Changes in Global Markets for Forest Products and Timberlands

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Global trends in production and consumption of forest products

- The global consumption and production of forest products are expected to increase largely following historical trends
- Increasing polarization of forest industry between the North and the South
- Saturation of the traditional main markets in North America and Europe
- Shifting consumption and capacity investment growth to emerging economies, especially to BRIC countries (Brazil, Russia, India and China)
- Paper recycling and decreasing use of fresh wood fibre in paper production are slowly separating pulp production from paper production
Factors affecting forest product trade flows

- Policies such as promotion of wood, subsides or tax on alternative materials can strengthen utilisation of wood
- Increasing demand of woody biomass for bio-energy
- With the incremental liberalisation of tariffs, the non-tariff barriers such as standardisation, certification of forest products and national regulations on packing and recycling of products are becoming relatively more important in affecting trade flows
- Asia and the Pacific will have a high deficit between production and consumption of roundwood with continued dependence on imports from especially the Russian Federation and possibly some countries in Latin America and the Caribbean
Environmental and social factors affecting forest product trade flows

- Climate change and rising energy prices also increase the level of environmental and social awareness, which might affect consumption and production.
- Traditionally, the consumption of paper products has been closely connected to population and economic growth, today, digital media is partly substituting printed media in many developed countries.
- The main consumer issues are explaining and segmenting consumers of specific wood products by their environmental and ethical attribute and the role and content of eco-labelling.
- The recently increased attention to environmental and social dimensions of corporate responsibility requires companies to innovate and more proactively change their business settings.
Global prospects after the financial crises

- The world economic downturn in 2008-2010 led to scaling down of production in all forest industries
- The demand for wood products is unlikely to reach the peak seen in 2005-2006 in the foreseeable future
- Projections suggest that the distribution of production and consumption among regions will not change markedly before 2030
Strategic responses to globalisation

- Global competition between individual forest industry firms has substantially increased during the 2000s and motivated companies to produce globally
- Forest industry companies in Europe and the USA react to competitive pressures from the new low-cost producers in Asia and South America by:
  - expansion of firm size
  - looking for economies of scale by FDI (foreign direct investments), mergers, acquisitions and diverse joint ventures
  - backward integration to ensure roundwood supply
  - diversification in product and market areas
  - investments in research and development (R&D) activities
Motives for foreign direct investments (FDI)

- No single general theory describes why firms engage in FDI
- FDI is attracted by market size, energy, labour, raw material costs, level of business taxation and also by infrastructure and communication related factors
- Resource-seeking motives: High quality and efficient procurement of raw materials, such as roundwood or wastepaper, motivate forest industry companies produce globally
- Market-seeking motives: In the densely populated emerging markets of especially China, India and Southeast Asia long term paper demand prospects will be better than in the more matured market of OECD
• Forest industry’s share of the global FDI stock was only 1% (2006)
• The growing internationalisation has been reflected clearly in the increased FDI flows and in the number and value of cross-border mergers and acquisitions
  – majority of FDI originate from mergers and acquisitions between Nordic transnational corporations
  – most FDI were made in developing countries and Eastern European transition countries
  – the value of FDI stock in the wood and wood products sector was over 100 billion USD (2007)
• The number of greenfield investments has been steady, especially in the pulp and paper sector
Consolidation as a means to meet market challenges

- The overall consolidation of forest industry has progressed very slowly
  - the benefits for sustainable profitability are not clear
  - FDIs may still have considerable effect, e.g. on employment and business performance at country-level

- In the last few years, competition between printed and digital media has intensified and the main end-users of paper industry (newspaper companies) are under severe economic pressure especially in North America
  - the constant excess of supply in the global paper markets has caused declining real prices in the 2000s
  - companies are trying to influence prices and lessen the cyclicality through increasing consolidation
The impacts of consolidation to profitability

- In North America and Europe several studies have indicated at least moderately increasing returns to scale, however, other studies indicate that firm size does not guarantee better profitability.
- In some cases the synergies of the high level mergers and acquisitions were overestimated and the cost of acquiring capacity was too high.
- Integrating distinct company cultures may be more challenging than originally anticipated.
- Forest industry companies have on average improved their performance during 2000s in emerging economies.
- The average return on capital for European forest industry has continued to decrease possibly due to the strengthening currency, Euro.
FDI or consolidation?

- In developed countries the more likely model of internationalisation will be consolidation rather than FDI
  - fibre resources are already more fully used and the markets mature
  - FDI decisions may be influenced by stock prices
  - fluctuations in currency rates may raise opportunities for strategic expansion of limited value chains
- More efficient utilisation of forests of the Russian Federation seems to continue extremely slow
  - need to reduce political risk and improve governance
Land is the most important factor for wood production

- Most of world forests are owned by state or held by communities as common resources
  - North and Central America, Europe (other than Russian Federation), South America and Oceania have a higher proportion of private ownership than other regions
- Intensively managed plantations are replacing natural forests as the basic source of wood supply
- The changing pattern of forest products trade and increasing role of FDI is coupled with new forest owners and timberland investments
Timberland ownership and investments

- Forest product companies have started to focus on their core operations and are selling their timberland to institutional investors, such as public and private pension funds.
- The farmer-owned timberland is becoming family forestland because of shrinking farm-business.
- Increasing population and wealthier society is demanding values other than timber from forestland.
- In addition to timber products the value of timberland is more and more reflected in other services such as recreation, location for second home, conservation etc.
New timberland owners: TIMOs and REITs

• The major institutional investors in timberland are the Timberland Investment Management Organizations (TIMOs) and the Real Estate Investment Trusts (REITs):
  – TIMOs are managers of timberland, they buy, manage and sell forestland and timber on behalf of various institutional investors
  – REITs own timberland, they buy, manage and sell real estate or real estate assets like mortgages on behalf of various private investors

• Also families and individuals are taking increasing share of timberland holdings
  – for example, both the share and total acreage in small parcels (less than 20 hectares) have increased in the last 10 years in USA

• Institutional timberland investments started in North America, but the phenomena is expanding
Reasons for including timberland/forest in investment portfolio

• Forest that holds mature timber will generate cash each year through the harvest and sale of timber, the harvests can be forecasted over many years
• Timberland can be classified as an investment in real estate
• Timberland has low correlation with other major financial assets including stocks and bonds, and negative correlation to real estate
• Returns are equal to or better than comparable risk/return investments
Risks involved in a timberland investment

- Economic risks are varying timber supply and demand, and fluctuations in timber prices
  - demand can be affected e.g. by substitutes of wood and imported wood
- Supply risks include such factors as the quality of silvicultural management and stringent environmental regulations
- Physical risks include fire, weather, insects and disease
- Timberland is relatively illiquid and isn’t efficiently priced in the marketplace
The consequences of changing timberland ownership

- TIMO investment is bringing much needed liquidity to timberland and hence increased value → good stewardship becomes more likely
- More diverse ownership may also increase non-forest uses of forestland, boost conservation deals and create new markets for uses such as carbon sequestration, recreation, spiritual purposes and watershed protection
- Many TIMOs have relatively short time horizons but timber investing demands long term forest management
- Changes in ownership can lead to fragmentation, development and loss of forest
  - however, private non-profit land trusts for land protection are the fastest growing part of the environmental movement