

# 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, subsidies 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

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- 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 cyclicity 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

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- 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

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- 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

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- 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

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- 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