of \$1 billion that rank in the top five of their global market. In 1985, Abitibi was one of only 15 Canadian global leaders and has remained on that list through 2011. (It is one of only six to do so despite its most recent bankruptcy). The institute claims that Abitibi’s success lies in a leading merger and acquisition strategy. To what extent do you agree with this claim? State your reasoning.

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