Strategic perspectives on international business success in the New Zealand forest industry

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Introduction
This paper comments on the strategic thinking, planning, and action required for long-term international business success in the New Zealand forestry industry.

Note that the title of the paper uses the term 'international business' rather than 'export'. The reason for this is that success requires thinking and action well beyond the function of exporting.

I am an observer of your industry, though not at present in close touch with it, although I was intensely involved in the period 1990-1997, when I was a director of Forestry Corporation of New Zealand. For this reason, I acknowledge with gratitude the assistance of Garth Cumberland, who pulled together information that was used in preparation of the paper, and provided valuable comments on an earlier draft.

I have been invited to draw lessons relevant to the present situation of forestry from the experience and practice of the dairy industry. I will bring forward several points, as well as referring to aspects of the kiwifruit industry.

The Current Position of the Industry
I know that this is well understood, at the level shown in Table 1, and this requires no further discussion here.

The most important point to note is the huge opportunity for reshaping the industry as the wood resource grows over the next five and ten years.

At another level, several issues relating to the strategic development of the industry have received much less attention. These issues are focused around the response to industry globalisation, and the organisation of international marketing. To review these issues, we must first consider the drivers of globalisation, and the changes that they have introduced to the industry as a whole.

Drivers of Globalisation
In general, the very rapid processes of globalisation in many industries have been driven by:

- Removal of trade barriers
- Financial deregulation in many countries

Table 1: Current Industry Position

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<tr>
<th>Description</th>
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<tbody>
<tr>
<td>Harvest of 17 million cu.m.</td>
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<td>Resource growing rapidly</td>
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<td>- sustainable cut of 32 million cu.m by 2005</td>
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<tr>
<td>- 65 million cu.m by 2025</td>
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<tr>
<td>92% of plantation forests are privately owned, about 40% by small independents</td>
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<tr>
<td>NZ$6 billion in outputs</td>
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<tr>
<td>NZ$2.4 billion in export sales</td>
</tr>
<tr>
<td>5-6% of NZ GDP</td>
</tr>
<tr>
<td>30,000+ direct employees</td>
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<tr>
<td>World's 20th largest producer of wood fibre</td>
</tr>
<tr>
<td>New Zealand currently produces only 0.4% of global wood fibre harvested</td>
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<td>New Zealand exports make up less than 1.5% of global wood exports</td>
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<tr>
<td>New Zealand is the 10th largest exporter of wood fibre</td>
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<td>There is an international surplus of wood fibre</td>
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<tr>
<td>Afforestation and pasture conversion is continuing</td>
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<tr>
<td>New Zealand domestic consumption is static – 3 cu.m per person per year</td>
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Source: Based on Wood New Zealand Business Plan, May 1999

- Convergent needs across markets
- Emergence of global competitors with transnational structures
- The support of low-cost, high-capacity electroacoustic communication systems
- Declining transportation costs

Again in general, these forces have resulted in radical change in many industries, so that firms:

- Are more flexible and responsive
- Keep to very tight delivery schedules
- Have access to, and use, much more information and knowledge
- Have strong innovative capabilities
- Operate through either transnational structures, or through networks of collaborating firms
- Compete on a global basis

Globalisation in the Forest Industry
On a worldwide basis, the forest industry has been slower to globalise than many other
industries, but the process of change is well underway. Information and knowledge are globally available and information technology is widely adopted. Flexibility, responsiveness and reliable delivery are very much expected by customers.

However, the competitive arenas of the industry tend to be regional rather than fully global – such as within the Pacific Rim or the Euro-Atlantic region – due to the relatively low value-density of products in relation to transportation costs. Finally, some of the industry’s structures have not yet adjusted, and this is the central issue of this paper.

A credible analysis by Braxton Associates (1996) demonstrated that the major ongoing changes in the Pacific Rim industry structures and strategies are:

1. International vertically integrated U.S. companies, such as International Paper, Georgia Pacific, and Weyerhaeuser, are capturing value not available to competitors that are less integrated or have a more home-market orientation. This is because:
   - they have improved ability to realise the value of their resources.
   - they have improved ability to manage costs.
   - their product/market diversity enables better management of the risk introduced by price cycles.

   These companies have also moved strongly to secure long-term sources of reliable wood supply, usually by acquisition, that they integrate into their various international market value chains.

2. These companies, as well as those with European bases such as IKEA and Assi Doman, increasingly develop very close relationships with end-user customers. This enables them to:
   - better understand changes in customer requirements
   - influence product preferences
   - respond more rapidly to competitive moves
   - enhance the reliability and cost position of their supply systems.

3. Japanese companies have moved more wood processing offshore, and are associating these investments with secure supply arrangements, by contract or acquisition.

Success Factors in New Zealand Forest-based International Business

Based on this globalising industry structure, I see four major success factors. Every one of these factors is a recognised corner-stone of the New Zealand dairy industry.

1. Product/market alignment

   In the short term, the emphasis must be on market selection, because trees are already grown. Hence, markets and customers must be chosen to align with the product range that can be processed from the near-mature resource with given specifications.

   Further market positioning is achieved by product information, technical support, and brand management. In this regard, attempts to correct users’ perceptions of radiata should merit strong attention. (See, for example, Harris, 1986, and Forest Research Institute, 1992).

   In the medium term, there is some scope to adjust products to meet anticipated market requirements, through selection of silvicultural regimes and developments in processing.

   In the longer term, tree and product characteristics can also be aligned with anticipated future market requirements, by means of breeding, developments in biotechnology, and innovative materials design technology.

2. Integration and harmony through value chains

   This requires reliable and seamless flows of product through the stages in the value chain. The same system must deliver clear and timely information from the market, through all stages, back to forest owners. It is in this area that vertically integrated companies really shine, because they are deliberately configured and managed to achieve these outcomes.

   However, value chain structures that involve independent companies at each stage can still perform well, provided that all players have trusting business relationships and goodwill towards the principle of value chain management. Arm’s-length transactions and imbalances in bargaining power can seriously undermine the effectiveness of value chains.

3. In-market presence

   The marketing function must be present in the market in such a way that suppliers are real and credible to customers. While the services of in-market distributors may be used, it is folly to assign total responsibility to them, so that customers have not direct knowledge of suppliers.

   Approaches to sales and marketing that rely on the email and fax, with one or two market visits each year, are inherently weak when competitors have continuous market presence.

   In-market presence is also the essential base for technical support, product promotion, and brand management.
4. Size and scale

There are distinct advantages of operating with size and scale in market operations. Essential in-market presence is affordable, and necessary levels of bargaining power with distributors and customers can be achieved. Further, the diversified customer base that comes with size reduces the risks of dependency on just a few customers.

The Dairy Board has built its considerable success on product-market alignment and in-market presence. It has sometimes struggled to achieve the scale of its competitors, but has responded to this by leveraging relationships with joint venture partners to achieve stronger presence in markets.

Further, the industry strives to integrate its value chains, although it must be acknowledged that this is not always harmonious, especially at the point of product mix decisions between the Dairy Board and the manufacturing cooperatives. The GlobalCo development will fix this problem.

Some companies in the New Zealand forest industry may well point out that they are operating quite satisfactorily without in-market presence, at a small size, and selling whatever they choose to produce. I would not contest such opinions.

However, the questions for the industry as a whole to consider are whether these approaches are sustainable industry-wide and in an increasingly competitive environment, whether the financial performance of this approach is as strong as it could be (or even acceptable), and whether risks are being properly managed.

In my view, New Zealand’s forest industry has no option; these principles should be adopted.

Models for International Business Development

Two quite different models are available for development of international business in the New Zealand forest industry. These are described in Table 2 as the ‘Reaching Back’ model and the ‘Moving Out’ model.

The ‘Reaching Back’ approach begins with an offshore transnational company, that then decides to invest in New Zealand through strategies such as acquiring forests, establishing long-term supply contracts, and processing. The product flow from its New Zealand operations is then integrated with its in-market distribution, sales and marketing value chains.

The ‘Moving Out’ model is the reverse of ‘Reaching Back’. It begins in New Zealand, with existing assets and operations, then moves to invest offshore in distribution, marketing and (in some cases) processing. This new offshore market value chain is integrated with the New Zealand supply chain. Further developments may then be undertaken, to invest in additional supply chains in other countries.

Both models have a similar outcome in terms of structure; a transnational value chain that manages processes from sources of supply through to satisfied customers. However, the models are quite different in their implications for investment priorities and ownership of the wealth that is generated. In the ‘Reaching Back’ approach, important investment decisions are made (or approved) by the offshore corporate centre of the transnational organisation. This includes decisions about investment in the New Zealand forest resource and processing. The investment criteria are aligned with the strategy of the whole transnational business and are

<table>
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<th>Table 2: Models for International Business Development</th>
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<tbody>
<tr>
<td>The ‘Reaching Back’ Model</td>
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<tr>
<td><strong>Original business</strong></td>
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<tr>
<td>Offshore transnational company</td>
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<tr>
<td><strong>Development</strong></td>
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<tr>
<td>Invests in NZ as a secure source of supply (and processing) which it integrates with its downstream international value chain</td>
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<tr>
<td>The ‘Moving Out’ Model</td>
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<tr>
<td><strong>Original business</strong></td>
</tr>
<tr>
<td>NZ producers, processors and</td>
</tr>
<tr>
<td><strong>Development</strong></td>
</tr>
<tr>
<td>Invest in offshore (processing), distribution exporters and marketing, integrated with upstream NZ value chain</td>
</tr>
<tr>
<td><strong>Later development</strong></td>
</tr>
<tr>
<td>Invest in production, processing and exporting from other countries to same marketvalue chains</td>
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therefore unlikely to coincide with investment patterns that are optimum for the New Zealand resource base.

Furthermore, the objective of the offshore business that is ‘Reaching Back’ is to maximise generation of wealth for its own shareholders. It will rationally pay New Zealand forest owners and service suppliers only those prices that are necessary to achieve its objectives, given the conditions of the relevant New Zealand markets. The company has no incentive to pay more. On the other hand, the transnational company also accepts the risks associated with its financial and contractual commitments to New Zealand interests.

By contrast, the ‘Moving Out’ approach aims to generate wealth for the owners of New Zealand resources, assets and intellectual capital. Offshore and local investment patterns are integrated and optimised from this perspective. Of course, the risks are also borne by New Zealand investors.

**Dairy Industry Perspectives on the Two Models**

The lessons from the dairy industry are most cogent for forestry in this area of determining approaches to international business development.

To the New Zealand dairy industry, ‘Moving Out’ is the only approach that makes sense, and ‘Reaching Back’ represents a great threat to the farmer owners of the industry. This is because the ‘Moving Out’ initiatives of the Dairy Board are delivering to farmers incomes substantially above those achievable from world commodity prices for first-level processed products. Farmers are receiving the net returns from in-market activities and global brand management that generate differential premiums for both ingredient and consumer products. The GlobalCo initiative is intended to intensify and expand this approach.

By comparison, a ‘Reaching Back’ approach would have transnational companies such as Nestle, Kraft, and Parmalat taking control of manufacturing and exporting, by either acquisition or contracts. Temporary inducements to the farmer owners of the manufacturing cooperatives would be attractive, but the prices received by farmers would soon decline to the levels required for them to be just sustained as reliable suppliers. These prices would probably be only a little above smoothed world commodity prices. The premiums currently earned from downstream differentiated strategies would be totally lost to farmers, because the value chains would be owned and managed by the transnational companies, who would naturally retain profits from these activities.

Critics of the ‘Moving Out’ approach of the dairy industry sometimes suggest that the industry has insufficient investment capacity to grow fast enough to be competitive. It is true that the farmers themselves have very limited capacity to subscribe equity funds. However, in practice, even very ambitious growth strategies can be funded through a combination of retained earnings, minority outside investments in subsidiary companies and joint ventures, and debt. Thus, subsidiaries are controlled but not necessarily wholly owned by the central organisation. The integrity of the whole structure is maintained through cooperative ownership of this central company, that also holds the key intellectual property and capital.

**Prevalence of the Models in the New Zealand Forest Industry**

The analysis shown in Table 3 indicates that, excluding investments in pulp and paper, US and Japanese companies that are ‘Reaching Back’ accounted for 73% of announced investment in wood processing over the period 1988-2001. If Fletcher Challenge is also included in the ‘Reaching Back’ category — which is certainly reasonable now, if not at the start of the period — the percentage rises to 82%.

If pulp and paper is included the corresponding figures are 66% and 90%.

Similar data for investment in forest ownership appear not to be easily obtainable but I understand that transnational ownership of these assets is lower, arguably between 40% and 50%.

It is clear that the ‘Reaching Back’ approach to international development is strongly established.

I also infer from the data used in Table 3 that the ‘Moving Out’ model is barely surviving. The evidence for this is that:

- Apart from Fletcher Challenge and Forestry Corporation, most of the New Zealand processing investments are very small and only a few are of medium size. They are all too small to be effective with ‘Moving Out’.
- Fletcher Challenge, the early bright star of ‘Moving Out’, is now essentially in the hands of offshore investors and has already been disaggregated.
- Forestry Corporation had an excellent base for ‘Moving Out’ and made a good start in the mid-1990’s. However, its continuing ‘Moving Out’ strategy required investment of $500m over 4 years, funded from retained earnings. The shareholder
Table 3:  Announced Investments in Wood Processing in New Zealand

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<tr>
<td><strong>NZ$m</strong></td>
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<tr>
<td>US Companies</td>
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<tr>
<td>Japanese Companies</td>
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<tr>
<td>NZ Companies excluding FC</td>
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<tr>
<td>Fletcher Challenge</td>
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<td><strong>1,050</strong></td>
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<td>NZ Companies excluding FC</td>
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<tr>
<td>Fletcher Challenge</td>
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<td><strong>2,142</strong></td>
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<th>Investments Announced 2002 – 2007</th>
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<tr>
<td>Non-NZ Companies</td>
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<td>NZ Companies</td>
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**Source:** MAF statistics

**Note:** The data exclude announcements less than $1m.

(Government) declined to forego its dividend to this extent, the strategy lapsed, and the only alternative considered was to sell the assets. A good price was achieved, but the assets joined the sorry outcome of the Fletcher Challenge/Citic forest interests.

**Ideological Issues**

An aside about business ideology and governance is appropriate here. Through declining to approve the ‘Moving Out’ investment proposed by the Board of Forestry Corporation, Government certainly confirmed that it was an ‘inappropriate owner’ of such commercial assets, as critics of the SOE model had suggested. However, the prevailing Treasury-led ideology, with which the Board of Forestry Corporation concurred, was that the only alternative was for the assets to be sold and thus be properly exposed to the disciplines of the capital market. We have seen what these disciplines have delivered to the stewardship of the assets sold by Forestry Corporation! The commercial ideology of the time made it impossible to even think about any alternative approaches that could have progressed the ‘Moving Out’ strategy in collaboration with other interests.

The lesson from this is that capture of important issues by particular ideologies and points of view can severely restrict thinking about alternative strategies and actions.

In the case of Forestry Corporation this had, in my opinion, disastrous consequences for the international development of the New Zealand industry.

There is no doubt that the New Zealand forest industry has required substantial foreign investment and will require much more because the investment capacity in New Zealand is insufficient to fund developments.

However, the prevailing ideology that I have referred to fails to differentiate between the consequences of foreign investment in the ‘Reaching Back’ and ‘Moving Out’ models. The logic of this point of view is evidently naïve and, I suggest, should not continue to be accepted by the industry as it moves forward.

Foreign investment in the context of ‘Moving Out’ is much more attractive to New Zealand producers and processors. This is not xenophobia; just good business logic.

**The Pathway Forward**

Where to from here? Has the horse bolted? I do not think so, largely because the size of the industry is projected to double within the next five years. Because of this, the industry still has huge scope to consider and determine its future shape and strategy. However, it does not have much time to do this. I have several concepts to suggest:

1. **The future process**

   If the industry wishes to move on to a well-considered, ambitious, and cohesive path forward, it will need a strong commitment to a
well-defined process. It will need leadership that is focused on, and committed to, the best interests of the industry.

2. The likely 'Reaching Back' perspective on resource growth

The transnational companies that have already 'Reached Back' into New Zealand, as well as others that could decide to do so, will rationally see the 'wall of wood' as an opportunity but not a commitment. It will be an opportunity for them to secure more wood as and when they need it. Note that the volume increase is huge in New Zealand terms, but not in the context of their businesses. I see no strong reason for them to feel committed to utilising the wood when it becomes available just because it is there.

Most will favour the option of waiting, picking and choosing. It is also unreasonable to expect them to become committed to infrastructural developments. Why should they when, perhaps after some delay, domestic interests will do it? They observe that some forest owners have expectations that the wood will be sold as soon as it is mature, and have capital structures based on this assumption. In these circumstances, the transnational companies will know that they have strong bargaining positions on price and other terms of sale.

This is not an attractive scenario for forest owners!

3. Collaborative marketing

The Wood New Zealand venture is a notable 'Moving Out' initiative. I concur entirely with the analysis on which it is based, and it is certainly a very important attempt – as far as it goes - to take the industry in a favourable direction. However, I understand that industry support for it has been insufficient to implement all the actions specified in its business plan. People close to it will know the reasons for this, and there is no point in me speculating.

However, the Wood New Zealand concept has one serious flaw in that it does not go far enough. In relation to the success factors outlined above, it focuses on in-market presence, and recognises the advantages of scale and market/product alignment. The flaw is that it does not have a strategy for value chain integration. It offers support for integration but does not ensure that it actually happens.

4. Collaborative business development

The opportunity is wide open for the industry to augment the Wood New Zealand concept with the parts that are missing. The result would be a collaborative networked business model with some of the features of the dairy industry, but actually more like the kiwifruit model, which has proprietary businesses embedded within the overall structure. It is not essential for all businesses to be involved, but for those that are, membership and commitment cannot be voluntary and/or temporary (which was another problem with the original Wood New Zealand concept). For this business model to work, firms must agree to be bound to transfer aspects of their sovereignty to the collaborative venture.

This approach requires substantial investment by New Zealand interests. As this is contemplated, it could well emerge that these interests have investments that are out of balance, being weighted too heavily on production and with insufficient investment beyond the forest. If so, sale of some forest assets to offshore interests may be necessary to release funds for 'Moving Out'.

Of course, if properly structured and managed, such a venture could also attract foreign investment, probably in the form of alliances and partnerships. Despite the venture having a 'Moving Out' vision, some or all of the transnationals currently in New Zealand could well accept the case for participating in this way. Thus, the outcome could be 'win-win' for all present industry participants.

I believe that the industry has very strong reasons for taking this strategic pathway.

Environmental Degradation, the 'Triple Bottom Line' and Global Warming

This final section goes beyond my brief for the paper and may appear to be a diversion. I think that this is not the case, because the following issues appear so important to the future thinking of the industry.

1. The 'Triple Bottom Line' opportunity

Environmental degradation on a global scale is well documented (see, for example Frankel, 1996). Arising from this, an increasing number of progressive businesses are adopting the 'triple bottom line' approach to performance reporting and, with a lag, management of their businesses (Elkington, 1998). This approach requires recognition of three sets of business goals of equal importance along the dimensions of wealth generation, social equity, and environmental recovery and sustainability. My observation is that the New Zealand forest industry, through its experience with sustainable plantation wood production, is in a strong position to be an exemplar of the triple bottom line. This would be not only socially responsible but also commercially savvy, because smart investors are beginning to search out tri-
ple bottom line opportunities.
2. Global warming

It would seem that the existence of global warming is no longer an issue. The questions now relate to when climate changes will occur, and their intensity. On this basis, can these effects be ignored in the strategic thinking of this industry? What could foresight analysis and scenario development tell us about consequent changes in wood consumption, necessary changes in plantation forestry regimes, and change in desirable locations for forests?

These issues are difficult to contemplate and most of us would hope that they will go away. I doubt that they will. If I am right, what is the responsible course for the strategic management of the industry?

Conclusions

This paper is intended to provide stimulus for thinking strategically about the future of the New Zealand forest industry.

It begins with a review of the forces of globalisation, then describes the way in which these forces are playing out in the worldwide forest industry.

Particular changes in the Pacific Rim arena of the forest industry are reported and key factors for success are developed. It is noted that the success of the dairy industry is based on the same factors.

Distinct 'Reaching Back' and 'Moving Out' models of international development of the industry are established, and investment analysis shows the prevalence of the 'Reaching Back' approach in the New Zealand industry. This model is not the one favoured in New Zealand’s dairy industry.

I have suggested that the imminent increase in harvest volumes in New Zealand presents opportunities to utilise the more favourable 'Moving Out' approach. Strategic and collaborative approaches to achieve this are proposed.

Finally, I suggest there are potential opportunities available through adoption of 'triple bottom line' approaches by forest businesses, and I question whether the issue of climate change has yet received due industry attention.

References

Braxton Associates (1996), 'Forestry Corporation of New Zealand: Future Strategic Direction'.
Forest Research Institute (1992), 'Comparison of New Zealand Radiata Pine with other Traded Species', What’s New in Forest Research, No. 216.

Calendar 2001

The following conferences, expos, courses and other events will be of interest to readers. Details are brief, so please contact the organisers for more information.

17-21 September 2001
5th International Biomass Conference of the Americas. Orlando, Florida, USA
Contact: joann@fsec.ucf.edu

23-28 November 2001
International Conference Advancing Community Forestry: Innovation and Scaling up Experiences. Chiang Mai, Thailand.
Contact: Dr Somsak Sukwong, Executive Director, RECOFTC, Kasetsart University, PO Box 111, Bangkok 10903, Thailand. Fax: +662-561-4860; Email: ficsss@ku.ac.th; URL: wwwrecoftc.org

9-11 October 2001
The first Global International Waters Assessment (GIWA) general assembly. Kalmar Sweden.
Contact: info@giwa.net

12-16 March 2002
New Zealand Forest Industries International Conference and Exhibition. bal@wave.co.nz

2-6 July 2002
Woodfor Africa 2002, Pietermaritzburg, South Africa. Contact: woodforafrica@futurenet.co.za

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