

ECONOMY AND MARKETS

Challenges and developments in the US tissue market

The United States constitutes by far the biggest tissue market in the world, at a value of over US\$11 billion, according to research from Euromonitor International.

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With an annual per capita consumption of 27kg the average American consumer tops the world list when it comes to usage in volume terms. As a comparison, his or her German counterpart will go through approximately 15kg of tissue per year; while globally the average remains under 4kg, due to low or virtually non-existing consumption in many developing markets. While such a huge market offers many opportunities for manufacturers, the market environment also poses many challenges.

FIERCE COMPETITION IN A MATURE MARKET. The US tissue market (toilet paper, tissues, kitchen towels and paper tableware) environment is unsurprisingly characterised by fierce competition, with volume maturity and price pressure putting constraints on growth. With the biggest subsector, toilet paper, already enjoying household penetration rates of close to 100%, pushing consumers towards the premium end of the market has become the chief driver of growth. For products such as paper tableware, commoditisation is another pressing issue, with manufacturers seemingly unable to add value to existing offerings, which therefore remain vulnerable to private label products and price-driven competition.

The US consumer tissue market is also highly concentrated, with roughly 80% of sales in the hands of the top three manufacturers Kimberly-Clark, Procter & Gamble and Georgia-Pacific. With growth rates at stagnant levels, effective and well-financed marketing is usually the means through which market share is gained. As an example, when Kimberly-Clark introduced Scott Extra Soft in early 2005, the launch was supported by more than US\$40 million worth of advertising and promotions.

In addition to competitive pressures, all manufacturers have suffered from increased input prices.

Inflated production costs have been responsible for the pressure on manufacturers' profit margins, stemming largely from price increases in wood pulp. Over the first half of 2004, average prices for both hardwood and softwood pulp delivered to the US rose sharply – in the case of softwood pulp from \$580/tonne to \$680/tonne. Added to this were rising energy costs, particularly of natural gas, which is a vital component in the through-air drying (TAD) process. Spurred by the sharp rise in input prices, and after years of falling or relatively stagnant pricing levels, the major manufacturers implemented a seemingly co-ordinated price hike during the summer of 2004. Thus, despite the overall industry challenges, the tissue market recorded a healthy growth of over 5% in 2004.

TOILET PAPER BACK ON TRACK. On the back of an increase in demand for value-added products such as softer and impregnated paper, growth rates for toilet paper returned to positive territory in 2004, following a year of declining sales. According to research from Euromonitor International, the US growth rate stood at close to 7% in 2004, largely driven by a boost in sales of luxury toilet paper. High-quality paper with attributes such as softer fibres and texture enhancements is fairly standard in the US. Within the luxury segment, additional features such as added vitamin E, camomile or aloe vera have been present for several years, and have generally been well received by US consumers. In

recent years manufacturers have also tried a number of innovations in search of the next product trend, with mixed results. Among these are products such as Charmin Scents, introduced in the second quarter of 2003, and wet-wipe extensions of toilet-paper brands.

Growth was further aided by the aforementioned price increases implemented during the summer of 2004. These increases mostly took the form of sheet-count reductions, thus making a roll of toilet paper appear to remain at the same price, although the consumer is actually getting less toilet tissue. Apart from the obvious advantage of such 'hidden' increases, this tactic also provides manufacturers with a future marketing tool by allowing a "new – larger roll!" or similar claim to be made, should the changes be reversed at a later date.

It is interesting to note that when it comes to toilet paper, US consumers are still largely brand loyal. Shares within the market tend not to experience dramatic changes from year to year. Furthermore, private label holds a fairly weak position in the market, with a value share of around 13%. This can be contrasted with Western Europe, where private label accounts for over 40% of sales. Admittedly, much of the explanation for the success of private label in Europe lies in the structure of retailer networks – particularly the establishment of so-called 'hard' discounters like Aldi and Lidl in Germany. Nonetheless, the average US consumer is generally more brand loyal and less price sensitive than his/her European counterpart.

KLEENEX – THE UNDISPUTED LEADER IN TISSUES. The US market for tissues, which encompasses both boxed facial tissues and pocket handkerchiefs, exhibited close to 3% value growth in 2004, according to Euromonitor International. While being unable to match penetration rates of toilet paper, boxed tissues can still be found in the majority of American homes. Capitalising on an extremely high degree of brand recognition, Kimberly-Clark's Kleenex still accounts for the lion's share of sales in the US. Kleenex is, in fact, so closely identified with boxed facial tissues that many consumers use it as a generic term for all such products.

In order to defy competition from private label products, premium offerings have proven to be vital in the product range of branded products. As private label has become increasingly sophisticated in recent years, manufacturers have, however, been given a run for their money. Private label copycat versions of tissues with value-added features, such as lotion and vitamin E, can now increasingly be found on supermarket shelves, thereby threatening the premium cachet of brands such as Kleenex.

Kimberly-Clark has been very active on the innovation front over the past year. Two new products launched in North America under the Kleenex banner are worth watching. In August 2004, Kleenex Anti-Viral facial tissue hit the shelves nationwide. This 3-ply tissue contains a middle layer treated with citric acid and sodium lauryl sulphate, which, the company claims, kills 99.9% of viruses within 15 minutes. Another recent addition to the brand range came with the launch of Kleenex Moist Cloths in March 2005. These are thick, disposable, soft cloths treated with a mild alcohol-free formulation, and are intended as an alternative to washcloths or wet wipes.

MIXED PERFORMANCES FOR KITCHEN TOWELS AND PAPER TABLEWARE. Demand for certain products that are considered essential purchases, such as toilet paper, tends to be quite inflexible. In contrast, the demand for kitchen towels is much more responsive to economic conditions as they are generally perceived to be discretionary purchases. During the boom years of the late 1990s, this dynamic worked in favour of towel manufacturers, supporting rates of value growth of 4-6%, but as the economic downturn became more entrenched and apparent to consumers, growth faltered.

2004 saw the return of value to the market after a sluggish 2003, with Euromonitor International registering sales growth in kitchen towels of close to 6% over the year, thereby pushing up the market value to US\$3.4 billion.

Paper tableware, comprising paper napkins and disposable tablecloths, meanwhile, only recorded a modest growth of 0.4% in 2004. Paper tableware is a relatively commoditised product type in which many consumers are price-focused, and private label offers tough competition. Furthermore, substitute products such as re-usable cloth alternatives can easily be found at a low price in the large number of US home-furnishing stores such as Pier One Imports, Linens 'n' Things, and Bed, Bath, and Beyond. In addition innovation within the sector has been lacklustre in recent years, focusing mainly on packaging features such as decorative boxes in the case of Georgia-Pacific's Brawny brand in 2004.

OUTLOOK. With little room for increased penetration, the saturated nature of the overall US tissue market places natural constraints on future growth prospects. Euromonitor International expects the market to witness a modest value growth of close to 2% over the 2004-2009 forecast period, equal to a compound annual growth rate (CAGR) of 0.4%. Coupled with continued competitive pricing structures at the retail level, weaker demand will dampen growth in commodity products. In fact, Euromonitor International predicts that tissues and paper tableware will be hit by declining sales over the forecast period. Of these two sectors, paper tableware will suffer the toughest blow, with an anticipated decline of approximately 12% in value.

The two biggest sectors- toilet paper and kitchen towels – are instead forecast to be the sole drivers of growth, with an expected CAGR of 0.6% and 0.9% respectively. Premium offerings will continue to drive sales in toilet paper, whereas kitchen towels will continue to benefit from economic recovery and a subsequent increase in discretionary spending.

FUTURE PRICE HIKES ARE ALSO TO BE EXPECTED. Kimberly-Clark and Procter & Gamble have both announced their

intentions to raise prices on their tissue products in early 2006. Whether or not these attempts will be successful remains to be seen. In the past, consumers have sought to mitigate price increases in a number of ways: by switching to lower-priced value brands and private label products, changing distribution channels to favour lower-priced stores such as mass merchandisers, or purchasing larger packages in search of better unit prices. After all, raising prices is easy – making them stick is the tricky part. •