AMERICAN

GREETINGS

A Case Analysis

Course: MGT 693
Time: Thursday 7:00 p.m.
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EXECUTIVE SUMMARY

The greeting card industry is ending a period of intense competition that lowered industry profits without materially altering market share positions. This experience has made clear the oligopoly and mature nature of this industry. American Greetings (AG) is the second strongest company in the industry and is poised to take advantage of its position and experience in other synergistic industries. It is the recommendation of this analysis that AG stabilize its position in the current market place, seek to lower costs, and plan for diversification into other synergistic industries.

EXTERNAL ENVIRONMENT

General

The greeting card business is divided into to broad segments: 1) seasonal cards and 2) alternative cards. Over one-half of all greeting cards sent in 1988 were seasonal cards. The remainder was of the alternative or everyday card category. General card sales are growing at about .6% per year while the alternative cards are growing at about 25% per year. The industry on a whole is growing about 5% a year and is considered by most analysts to be mature.

Competition

The greeting card industry is made up of some 500 - 900 firms of which three firms dominate. The big three are Hallmark, AG, and Gibson. Below is a comparison between the big three as of 1989:

Company	Sales	Sales per Employee	Number of Products	Number of Outlets
Hallmark	$2.0B	$71,000	20,300	37,000
American Greetings	1.3B	45,000	20,000	90,000
Gibson	.4B	51,000	N/A	50,000

As can be seen Hallmark is clearly the industry leader in most measures. However, AG has a distribution system nearly twice the size of the other two largest competitors.

During the 1980's the big three engaged in a market share battle, prompted by AG's and Gibson's growth strategies, using all available marketing techniques. The primary price competition occurred during the period 1985 through 1987. The end result of this intense competition was to lower overall industry profits. AG and Gibson did gain some market share during this period (see estimated market share below).

Company	1989	1985	1977
Hallmark	41%	42%	50%
American Greetings (1)	32	33	24
Gibson (1)	9	9	5
Other	18	16	21

(1) These companies together hold 87% of the alternative card market.

This gain in market share was accompanied by a decline in return on revenue as demonstrated in the below table

	Return On Revenue					
Company	1990	1989	1988	1987	1986	1985
American Greetings	5.5	3.47	2.9	5.6	7.2	8.1
Gibson	7.8	9.1	8.7	6.7	7.0	8.7

Both AG and Gibson began to recover from the price competition with renewed margin in 1990. However, they still have not recovered fully.

Additionally, Prudential-Bache warns that price competition may again emerge in the future due to market maturity and competition to hold or steal accounts.

Potential Entrants

Currently the industry faces little threat from external entrants other than smaller niche players. The necessary capital expenditures, low growth rate, and required distribution networks appear to act as significant barriers against new competitors. However, this industry can always be entered by any well established entertainment or other related company looking for potential expansion. Another source of new entrants is from foreigners. As the world becomes one large market the industry can expect more competition from foreign manufactures. Finally, a future source of competition my exist. Electronic mail. As more homes and businesses are using electronic mail to communicate with friends and associates this media may being to be used to communicate greeting messages.

Suppliers

The greeting card industry primarily designs and prints cards. All required technology and materials have been in existence for many years and have reached commodity status. Therefore, suppliers have little influence in this market.

Buyers

Women purchase approximately 90% of all greeting cards and those 55 years old tend to send more card than do younger persons. These consumers individually can exert little influence on the suppliers. However, current social trends, such as towards ecology, may cause collective swings in purchasing behaviors. The middle tier purchasers of greeting cards include drug stores, mass merchandisers, supermarkets, stationery and girt shops, combo stores, variety stores, military post exchanges, and department stores. Here again the fragmented nature of these buyers provide them individually with very little influence on the market.

It should be noted that Prudential-Bache believes that at least 5%-10% of the industries current sales are to retail outlets that the industry leaders are not servicing because their small size makes them too expensive to reach. This may present a market share opportunity.

Substitutes

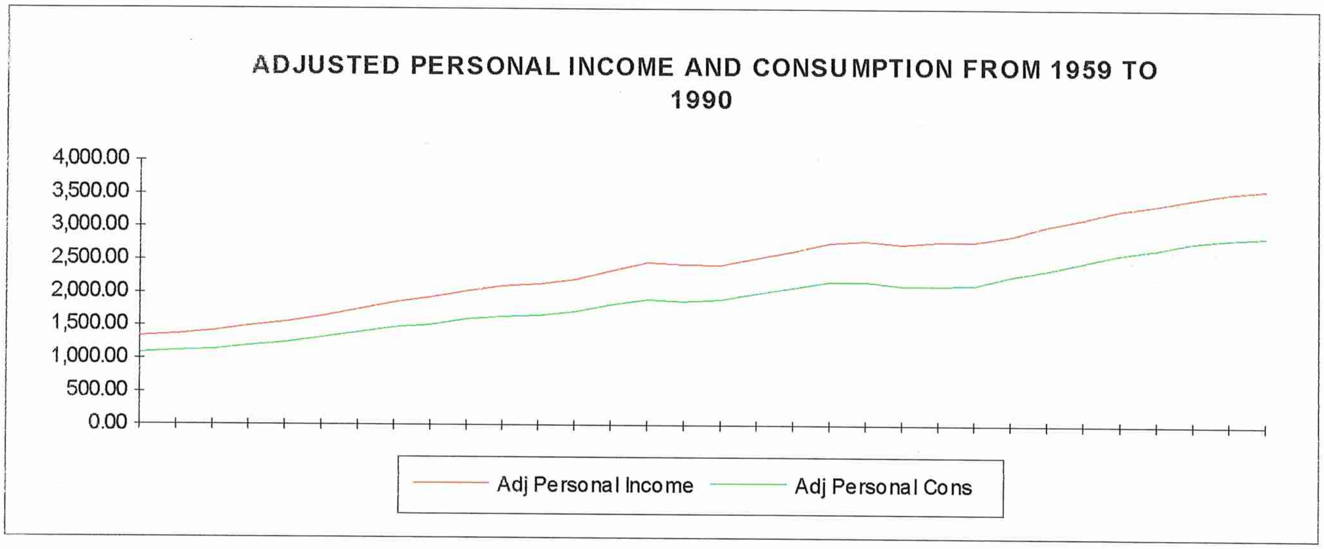
There are many substitutes for greeting cards. These include mail order gifts (e.g. cookies, flowers), small presents (e.g. stuffed animals), special decorative stationary, etc. However, none of these types of substitutes appear to be any significant threat to the industry.

Legal/Political/Union

There is no special legal or political threats faced by this industry. Union relationships appear satisfactory.

Economy

Recent trends in gross domestic product and interest rates may indicate the possibility of an economic slow down in the future. Such a slow down will be beneficial for the greeting cards industry because when the economy slows card sending tends to replace present giving. If the slow down is severe, of course, it could result in a general loss in revenue. Other general trends are also positive for the industry. First, US personal income and consumption adjusted for CPI continues to rise. Second, US population continues to increase with the proportions switching to the older generations which, as indicated above, tend to consume more cards (see charts on next page).


ADJUSTED PERSONAL INCOME AND CONSUMPTION FROM 1959 TO 1990
4,000.00
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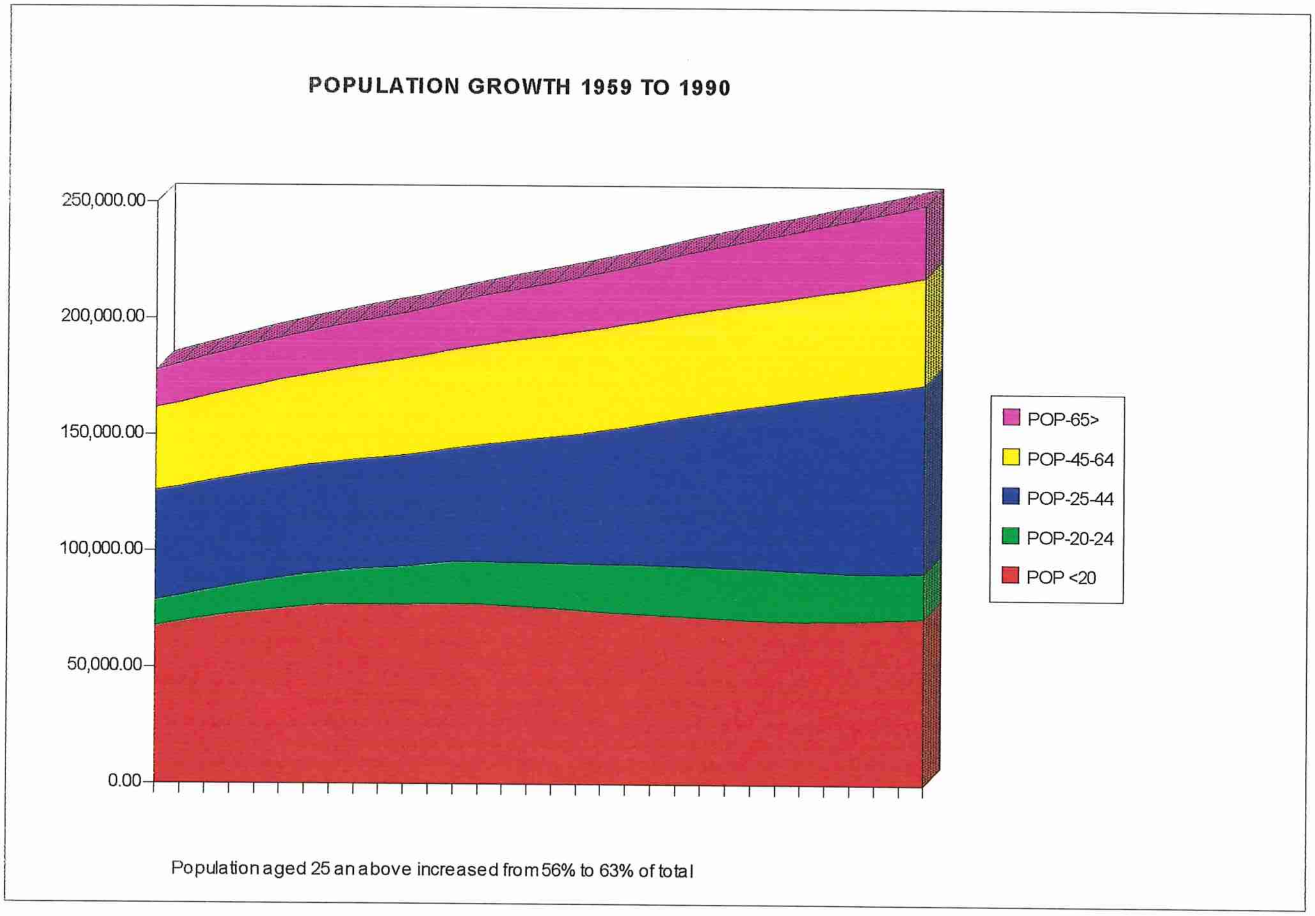
POPULATION GROWTH 1959 TO 1990
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POP-65>
POP-45-64
POP-25-44
POP-20-24
POP <20
Population aged 25 an above increased from 56% to 63% of total

INTERNAL ENVIRONMENT

Finance

The 1980's price competition between the big three manufactures significant effected AG's profitability. As the below analysis demonstrates.

Decreasing price resulted in higher percentage expenses

Consolidated Statement of Income (000's) and Relative Size Analysis

	1990		1989		1988		1987		1986	
Net sales	1,286,853	98.3%	1,252,793	98.2%	1,174,817	98.0%	1,102,532	97.9%	1,012,451	97.8%
Other Income	22,131	1.7%	22,566	1.8%	24,155	2.0%	23,463	2.1%	23,200	2.2%
Total Revenue	1,308,984	100.0%	1,275,359	100.0%	1,198,972	100.0%	1,125,995	100.0%	1,035,651	100.0%
Material, labor, production	543,602	41.5%	546,214	42.8%	540,143	45.1%	476,725	42.3%	416,322	40.2%
Selling and distribution	431,254	32.9%	415,597	32.6%	400,033	33.4%	355,363	31.6%	308,745	29.8%
Administration	149,771	11.4%	148,095	11.6%	135,224	11.3%	125,407	11.1%	131,928	12.7%
Depreciation	40,251	3.1%	39,527	3.1%	34,191	2.9%	29,059	2.6%	23,471	2.3%
Interest	27,691	2.1%	33,479	2.6%	32,787	2.7%	24,875	2.2%	19,125	1.8%
Restructuring	0	0.0%	23,591	1.8%	0	0.0%	12,371	1.1%	0	0.0%
Total Expense	1,192,569	91.1%	1,206,503	94.6%	1,142,378	95.3%	1,023,800	90.9%	899,591	86.9%
Income before tax	116,415	8.9%	68,856	5.4%	56,594	4.7%	102,195	9.1%	136,060	13.1%
Tax	44,238	3.4%	24,582	1.9%	23,203	1.9%	38,834	3.4%	61,635	6.0%
Net Income	72,177	5.5%	44,274	3.5%	33,391	2.8%	63,361	5.6%	74,425	7.2%

This in turn decreased overall profitability

As was mentioned earlier this situation seems to be stabilizing. The price competition seems to have had no effect, other then the decrease in percentage increase in retained earnings due to decreased profitability, on AG statement of financial position. The only noticeable trend highlighted on the below analysis is the increase in cash.

Summary Consolidated Statement of Financial Position (000's) and Relative Size Analysis

	1990		1989		1988		1987		1986	
Cash	122,669	10.8%	94,292	8.7%	36,534	3.2%	17,225	1.7%	26,853	3.1%
Net accounts receivable	254,285	22.3%	242,582	22.3%	278,559	24.2%	284,135	27.8%	240,471	27.5%
Inventories	242,314	21.2%	239,896	22.1%	316,354	27.5%	282,515	27.6%	251,033	28.7%
Other assets	169,465	14.9%	152,847	14.1%	144,359	12.5%	125,760	12.3%	89,982	10.3%
Net P.P. & E.	352,283	30.9%	358,003	32.9%	374,475	32.6%	312,984	30.6%	264,963	30.3%
Total Assets	1,141,016	100.0%	1,087,620	100.0%	1,150,281	100.0%	1,022,619	100.0%	873,302	100.0%
Notes and Accounts payable	111,670	9.8%	100,532	9.2%	166,376	14.5%	105,161	10.3%	87,392	10.0%
Other short term liabilities	89,086	7.8%	83,959	7.7%	85,300	7.4%	80,559	7.9%	91,329	10.5%
Long term debt	235,497	20.6%	246,732	22.7%	273,492	23.8%	235,005	23.0%	147,592	16.9%
Deferred Income tax	100,159	8.8%	91,409	8.4%	86,426	7.5%	77,451	7.6%	64,025	7.3%
Common Stock	115,551	10.1%	122,667	11.3%	122,166	10.6%	119,449	11.7%	125,240	14.3%
Adjusted Retained earnings	489,053	42.9%	442,321	40.7%	416,521	36.2%	404,994	39.6%	357,724	41.0%
Total Liabilities & R.E.	1,141,016	100.0%	1,087,620	100.0%	1,150,281	100.0%	1,022,619	100.0%	873,302	100.0%

Comparing AG's key ratios to those of Gibson as reported by Standard & Poor's Compustat Services, Inc. indicate that AG is performing within general standards.

	1990	1989	1988	1987
American Greetings				
Revenues	5.8	5.6	3.5	2.8
Assets	6.9	6.5	4.0	3.1
Equity	13.1	12.3	8.0	6.3
Current Ratio	2.9	3.4	3.5	2.7
Debt/Capital Ratio	24.6	25.0	27.3	30.4
Dividend Payout Ratio	27	29	48	63
Gibson				
Revenues	7.8	9.1	8.7	6.7
Assets	8.0	11.1	11.4	8.5
Equity	16.3	20.6	20.6	16.5
Current Ratio	1.5	1.9	25	2.4
Debt/Capital Ratio	7.4	11.5	8.7	12.6
Dividend Payout Ratio	1.4	12	13	16

The weaker "return on" ratios are probably due to AG's larger size, however, the weaker debt ratio may also be reducing the "return on" ratios due to higher interest expense. The higher dividend payout ratio may provide AG the opportunity to decrease dividends and increase cash availability for other purposes. However, this would necessitate a departure for the company's .66 per share dividend policy followed over the last 4 years. Such a departure could hurt the company's stock price.

The market stock price has ranged between $42 and $13 per share over the last five years. During the last year the stock price ranged between 37 1/2 to 20 3/8 per share. Trading in this range provides AG with further cash generating opportunities.

In conclusion, net income appears to be returning to health and the balance sheet, dividend policy, and stock price provide cash generating opportunities.

Marketing

AG has 26 regional and 58 district sales offices in the US, Canada, United Kingdom, France, and Mexico; through these offices AG markets its cards to 90,000 retailers in 50 countries and 12 languages. AG's product mix has remained relatively stable over the last 10 years and is broken down as follows:

	Average 10 Year Percentage
Alternative cards	37%
Holiday cards	27
Gift wrap and party goods	19
Consumer products (toys, etc.)	8
Stationery	9

Although this breakdown has been stable more emphasis has been given to the alternative card market in recent years and AG now has a 20% share of that market.

AG also licenses its characters. Revenue from licensing in 1990 however was only 1% of total revenue.

AG does no advertising but focuses on customers needs by sophisticated direct market research.

Production

AG has been investing in production efficiency by increasing automation to cut labor costs and by increasing inventory control procedures. These efforts have been marginally successful. Materials, labor, and other production costs as a percentage of sales has been reduced from a 1981 amount of 44.7% to a 1990 amount of 41.5%. These gains may be greater then reflected in these percentages once the decrease in selling price is taken into account.

Organization

AG is divided into two groups:

- US Greeting Card Division - includes core greeting card business, manufacturing, sales, merchandising, research, and administration.

- Domestic and International Subsidiaries includes:
    - Domestic:
      Acme Frames Products - picture frames
      A.G. Industries, Inc - greeting card cabinets/displays
      Plus Mark, Inc - promotional Christmas products
      Wilhold Hair Care Products - hair care products
      Summit Corporation/Summit Collection - cards
      Those Characters form Cleveland, Inc - characters licensing
    - International:
      Carlton Cards - Canada, England and France cards
      Rust Craft Canada - cards
      Felicitaciones Nacionales S.A. de C.V. Mexico - cards

AG has divested or consolidated several business enterprises over the last few years.

In analyzing AG's business portfolio it can be seen that most of its business is in a low market growth / high share of the market share classification. That is mostly greeting cards. However, further breakdown shows that within this general market AG is weighted more heavily toward the alternative card market which could be classified as high growth. AG is positioned here as a low share of the market competitor. It is possible that this business could be very profitable but it is difficult to evaluate from the information available. It is clear that the general card market should provide substantial cash flow for many years.

Other related businesses that AG currently competes in (namely gift wrap, party goods, and card cabinets/displays, consumer products, and stationary) should be classified as low market growth / low share of the market. These businesses will probably never substantially increase AG's profits, however, they may provide better customer service and synergistic effects.

Finally, AG also sells picture frames and hair care products. These are slow market growth / low share of the market businesses.

Critical Issues

AG's goal is "to improve competitiveness and enhance future earnings prospects in order to maximize shareholder value." As is evidenced by the standard shareholder value measures (see table below), during the intense competition of the 1980's, AG did not achieve that goal.

	1990	1989	1988	1987	1986
Net return average shareholders' equity	12.3%	8.0%	6.3%	12.7%	16.5%
Pre-tax return on total revenue	8.9%	5.4%	4.7%	9.1%	13.1%
Stock Price	31.25	21.25	17.63	28.75	35.62

However, 1990 is a recovery year and it appears that AG is poised to improve its performance. Yet several challenges still remain. The table below lists the internal strengths and weaknesses and external opportunities and threats (S.W.O.T. table) faced by AG.

INTERNAL

Strengths
- One of the top two companies in the industry
- Largest distribution network in the industry
- Competitor in the alternative card market
- Profit margin improving
- Relatively strong stock price
- International experience
- Knowledge in market research techniques
- Experience with acquisitions and divestitures

Weaknesses

- General slow growth in card sales

EXTERNAL

Opportunities

- Strong growth in alternative card market
- Increase in older population increases potential market
- Smaller retailers are not being serviced
- Potential economic slow down

Threats

- General slow growth in greeting card market
- Potential continued market share competition
- Telecommunication revolution may replace existing card giving

After evaluation of the S.W.O.T. table above several critical issues can be identified. These critical issues are:

- The threat exists in the oligopoly and mature nature of the greeting card business that any overt move to gain market share by any of the top three firms will be responded to quickly by the other two competitors. This makes AG's profits vulnerable to moves from other major competitors.
- An opportunity exists for AG to use its current financial position and distribution system to penetrate related industries that will provide higher profit margins. Given that AG has a vast retail network and sophisticated marketing skills it should be possible to identify markets related to the greeting card business that could improve margins and long term growth.

Strategic Alternatives

AG could renew its efforts to gain market share and go head to head with the other two market leaders. Such an alternative proved unsuccessful during the 1980's and will continue to be unsuccessful as long as the industry remains an oligopoly. Any significant move by one player will immediately be matched by the others. AG can best assure that a market share battle does not being by not starting one. This does not mean that market share can not be improved. The key is in finding segments of the market the market that are not being services by the big competitors, such as the smaller retailers, and servicing those segments profitably. Additionally, market share can be improved by expanding the market in to new and innovative ways such as utilizing an electronic communication network.

AG has attempted to automate its factories to improve margins. Although it is difficult to evaluate it appears that this strategy has been only marginally successful. Other alternatives to improving margins by reducing costs lay in the reduction of distribution costs or administrative expense.

Most of AG's businesses are in low growth markets with the substantial exception of the alternative card market. AG could focus entirely on this market segment, however, in so doing it would miss out on the cash generating abilities of the seasonal card segment and would not benefit from the increase in name recognition that that segment generates. Although the alternative card business is high growth and AG should devote proportionally more of its greeting card resources to it, other opportunities also exist.

One such opportunity is to use AG's marketing talent to identify unfulfilled customers needs that can be supplied by its established retail network. Another is to identify other related businesses that could be started or acquired that would provide a higher rate of return than the existing businesses. AG could become diversified into more heterogeneous business (as it appears it has done with entry into hair care, etc.) which provides for an evening of the income stream. Yet this strategy has proved unsuccessful for most companies as it is difficult to add value in an industry that you have limited experience. Therefore, it is typically better to remain in the industry you know best. Another strategy which is less risky then entering a new business is to expand on one or more of AG's current non-greeting card businesses such as the character licensing or stationary businesses. Such a strategy could increase profits, although perhaps not returns, with less risk.

Recommendations

Corporate Strategy

Given the mature nature of the greeting card industry, AG should pursue a policy of stability while it evaluates the possibilities of diversification into related industries. By pursuing stability AG can allow the industry and itself to recover from the 1980's market share competition. However, as AG has a very strong position in a relatively mature market it should begin looking for opportunities to start or acquire businesses that will create corporate synergy.

Competitive Strategy

AG should follow a cost leadership strategy. By aggressively seeking ways to more efficiently deliver its greeting cards (e.g. more effective distribution methods, overhead control, etc.) it will secure a competitive position even during times of heavy competition.

As AG diversifies into related businesses those business competitive strategies will have to be determine on a business by business basis.

Other

AG should begin to explore the starting or acquiring of businesses related to the greeting card industry that offer higher profit margins. Such businesses might include telecommunication greetings, specialized printing, wedding items, etc. AG should also begin to expand its current non-greeting card businesses such as its stationary and character licensing businesses. Although this may not increase margins it is a relatively safe way to improve revenues.

Implementation Plan

Of course maintaining the status quo by following a stability plan is relatively easy. AG should, however, always be cautious to assure that none of the big competitors make market share moves that remain unaddressed.

Finding and/or expanding into related businesses requires some planning. First the desired business must be found. The three basic criteria should be financial returns, market potential, and goodness of fit with existing business portfolio. Once the business has been selected the necessary resource needs should be identified. The resource need of first priority is financial. Various capital sources exist for AG. Given the company's current position, stock issuance may be the best option for raising large amounts of capital or for smaller sums internal funding should be possible. After funds are made available human and technical resources must be identified or acquired. If the business is properly selected to fit into AG's current business portfolio then human resources should be available from within the company. Depending upon the business, technical resources may or may not need to be acquired. Finally evaluation and control procedures will have to be developed. Usually, these are of a financial and market share nature.