

G. Wallace F. McCain Institute for Business Leadership

University of New Brunswick

Case Study: Ganong Bros. Limited*

* Matthew Hurly prepared this case with Daniel Doiron's assistance for the purposes of classroom discussion rather than to illustrate either effective or ineffective management practice. The G. Wallace F. McCain Institute provided financial support for the production of this case. Copyright 2008 by the G. Wallace F. McCain Institute.

ASSIGNMENT...

What do people buy when they buy an unbranded piece of hard candy in a cellophane wrapper? A Cadbury's candy bar? A Godiva truffle? What accounts for the differences in prices of these candies?

What is your assessment of the Ganong strategy? In the long run, in a globalizing world, will Ganong be able to compete successfully based on price (in either branded or non-branded business)?

What advice would you offer David Ganong as he faces challenging business conditions at the time of the case?



David Ganong, President and Director of Ganong Bros. Limited, looked out from his office on the upper floor of the St. Stephen, New Brunswick confectionery factory. It was January 2007 and the cold bleakness of the scene outside his window seemed to mirror his mood. Ganong recently had received confirmation that yet another Canadian confectionery company had gone out of business. Beta Brands, a manufacturer of sugar confectionery such as jelly beans, based in London, Ontario, had not even gone into liquidation or a downturn; it just closed the doors, laying off 300 employees.

There was no doubt that the strengthening Canadian dollar was taking its toll on the industry. Ganong could not help but wonder about the fate of his rural-based company, with its small local market, if a company based in southern Ontario, the heartland of Canada's manufacturing sector, could not maintain profitability despite its close proximity to major Canadian and U.S. markets. Perhaps Ganong's strategy was flawed; after all of these years perhaps he and his family should concede that there was not a future for chocolate and candy manufacturers in Canada.

The Confectionery Industry

The Canadian confectionery market was valued at approximately \$2.5 Billion¹ in 2007¹. Chocolate accounted for approximately 59 per cent of this market, with the remainder comprised of sugar candy (20 per cent), chewing gum (17 per cent) and everyday cough drops (four per cent). The market had grown steadily by three to five per cent in the years leading up to 2007. Most of the growth occurred in the chocolate and gum sectors; sugar candy and cough drops showed no appreciable change in market revenue. Particularly high growth areas included fruit snacks, sugar-free products, and high value products, such as premium chocolates.

The average Canadian consumes approximately 25 pounds of chocolate per year. Chocolate products are divided into three categories: boxed chocolates, chocolate bars and novelties. Boxed and novelty chocolates are seasonal and tend to be sold primarily around Christmas, Valentine's Day and Easter. These gift-oriented products are brand sensitive and a product's name usually carried a sense of nostalgia, which drives the consumer to purchase one brand over another. Chocolate bar sales are steady the whole year round².

Branding of chocolate bars was critical. In a sector where five of Canada's top 10 chocolate bars had been on the market since before World War II and all but two had been around since the 1960s, new chocolate bars did not fare well. Most were gone from store shelves before they'd had time to make a lasting impression³. A bar was considered

¹ All Financial Figures in Canadian Dollars

a success if it captured four to five per cent of the market². The Canadian chocolate industry was unique, characterized by low profits and intense competition between Cadbury, Hershey, Mars and Nestlé, four similarly sized multinational chocolate bar companies².

Sugar candy operations were generally smaller than chocolate operations and produced a wide variety of products, such as hard candy, jelly beans, jujubes and toffees. Profits tended to be higher in the sugar confectionery industry. The sugar confectionery industry was less brand-oriented than the chocolate industry, with consumers generally making purchasing choices based on price rather than the manufacturer².

The cost of raw materials (including packaging) dominated the Cost of Good Sold (COGS) in both the sugar and chocolate confectionery sectors, representing 73 per cent and 85 per cent respectively of the COGS (see Exhibit A for further detail)^{4,5}. The industry was therefore very vulnerable to fluctuations in the price of materials and supplies. Primary ingredients used in the manufacturing process included commodities such as cocoa products (20 per cent), sugar (five per cent), dairy products (seven per cent) and nuts (six per cent)². Packaging costs were also significant, estimated at 20 per cent of raw materials cost.

Confectionery companies competed on the basis of brand name, specialty products, advertising and promotion and cost, with continuous promotion essential for success in a sector where the majority of were discretionary and made at the spur of the moment².

Manufacturing Processes

In the industry's early days, candy-making was labour intensive, typically made by hand in small kitchen-type operations. As companies grew and technology improved, the reliance on labour declined and older operations closed down. The variety in the processes that are used in the manufacture of chocolate and non-chocolate confectionery has not changed due to the large number of products available on the market.

Chocolate is made from cocoa beans in an involved process which includes roasting the beans, refining the chocolate liquor, conching (turning and grinding) the mixture, and finally molding. As the process required to make chocolate from cocoa beans is so complex, many manufacturers who only use chocolate as a raw material (rather than produce it as a main product), will buy the chocolate instead of producing it in-house. These manufacturers melt the purchased chocolate and use it in one of two ways, either in enrobing or molding. Enrobing involves smothering previously-made centres with a layer of chocolate, while molding involves pouring the melted chocolate over a centre which is in a mold. Molding results in a chocolate that has a very smooth, consistent and glossy finish.

Some of the more common processes in the manufacture of sugar confectionery products include using a starch mogul, panning and extrusion. The starch mogul uses trays of starch which are imprinted with the shapes of the candy required. Candy mixtures are made in different textures, flavours and colours. These mixtures are then poured into the molds, taken off for drying, and then shaken from the starch. Panning is used to form products such as jelly beans and certain types of mints. Cores (from the starch mogul) are placed into the rotating pans, after which sugar, flavouring and colouring is added according to specific recipes. Some candy products (for example marshmallows and some centres) are made by mixing the different raw ingredients together, cooking where appropriate, and then extruding them into a certain shape before finally cutting them to size.

Once the different chocolates and candies are made they still need to be packaged into cellophane bags or boxes. For sugar candy the bags are typically filled automatically by machines controlled by the weight of the bags. Chocolate bars are also wrapped automatically by machine. Boxes of chocolates, however, are often packed by hand.

Large companies are capital intensive with highly automated, technologically modern processes that produce high volumes of the same product with very few or no changeovers² required. Smaller companies tend to make lower volumes of a specialty or niche product. These operations are generally more labour intensive with less automation and more changeovers for different products required, all of which drive costs up and efficiencies down. It is estimated that worldwide, the industry runs at approximately 75 per cent of full production capacity. This is partly due to the specialized equipment required for seasonal product lines².

Increased public awareness and vigilance of food allergies, and in particular peanuts, has also had a major impact on the industry, which uses nuts in a variety of products. This change in public expectations has forced confectionery companies to provide public assurances that products have been made in a peanut-free environment. To meet this pledge, companies have modified factories and in some cases installed duplicate equipment. This has at times been money spent just to stay in business.

Outsourcing

Major confectionery manufacturers had dozens of products on the market. Due to the specialized equipment required for some products it was not unusual in the industry for manufacturers to outsource parts of their production to other, usually smaller, manufacturers. The products that were outsourced were typically those that were

² A changeover is when a production line needs to be stopped, potentially cleaned, and changes made to the line in order to change from one product to a different one.

important for business but are not one of the marquee products. The smaller manufacturer produced the confectionery with recipes, packaging and labelling provided by the brand owner. The benefits to the smaller manufacturer included guaranteed revenue for the term of the contract without the overhead costs in sales, marketing and distribution. Depending on the contractual delivery requirements the smaller company also could use the production to help level fluctuations in manufacturing due to the seasonal demand of its own confectionery products.

Distribution

Distribution was a major factor in the Canadian confectionery industry. Traditionally, manufacturers distributed product to a large number of small, usually locally-owned retailers. However, consolidation in Canada's retail sector has left the sector dominated by major grocery store chains, the largest being Loblaw (including Canadian Superstore, Atlantic Superstore, Zehrs and Dominion), Sobeys (including IGA, Foodland, Price Chopper and Thrifty Foods), both of which are nation-wide, and Metro, which is in Quebec and Ontario under the additional banners A&P, Loeb and Food Basics.

This consolidation in the retail industry had a major effect on distribution in the confectionery industry, especially for the small and medium size manufacturers. National retailers, because they buy for their full chain, prefer to buy from national suppliers. This has put small and medium size confectionery companies at a disadvantage because the influence they once had with local and regional retailers is of little use when prime shelf space of store visibility is determined in the chain's head offices, which gives preference to national brands. These prime spots tend to go to high volume, low price products.

In addition, national confectionary producers usually produced other non-confectionery products, all of which was delivered via its distribution network. This resulted in a cost advantage and a further scale advantage that they could leverage with retailers. In the United States for example, General Mills owned the Betty Crocker brand of fruit snacks as well as a large number of other products including breakfast cereals and baking products. This gave the Betty Crocker fruit snacks a level of dominance in the retail sector that was difficult for other companies to overcome.

Consolidation, Markets & Customers

The confectionery industry in Canada had been consolidating for some time, impacting everything from production to promotions. Smaller family-run businesses had felt the pinch first as larger corporations were more cost effective, had economies of scale, better distribution and could afford to invest in new technology and automation. By 2003, there were 94 plants in Canada, down from 194 plants in 1961³. About 70 per cent of Canada's confectionery manufacturing was located in Ontario and Quebec, which was

also home to approximately 63% of the Canadian population (see Exhibit B). The majority of the remaining confectionery operations were located in Alberta and British Columbia, although smaller operations existed in most of the remaining provinces. Sales and marketing for major companies was generally done by in-house sales forces, while smaller companies usually depended on independent food brokers or agents.

Global rationalization had also taken its toll on the industry with manufacturing facilities, especially for the larger confectionery companies, moving to areas such as Mexico and South America where products could be made more competitively ¹. Foreign ownership in the Canadian confectionery industry was high; most major Canadian companies were subsidiaries of large foreign-based confectionery manufacturers ⁶.

The Traditional Canadian Confectionery Manufacturing Advantage

Prior to the mid-1980s the Canadian confectionery industry was primarily focused on the domestic market. In 1988, less than 12 per cent of shipments were exported. However, that changed with the introduction of multilateral trade agreements, most notably the North American Free Trade Agreement (NAFTA), and an overall increase in global trade. By 2007 exports had overtaken domestic sales, accounting for over 50 per cent of shipments by 2005, up from only 32 per cent in 1997 ². The United States is the primary market, with 90 per cent of exported Canadian confections heading south, due largely to NAFTA, which increased access to major markets and encouraged the development of a sophisticated transport infrastructure between the two countries ⁷.

Although Canadian manufacturers were at a disadvantage of scale because of their relatively small size compared to American and European manufacturers, they also enjoyed three important and historic advantages:

- Although overall Canadian productivity levels in all industries were about 80 per cent of U.S. productivity levels ⁸, this was offset by a weak Canadian dollar. When the Canadian dollar was valued between 65 cents and 80 cents to the U.S. dollar, this gave Canadian companies a cost advantage, enabling Canadian firms to compete on par with U.S. companies, across all industries, including the confectionery sector. This advantage began to erode substantially in 2003, as the Canadian dollar rose, relative to the U.S. dollar, (see Exhibit C) which had a major impact on export sales for many Canadian manufacturing industries, including confectionery.

- Canadian confectioners bought most of their raw sugar on the world market, which was generally cheaper than the artificially inflated price U.S. manufacturers contended with because of U.S. sugar policies^{3 9}.
- Labour and benefit costs were lower in Canada, and while the exchange rate was important, it was not the major factor. Rather it was the country's public health care system, funded by the federal and provincial governments, which significantly reduced the cost to business of employee health benefits.

These advantages have attracted multinational companies, such as Hershey's and Nestlé, to invest in and operate in Canada, eventually becoming dominant players in the Canadian confectionery sector. By 2003 Canada had a \$500 million trade surplus in confectionery products⁷.

Ganong Bros. Limited

Ganong Bros. Limited was founded in 1873 by brothers James and Gilbert Ganong in the town of St. Stephen, New Brunswick. In 2007, it remained a family-owned company, having always been run by a member of the Ganong family. The company was the second largest employer in the small border town of approximately 2,000, which relied on the chocolate company, a wallboard factory, and cross-border traffic for survival. St. Stephen was known as 'Canada's Chocolate Town', and each August Ganong and the Town co-hosted the popular Chocolate Festival. In its early days, the company employed up to 800 local people, but by 2007, that number had dropped, due to increased automation and changes in technology, to 250 to 300 production workers and 60 office staff, including the sales and marketing team.

Through its 134-year history, Ganong had been through many boom and bust periods and had faced numerous challenges, from tough economic times and government excise taxes to factory fires and family disputes over ownership and company direction. In all this time, its owners had remained fiercely loyal to St. Stephen, resisting the temptation to move the factory closer to a bigger market, such as Ontario. Numerous offers from multinational companies to buy the company had been spurned for fear that the factory would close or relocate; for similar reasons the attraction of going public to raise money for capital investment had never been pursued for fear of losing control of critical management decisions.

Innovation

³ The high U.S. sugar cost is as a result of a U.S. Government price support system designed to aid sugar cane and sugar beet farmers.

Ganong had a history of product innovation. In the 1890s, one of its signature products was the All-Day Sucker, marking the company as one of the first, if not the first, Canadian confectioner to produce a lollipop. In 1910 Arthur Ganong (the second generation owner) and George Ensor (one of Ganong's early candymakers) began experimenting by sprinkling nuts onto Ganong's own brand of milk chocolate, and shaping the product into long narrow pieces. At first, they kept the candy to themselves, wrapping them up and taking the bars on long fishing trips. Soon after they began mass producing and selling the candy, creating, according to Ganong family lore, the world's first chocolate nut bar ¹⁰.

Two other distinctive innovations demonstrated Ganong's innovative methods of candy-making, both of which became signature products: in 1885 it created Chicken Bones, a hard pink cinnamon shell over a strand of chocolate, and in 1919, it introduced the Pal-O-Mine bar, with a centre of yellow fudge and coconut coated with chocolate and peanuts. At points in its history Ganong's St. Stephen factory has produced up to 400 items, each with its own unique manufacturing requirements.

Management

Ganong Bros. had been fortunate over time to have the right leader at the right time. The founders had been promoters and prudent businessmen. Arthur Ganong, the second generation owner, was known as an astute manager, while Whidden was remarkable because of his prowess in production. A family story was told that Arthur noted when watching his young grandson David at play that; "[w]e Ganongs have always lacked ambition, but not any more." ¹⁰ Many years later, David Ganong, now a grandfather himself, was proud of the progress, growth and change he had overseen between 2000 and 2005, following the turbulence of the 1990s. He had a long history with the company that bore his name. In 1970 he joined the family company as sales and marketing manager after receiving an MBA from the University of Western Ontario. Seven years later, at the age of 34, he became CEO, succeeding his uncle Whidden Ganong and becoming the fourth generation Ganong to run the candy maker.

Under David Ganong's leadership, company revenues had increased 20 times, and he had built a management team with experience in the confectionery business. This desire to reach outside the family for expertise built upon his grandfather Arthur's creation of an independent board, with full fiduciary responsibility, to provide counsel to the family-owned and controlled business. David Ganong maintained primary ownership of Ganong, with a 90 per cent stake; the remaining 10 per cent was divided amongst the management team and two of his children active in the business. This personal investment meant that Ganong had a strong commitment to both the company and the community of St. Stephen, which had grown alongside the business and continued to depend on Ganong for its economic viability.

Ganong, who was made a member of the Order of Canada in 2005, had served on a number of corporate boards, including Sun Life Financial, Clarica Life Insurance Company and Air Canada (see Exhibit D).

Marketplace

Ganong Bros. had a number of long-standing competitive disadvantages it needed to address in order to successfully compete in the North American confectionery market. It's location meant that was a day's drive to any substantial major market base. This has resulted in some soul-searching during economic downturns, when the possibility of leaving rural New Brunswick for a larger urban centre may have made business sense. In an age of high volume throughput of product, Ganong also lacked the economy of scale to directly compete with the major market players. For this reason the Ganong brand, apart from the Delecto assorted chocolates, was not well known outside Atlantic Canada⁴.

Ganong's competitors were many and varied depending on the product. In the sugar confectionery business competition came from companies such as Dare Foods and Cadbury; boxed chocolates competitors included Hershey's (Pot of Gold), Lindt and Russell Stover; for fruit snacks the main competition came from American-based Betty Crocker. Ganong was in a fairly unique and at times uncomfortable position. While other, similarly-sized confectioners had positioned themselves to compete in the high-end product marketplace, where price was less of a factor than a product's quality or uniqueness, Ganong competed in the mainstream marketplace with industry giants. This was a major challenge. In 2006, its signature branded product, the Delecto range of assorted chocolates, represented only 3 per cent of the Canadian boxed chocolate market. As David Ganong explained, it was a challenge to try and drive company growth via the Ganong brand:

“We have to figure out how to double (the company) again. The people we compete with in the marketplace, the Nestlés, the Cadburys, the Russell Stovers, the Hersheys, even though they may make the stuff in Mexico, it's still being marketed here. We're not going to be able to grow 20 per cent per year by stealing market share from those guys; you may get a new product in there, but if you take a look at the fundamental baseload business, they're not going to let us take share that fast.”

1990s and Early 2000s

⁴ Atlantic Canada is the four provinces of New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland & Labrador

In the late 1980s, David Ganong realized the company needed to expand and modernize to remain competitive. A new, modern factory with state-of-the-art machinery was built on the edge of St. Stephen, officially opening in 1990. The main focus of the factory design was in accordance with Ganong's traditional strength, namely to produce boxed chocolates (using chocolate purchased from suppliers). A portion of the old factory was turned into a Chocolate Museum (a popular tourist attraction), with the company's sole storefront retail outlet located adjacent to it.

The mid-1990s was a turbulent time for the company. Expected growth in market share in the boxed chocolate business did not occur due to intense competition and aggressive marketing campaigns from companies such as Hershey's, Nestlé and Russell Stover. As a result, the company started losing money. With cost inefficiencies, lack of growth in branded products, and a new factory running at 50 per cent capacity, Ganong Bros. needed to make some drastic changes to stay afloat. A number of key strategic decisions were made at this time.

- The number of products was cut drastically. Each product was examined closely for its impact on the bottom line, and those that were not critical to the brand or covering production costs were cut.
- Agreements were made with other confectionery companies to produce each other's products. This allowed each company to optimize its facility. For example an agreement was made with Kerr Bros. to produce Ganong Scotch Mints, while Ganong produced jellybeans for Kerr Bros. This allowed Ganong to remove its hard pans used for finishing scotch mints and replace them with more soft pans used for finishing jelly beans, which was more in line with its core competency.
- A major cost cutting drive was initiated. The office staff was reduced by one-third, Ontario and western Canadian sales staff were replaced by independent brokers and the company withdrew from a once promising venture in Thailand. Any excess spending was cut, including newspaper subscriptions and memberships in business organizations.

Contract Pack & Control Label

Perhaps the most significant change made at the time, however, was the decision to pursue control label and contract packaging business. Control label products was defined as the manufacture and packaging of various products for sale under a retailer's brand. Contract packaging was the manufacture and packaging of various products for other confectionery companies. Ganong struck multi-year deals⁵ with various companies to manufacture products such as jellybeans and chocolate covered nut clusters, for the local market and for export to the United States. A further agreement was reached with Sunkist

⁵ Specific details of many of the contracts were not available to the author for confidentiality reasons.

to manufacture and market fruit snacks under license. In 2004, a multi-year contract was finalized with Laura Secord⁶ to produce assorted chocolates and confectionery items. Ganong doubled its revenue between 2000 and 2005 as a result of the new control label and contract packaging business.

Manufacturing Capabilities

New competencies and manufacturing capabilities were developed to support some of these contracts. In the case of the Sunkist fruit snack license, Ganong needed to distinguish itself in this developing market. By using in-house expertise and exploiting its traditional strength in innovation, Ganong developed a fruit snack with the highest percentage fruit on the market. This was accomplished by developing a product using frozen fruit purée, rather than fruit juice, the industry norm. Ganong quickly became the major manufacturer of fruit snacks in Canada.

For another contract, Ganong installed a production system to manufacture chocolate-covered nut clusters, as well as a production line to produce molded chocolates using a high-capacity single-shot moulding line. These capabilities were instrumental in winning the Laura Secord contract, although further capabilities were also added, including extrusion equipment and facilities to make Laura Secord Easter eggs. Additional equipment to package various products and new production lines to package Laura Secord's boxed chocolates were also installed.

Some of this equipment was bought second-hand or leased (and at times ultimately purchased) from other confectionery companies. For the Laura Secord contract new production equipment was purchased using financing provided by the Atlantic Canada Opportunities Agency (ACOA)⁷. Very little money was spent on improving the efficiency of the production facility, as the company was expanding rapidly; as soon as one line was installed, work would begin to install the next line.

In this time period, Ganong augmented its existing production facility with utilizations running at 70 to 80 per cent, closer to the industry norm. Ganong also further increased its capacity and substantially broadened its manufacturing capabilities, particularly in its niche of making a large variety of 'difficult' products. This broad manufacturing expertise was in contrast to an industry in which factories often produced fewer products in higher volume.

⁶ Laura Secord is a large Canadian chocolatier with over 140 retail outlets.

⁷ Atlantic Canada Opportunities Agency (ACOA) is a Canadian government funded body which promotes business and job development by giving grants and forgivable loans to companies who are starting up or expanding

One disadvantage of this broad manufacturing ability, and Ganong's contractual obligations to make so many different products, was the number of changeovers required during an average production period. As David Ganong said:

“Doing a changeover of chocolate from dark to milk takes a couple of hours ... you have to stop, take it out, move that chocolate someplace else ... once you get into milk, you want to stay in milk for the week ... you don't want to be changing that chocolate every day or that cost begins to affect your competitiveness. So changeovers are a challenge for us because of the variety of products we manufacture.”

Products

By the end of 2006, Ganong's manufacturing output was divided into two categories - branded and non-branded:

- Ganong-branded products included the Delecto Assorted Chocolates, the Fruitfull fruit jelly lines, various sugar candies such as jelly beans and jujubes, assorted types of mints, and the Pal-O-Mine bar. Sunkist was also considered a branded product.
- Non-branded products were generally split into two major categories; control label products for retailers and contract packaging for Laura Secord and other major confectionery companies.

Branded products accounted for approximately half of the company's revenue, however, this figure tended to fluctuate, depending on the sales and contract mix for the year (see Exhibit E for further detail on financial figures).

Financials

Cost of Goods Sold (COGS) was split into three major categories: raw and packaging materials, labour, and overhead directly linked to production. Overhead and labour allocation for products was done by dividing the factory into the various 'production rooms', for example Starch Mogul Room, Pan Room, Bagging Room, etc. Each room was then allocated overhead costs based on the type of cost. For example, property tax was allocated based on the square footage of the room. Similarly, each room had a weighted average labour rate. A product's path through the factory determined its overhead and labour allocation.

For the whole factory, raw and packaging materials made up approximately 55 per cent of COGS, labour 16 per cent and overhead the remaining 29 per cent. These percentage

splits varied by product. For example, fruit snacks generally had a higher material percentage but lower labour and overhead percentages.

Gross margins for branded products tended to be higher than non-branded products (as high as 55 per cent for some products, see Exhibit E for further breakdown). Branded products, however, attracted non-production related costs not associated with contract packaging or control label products. These included distribution costs, substantial advertising and promotion costs, as well as the cost of the head office marketing department. Both control label and contract packaging had no advertising and marketing costs. In addition, contract packaging did not have distribution costs (the customer paid these costs). Once all these costs were accounted for, the net margins per product group were fairly similar, generally in the 15 to 20 per cent range.

Ganong also contended with cash flow issues associated with the seasonality of the market, especially with respect to its branded products. Christmas candy (mostly packaged chocolates) production typically started in March. Inventory of finished product grew slowly through the year, according to the production plan for the year, which was put together based on expected demand for branded products as well as contractual obligations from contract packaging or control label customers. Christmas candy typically started shipping in October, with payment received a month or two later.

Customers

Major Canadian customers (apart from the contract packaging and control label customers) included retailers such as Wal-Mart, Loblaw, National Brands, Empire and Shoppers Drug Mart. These retailers had strict delivery terms in their contract, which Ganong was able to meet. Product was distributed from the St. Stephen plant by truck to the geographically close markets, and by rail to markets further away. The company leased a warehouse in Calgary for its western Canadian distribution.

The major products sold to the U.S. market were fruit snacks and ‘cellos’ – sugar confectioneries sold in cellophane bags. Ganong sold very little branded product in the U.S. and relied on its traditional Canadian advantage to remain competitive in this marketplace. Exports to the U.S. had varied over the years; in 2004 it had risen to 33 per cent from a low of six per cent in 1998. Much of this increase was due to a rise in control label sales (to dollar store-type retailers) and contract packaging business in this time period.

Current Challenges

In 2006 and 2007 the rising Canadian dollar started having a major impact on Ganong Bros. At the same time rising fuel prices started affecting the price of commodities, such

as sugar and corn starch (glucose). Contracts with some of the major confectionery companies were not renewed because rising costs had reduced Ganong's competitiveness. The company began to lose its business to the United States, with exports dropping into single figures (see Exhibit E).

The rising dollar and commodity prices also had a major impact on the rest of the Canadian confectionery industry. Other companies started losing export orders as it became cheaper for U.S. multinationals to source products in the U.S. or elsewhere, typically Mexico or Brazil. By 2006, Canada's confectionery trade surplus with the U.S. had dropped to just over \$200 million⁷. Canadian companies were forced to lower their prices just to remain operational and soon a glut in the market occurred. It became inevitable that companies started to fail. David Ganong explained:

“You have a situation in which you have declining volumes, declining margins, because you are actually cutting prices as opposed to increasing prices, and your two major commodities are going up in price – that is a scenario that says someone is going to go. The industry is going to rationalize; who's it going to be and when?”

In addition to the news from Beta Brands, Hershey's had announced the closure of manufacturing plants in Dartmouth (Nova Scotia), Smith Falls (Ontario) and Montreal (Quebec), affecting over 1,200 employees in total. The company had cited higher costs, facilities running at half capacity, a lack of competitiveness, and global rationalization as its reason to close the facilities. Within two years, five of the ten major sugar and chocolate confectionery plants in Canada had closed down.

Ganong was in grave danger of closing after 134 years of business. It had experienced two years of very large losses. The company's strategy during this time was twofold. According to David Ganong:

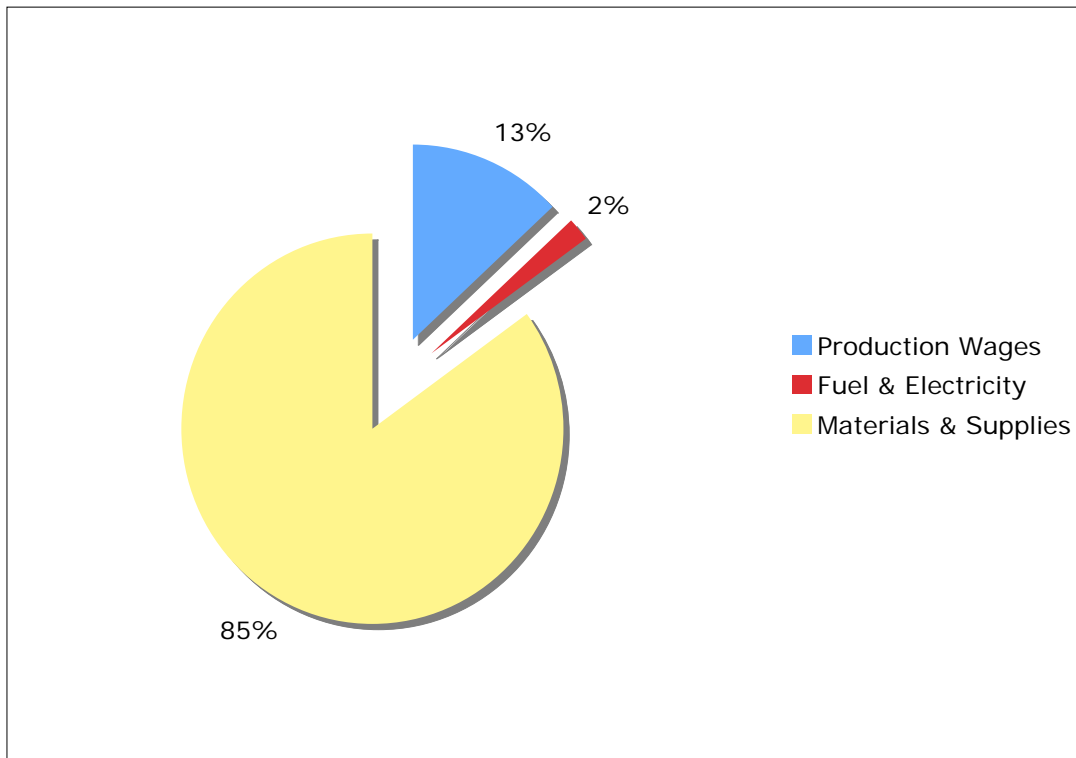
“Our strategy ... is to survive; we want to be standing when the tsunami washes back out. Our goal is to be a consolidator ... assuming we have the human and financial resources to grab a hold of the opportunities that are inevitable in a consolidating industry.”

The company was losing money; the board wanted an action plan. Cutting costs and potentially employees might help in the short term but building the Ganong brand further would be difficult, as it would cost money the company did not have available. David Ganong gazed through the window, reflecting on his company and the confectionery industry. This was a tough industry, where competition from the major players results in small returns. Canada appeared to have lost the competitive cost edge that a weak dollar provided. The company remained committed to its location in St. Stephen. How could Ganong survive this unprecedented downturn in the Canadian manufacturing sector,

while at the same time position itself for a rapid ascent to become the premier branded provider in Canada?

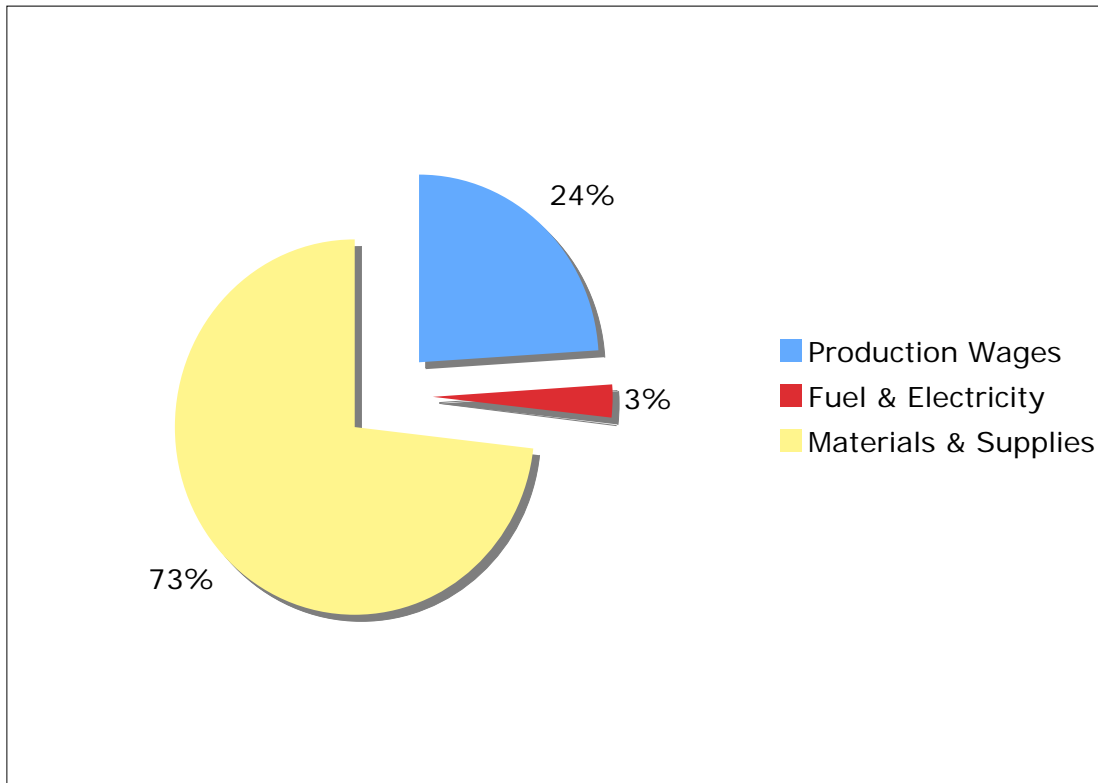
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**Exhibit A-1 – Manufacturing Costs by Type: Chocolate & Confectionery
Manufacturing from Cacao Beans Industry (NAICS 31132)**



Source: Industry Canada, 2006

**Exhibit A-2 – Manufacturing Costs by Type: Non-Chocolate Confectionery
Manufacturing Industry (NAICS 31134)**



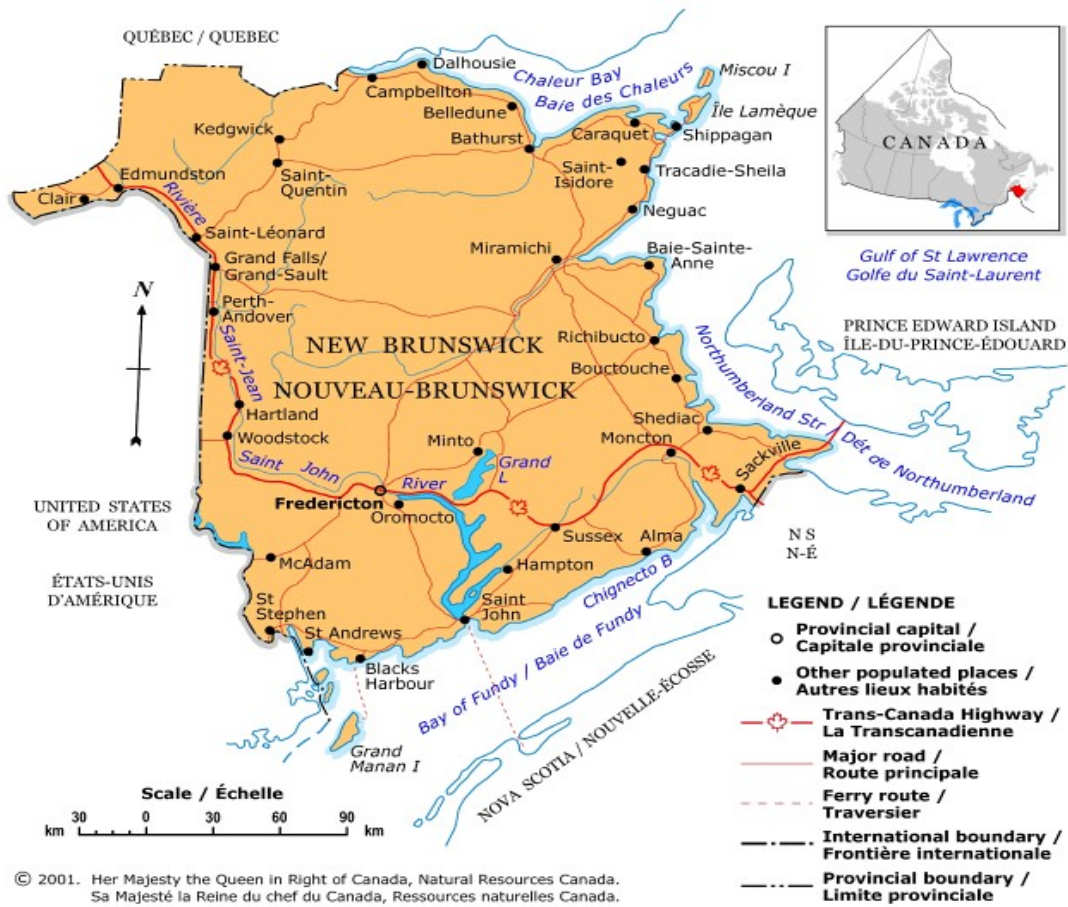
Source: Industry Canada, 2006

Exhibit B-1: Map of Canada



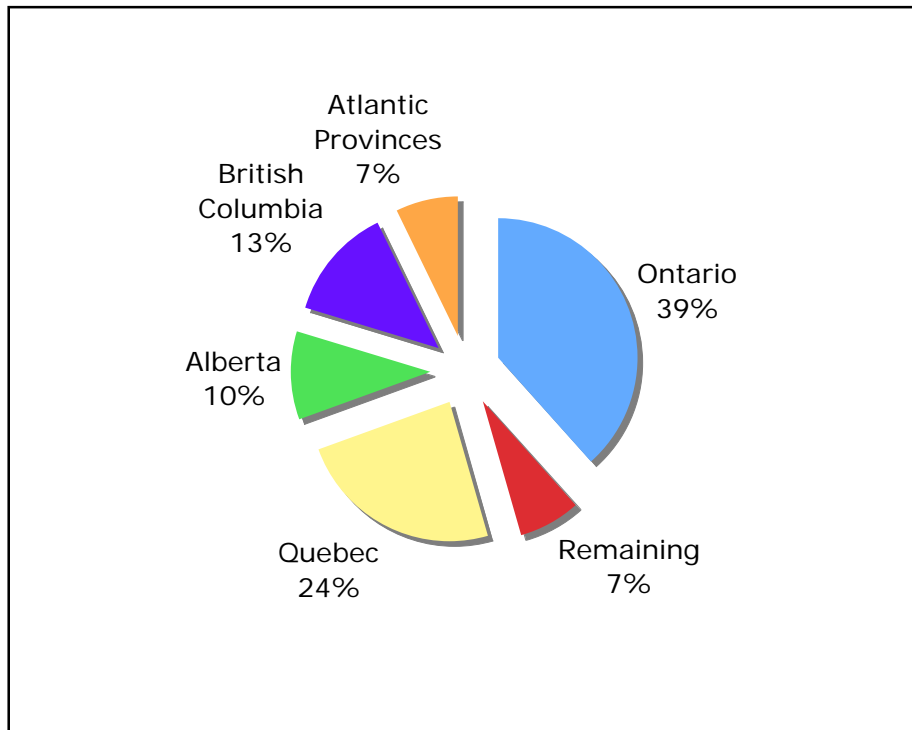
Source: www.nrcan.gc.ca

Exhibit B-2: Map of New Brunswick



Source: www.nrcan.gc.ca

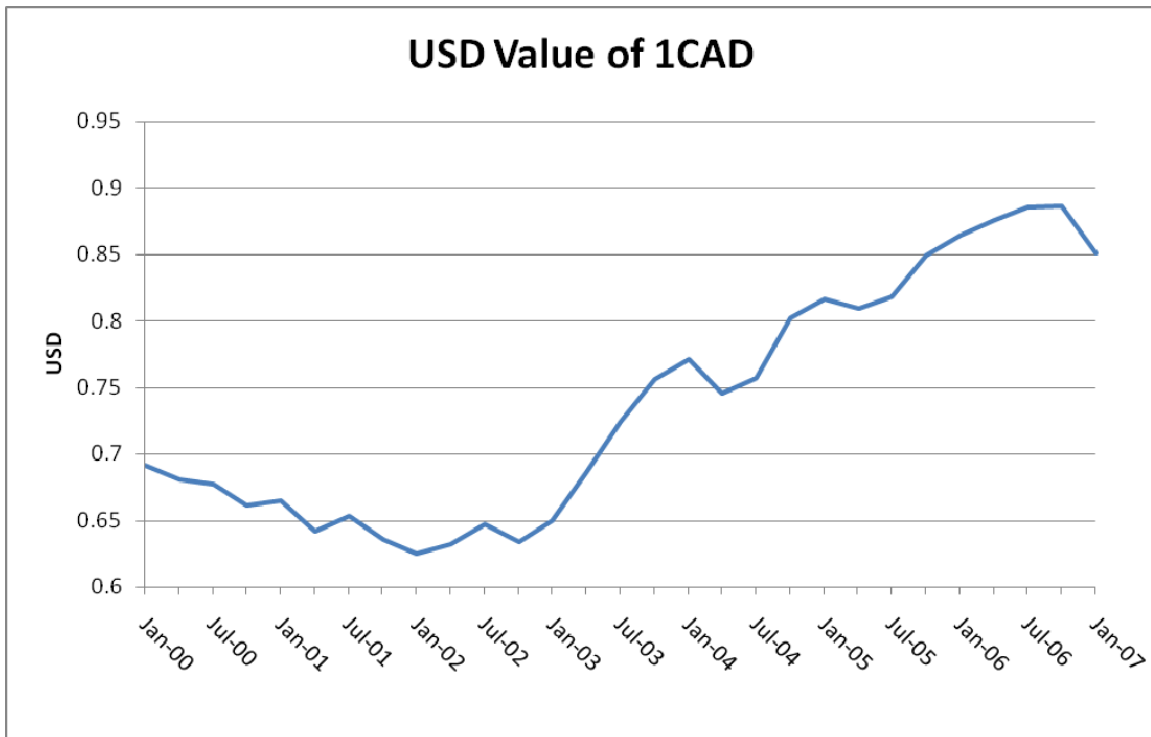
Exhibit B-3: Canada Population Split by Province



Total Population: 31.6 million

Source: Statistics Canada (2006 Census)

Exhibit C: U.S. Dollar vs Canadian Dollar: Jan 2000 to Jan 2007



Source: Bank of Canada

Exhibit D – David Ganong Biography

POSITIONS CURRENTLY HELD

Director, Ganong Bros., Limited
Director, Canadian Council of Chief Executive Officers
Member, Board of Governor's University of New Brunswick
Director, Sun Life Financial
Director, Conference Board of Canada
Member, New Brunswick Council
Member, North American Competitiveness Council
Member, Governor General's Canadian Leadership Conference.

AWARDS RECEIVED

CPSA Sales Hall of Fame(Cdn. Professional Sales Association) 1999
Top 50 CEO Award – Atlantic Business Magazine, 2003
Golden Pencil Award, November 2003
Order of Canada, November 2005
Laureate, Junior Achievement Business Hall of Fame

PAST POSITIONS HELD

Chairman, Confectionery Manufacturers' Association of Canada
Chairman, Young Presidents' Organization, Atlantic Chapter
Chairman, Atlantic Provinces Economic Council
Member of the Atlantic Enterprise Program
Member, Cape Breton Advisory Committee
Vice Chairman, New Brunswick Industrial Appeals Board
Vice President, Canadian Area of YPO
Chairman, Canadian Council of YPO
Director, International Board of YPO
Member Committee on Trade Opportunities Strategy, External Affairs & International Trade
Director, L. E. Shaw Limited
Mentor, Federal Business Development Bank Program
Director, Ganong Limited(Thailand)
Director, Dalhousie Medical Research Foundation
Chairman, Audit Committee, Air Canada
Member North American Chain Drug Alliance Committee
Vice Chairman, Board of Governors, University of New Brunswick
Chairman of the Board, Clarica Life Insurance Company
Director, Air Canada
Director, New Brunswick & Canada Railway
Chairman, Investment Policy Committee, Air Canada
Chairman, Board of Governors, University of New Brunswick
Chairman, New Brunswick Business Council

EDUCATION

B.A. - University of New Brunswick (1965)
M.B.A. - University of Western Ontario (1970)

Source: www.ganong.com

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Exhibit E - Ganong Bros. Limited Financial Information^{8,9}

Table E.1: Company Total 2006 Sales Figures, COGS & Gross Margin – Breakdown by Product Type

	Sales (\$)	COGS (\$)	GM (\$)	GM %
Packaged Chocolates	37,338	26,688	10,650	28.5%
Fruitfull	5,080	3,032	2,048	40.3%
Bars	2,336	1,056	1,280	54.8%
Cellos ¹⁰	20,506	15,000	5,506	26.9%
Staples ¹¹	4,822	3,932	890	18.5%
Sunkist	3,844	1,808	2,036	53%
Fruit Snacks	11,890	7,896	3,994	33.6%
Other Goods	190	190	0	0%
Total	86,006	59,602	26,404	30.7%

**Table E.2:
Company Total 2006 Sales Figures, COGS & Gross Margin – Breakdown by Category**

	Sales (\$)	COGS (\$)	GM (\$)	GM %
Branded	35,720	19,260	16,460	46.1%
Control Label	10,740	7,532	3,208	29.9%
Business Development	576	454	122	21.2%
United States	13,872	11,214	2,658	19.2%
Contract Pack	25,098	21,142	3,956	15.8%
Total	86,006	59,602	26,404	30.7%

Notes:

- Branded Products are made up of 43% Packaged Chocolates, 21% Cellos, 11% Sunkist, 10% Fruitfull, 6% Bars, 5% Staples, 4% Fruit Snacks
- Major Control Label products are 62% Fruit Snacks, 30% Cellos, 5% Fruitfull
- Business Development varies from year to year
- Major U.S. Products are 71% Cellos, 26% Fruit Snacks
- Major Contract Pack products are 87% Packaged Chocolates, 10% Staples

⁸ All dollar figures in thousands of Canadian dollars

⁹ Sales and COGS figures have been adjusted for confidentiality reasons. However, Gross Margin Percentages and the various splits are reflective of Ganong Bros. Limited business.

¹⁰ Cellos is products (generally sugar confectionery) packaged in cellophane bags up to 1kg

¹¹ Staples are similar to Cellos but are packaged in bigger bags in a bulk case

Table E.3: Company 2004 to 2006 Gross Margin – Breakdown by Category

	2004	2005	2006
Branded	45.5%	46.9%	46.1%
Control Label	29.4%	30.1%	29.9%
Business Development	36.4%	40.6%	21.2%
United States	24%	22.6%	19.2%
Contract Pack	N/A	15.4%	15.8%
Total Company	36.1%	32.3%	30.7%

Table E.4: Per cent of Sales Revenue Exported to United States

	% Sales to US
2004	33.1%
2005	21%
2006	16.1%

Source: Ganong Bros. Limited

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