CASE ANALYSIS

CROWN CORK & SEAL IN 1989

INDUSTRY STRUCTURE

- Five firms dominated the $12.2 billion US metal can industry in 1989 with an aggregate 61% market share.
- The country's largest manufacturer – American National Can (25% market share), Continental Can (18%), Reynolds Metal (7%), Crown Cork & Seal (7%) and Ball Corporation (4%).
- **Pricing –** Pricing was very competitive in metal can industry. Organizations relied on long run of standard items to increase capacity and reduce cost and reduce need of costly changeovers. Operating margins fell from 7% to 4% for industry due to
  - 15% increase in aluminum sheet which was not incorporated
  - 7% increase in beverage can production capacity
  - Major brewers producing containers in house
  - Consolidation of soft drink bottlers increased the buyer power which dominated the market to get discounts
- **Customers -** Consolidation of the soft drink bottlers from approx. 8000 to 800 placed a significant amount of beverage in few large companies like Coca Cola, Anheuser-Busch, Pepsico etc. These bottlers maintain relationship with more than one metal can suppliers, so that poor services and uncompetitive prices are punished by order cuts.
- **Distribution –** Due to bulky nature of cans, manufacturers located their plants close to customers to minimize travel costs. The primary cost involved is Raw Material (65%), Direct Labour (12%) and Transportation (7.5%). Economical distribution for a plant is between 150 to 300 miles.

INDUSTRY STRUCTURE

- **Manufacturing –** Industry was moving from two piece can to three piece can to reduce the cost of production lines. 2-Piece line cost $16 million and with investment in peripheral equipment makes it $20-$25 million per line. While 3-piece line cost about $8-$9 million. Most plants have 12-15 lines for increased flexibility of handling more than one type of can.
- **Suppliers –** In 1970, steel accounted for 88% of metal cans, but dropped to 29% in 1989. Aluminum become the choice as by 1989 it accounted for 99% of the beer and 94% of soft drink. The three biggest suppliers were Alcoa, Alcan and Reynolds metal. Reynolds metal also was the competitor as it was producing 11 billion cans itself.

METAL CONTAINER INDUSTRY TREND

- **In house Manufacturer –** Producing can for own company use accounted for approx. 25% of total can output. Nation's major food producers and brewers expanded the inhouse manufactured cans facility. They found it advantageous to invest.
- **Plastics –** Plastic is now growth leader in the container industry. Market share in 1980 was 9% which got increased to 18% in 1989. Plastic could contain carbonation for 4 months while aluminum holds for 16 months. US brewers expect beer containers for atleast 90days.
- **Glass Bottles –** Glass bottles accounted for 14% of domestic soft drink sales. Soft drink bottlers though prefer metal can to glass because of logistical and economic benefits like faster filling, lighter weight, compactness for inventory, transportation efficiency.
- **Soft Drink and Aluminum Cans –** Aluminum penetration can be traced to factors like weight advantage over glass and steel, ease of handling, wide variety of graphic option, consumer preference. Aluminum growth also supported by vending machine which was designed accordingly and constitute 20% sale.
- **Diversification and Consolidation –** Low profit margins, excess capacity and rising labor and material cost prompted many major companies to diversify its businesses and subsequent consolidations throughout 1970 and 1980.

JOHN CONNELLY'S APPROACH

- John took over the company when it was on the verge of bankruptcy and he changed it to a profitable entity.
- John's approach was simple "Just common sense". He structured the company to be successful and took company in direction of owner-operators. Though he continually look for new ways of controlling cost, he never compromised on quality and was hell bent in improving quality.
- Connelly's first action was to pare down the organization
  - Reduced HQ staff by half to reach a lean force of 80.
  - Abandoning its paternalistic culture to simply functional organization
  - Reduced payroll by 24% and eliminated 1647 jobs
- Second action was to institute the concept of accountability
  - Establish crown managers as owner operators
  - Plant managers take responsibility for plant profitability and associated costs
- Third action was to focused on company's debt
  - Crown paid off banks mainly through inventory reduction and liquidation netting $47 million
  - Also introduced sales forecasting dovetailed with new production and inventory control. This move put pressure on plant manager who were no longer able to avoid layoff by dumping excess product into inventory
- Connelly was not satisfied with short term reorganization and developed a strategy that would become hallmark for next 3 decades.

JOHN CONNELLY'S STRATEGY

- **Products and Markets -** Crown recognized its strengths and focused on only two products: tin-plated cans and crowns. Being small producer in competitive market, it was important to focus on few products and build competencies. To follow this, Crown exited from the oil can market instead of spending resources on competing in this changing market. They also focused on the "hard to hold" applications in their domestic market of beverage cans (taste) and aerosol cans (pressure). They designed equipment to specifically meet the needs of soft drink producers and improved printing lines to allow for quick design changeover to accommodate JIT delivery.
- Connelly's strategy was based on 2 geographic thrust, expand national distribution and invest heavily abroad. Crown did not setup to serve one customer but multiple customers near their plants. Abroad, they invested heavily in developing nations first.
- **Manufacturing -** In 1957, Crown had a serious problem related to antiquated machinery and poorly located manufacturing facilities. To remedy this, Crown invested in new manufacturing facilities and technology. Additionally, crown instituted a total quality improvement initiative and enacted inventory policies that allowed it to serve customers' needs for JIT delivery. They focused on reducing mistakes to improve efficiency and reduce costs. They also spread out domestic plants to be closer to many customers (not focusing on just one) to reduce transportation costs.
- **Recycling –** In 1970, Crown formed Nationwide Recyclers Inc as a wholly owned subsidiary. By 1989, it was one of top 4-5 recyclers.
- **R&D -** Crown chose to avoid basic research and instead focus R&D on enhancing existing skills in die-forming and metal fabrication, increased adaptability and the ability to quickly change products to customer's needs. This approach paid off with two-piece cans: Crown beat all of their competitors to market and had greater production capacity than anyone else.

JOHN CONNELLY’S STRATEGY

- **Finance -** Crown first sought to deal with its short-term debt obligations and then focus on reducing the firm’s debt/equity ratio, which went from 42% in 1956 to 5% in 1986, and by 1988 their debt was less than 2% of their total capital. Crown also set out to plug its cash drains by ending preferred dividends and repurchasing stock. This improved their financial strength resulting in increased EPS by 1988.
- **International Strategy**: Firms seeking international business wish to have international revenues grow enough that domestic revenues are not the overwhelming majority. Crown achieved this, reporting in 1988 their international business which accounted for 44% of sales and 54% of operating profits. They had “pioneer rights”, allowing them to be the first-mover in a developing nation and getting a foothold by opening Crown production facilities. Crown could save costs by transferring outdated domestic production equipment to these new plants abroad. They also focused on retaining National management in those countries, understanding that locals have a grasp on the unique aspects of supply and demand in their market.
- **Marketing and Customer Service**: Since there was nearly no differentiation at the product level, Crown focused on providing high-levels of customer service to provide fast technical assistance and problem solving in person, at the plants. They were customer driven and focused on maintaining close customer relationships with improved speed, quality, efficiency, and flexibility.
- **Performance -** Healthy & consistent ROE of 14%. Low /consistent ROS of 4-5%. Operating ratio of 8 - 9 % consistently , however high operating ratios of 15-18% from the rest of the world markets. Low SGA per sale of 3% vis-à-vis 5-8% in the industry (American can company around 15%). Very low debt to equity ratio. Consistent cost of goods per sale of 85%. International operating ratios is consistently improving from 14% to 18% (1986 to 1988).

AVERY'S CHALLENGES

- **Challenge 1 –** Diversify into plastic containers and closures as well as glass containers

Pros	Cons
With slow growth in metal containers, plastic is only container segment offering promise	Possibility of diversifying beyond container manufacturer looks appealing but appropriate opportunity was not in hand.
Competitors are also expanding aggressively and producing plastic containers	Connelly always been cautious and played on strength and was successful. Avery wondered if it is time for change or not.

- **Challenge 2 –** Whether or not get involved in the bidding of Continental Can

Pros	Cons
With acquisition, Crown will be Largest single presence outside of US in Canada. US business of crown will get doubled and will come in competition with its biggest rival American can.	Bidding will have competition with its US rivals and also with European and other companies
Plastic container line will be added in its product.	Most mergers in industry have not worked well
Also increase market share and world wide expansion and thus bargaining power with supplier and buyers.	Bringing two different organization under one roof will be a challenge and processes will have to be amended.

RECOMMENDATIONS

- Crown should go ahead with bidding of Continental Can and should acquire it. William Avery should look at the broader future and at the same time continue Crowns legacy of focusing on cost, quality and superior customer service.
- Due to high volume and low margin business. Crown needs to expand and gain on volumes.
- By taking over the Continental Can, market share of Crown will become 25% from 7% making it same as of American Can, the biggest player in the industry.
- The low debt equity of Crown will help them to generate funds for the acquisition. Continental can plastic container production line will help crown to expand and diversify into plastic containers.
- It has to continue Connelly's approach to continue with its strength and make international investments in developing countries while focus on quality. This approach has served them well for three decades even when competitors were diversifying. Avery can use same after acquiring Continental can.
- Although John Connelly's Simple, no-nonsense approach served CCS very well, its prudent to recognise that there is a industry shift happening. Avery needs to strike a right balance to maintain and sustain the traditional metal can business and at the same time look at plastic and glass diversification.
- Like his predecessor, if the need arises William should also be ready to take tough decisions to see or divest business in markets which may not perform well due to changing times.
- Avery should also have a contingency plan for each of the above, as not all decisions are going to hit the desired target. For e.g Continental Canada had multiple bidders, if Avery doesn't get the deal, what are his secondary options, - other acquisitions etc.
- Finally we also believe Avery should look at expanding to new business if the opportunity is available both in Aluminum and eventually plastic and glass – for eg – Perfume containers (glass), Aluminum tin foil containers(food packaging)

SWOT ANALYSIS

STRENGTH

- Cost Efficiency
- Financially sound (low debt to equity ratio)
- Customer focus strategy and support

WEAKNESS

- Lack of R&D
- No diversity in product line
- Smaller than its competitors

OPPORTUNITY

- Chance to explore other products than metal like plastic and glass
- Chance of globalization /Pioneer rights.
- Acquisition and consolidation

THREAT

- Slow growth
- Substitutable
- Emerging plastic and glass market
- Challenges from buyers and suppliers
- Price pressure, Customer base shrink

PORTER FIVE FORCES ANALYSIS

Threat of New Entrants (Low)

- High initial investments
- Low profit Margins

Bargaining Power of Suppliers (High)

- Only Few Suppliers
- Threat to forward integrate
- No good alternative to aluminum

Rivalry Among Existing Firms (High)

- Dominated by few big players
- Excess capacity

Bargaining Power of Buyers (High)

- Few Big Buyers
- Threat to backward Integrate
- Huge discounts

Threat of Substitute Products (High)

- Low switching cost
- Plastic/Glass as alternatives

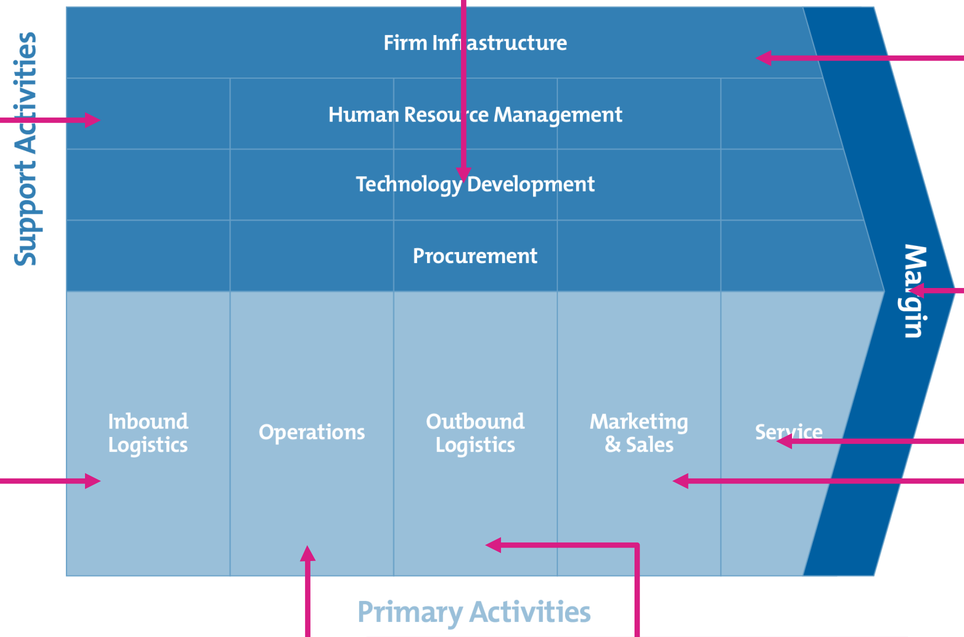
VALUE CHAIN ANALYSIS

- Reduced payroll by 24%
- Removed 1647 jobs
- Change divisional lines to “Owner Operators

- Introduced sales forecasting dovetailed with new production and inventory control

- Disbanded central research and development facility

- Inventory reduction and liquidation



- Sales increased from $115 to $176 million. Profits soared.
- 15,5% increase in sale and 14% in profits.

- Closing down Philadelphia facility
- New and geographically distributed plants

- No quality compromise

- Flexible and quick response to customer needs

THANK YOU