
Markets, strategy, and capital – a perspective on a current radiata pine lumber export opportunity

The after-dinner speech presented by Dr. Robert H. Donnelly at the New Zealand Institute of Forestry Conference and AGM dinner, in Auckland on April 9.

Introduction

I have just returned from a three-week visit to Brazil and have to report briefly: the Brazilians are suffering through an economic recession. There is high unemployment and industrial production is down. Most of the forest products industry reported losses for last year. At the same time, there is considerable optimism for the future. Business leaders in our industry see significant opportunities for investment and expansion over the next several years.

At the same time the Brazilian Government is taking a hammering; President Collor rates very low in public opinion. His most recent move was a surprise dismissal of all his Ministers, with three exceptions – Health & Welfare, Education and the Finance Minister. The Health and Education Ministers were newly appointed the previous week, after some scandals were disclosed. And the Finance Minister is doing very well as inflation is down to 20% a month. The stock market responded with two days of steady gains following these Ministerial changes.

Surprisingly, the economy is doing quite well, but no credit goes to the Government. It sounds familiar. And I will return to discuss Brazil from a forestry aspect in due course.

Background

It was Bill Liley who recruited me for this task. He implied that my varied background gave me an obligation to speak. I thought about that for a while in Brazil, and it seemed right. My career in the forest products industry has given me an opportunity to hold a variety of positions, in several parts of the world. This includes the pine sawmills of Idaho in the US, Canadian log and lumber marketing in Japan, and pulp and paper management in Canada and Brazil. For the past five years I have been lecturing at the Canterbury School of Forestry in marketing and international trade. In addition, this has been combined with consulting, including radiata pine lumber marketing. And I am also a small forest owner in a radiata pine venture in Canterbury.

So I am here this evening as a forester, an investor and an international businessman working in the forest products industry. And I am a strong supporter of radiata pine.

Overview and Framework

I plan to briefly review the New Zealand perspective and discuss one emerging opportunity for radiata pine. It involves sawn timber for the US market. In passing, I will touch on a potential industry structure problem and a perceived requirement for business excellence.

It is appropriate to start from where we are in 1992. Today New Zealand supplies a large volume of log exports ($3m+m^3/yr$) but a much lower volume of lumber and solid wood product exports ($.6m+m^3/yr$) – largely lower grades for Australia and Japan.

Earlier this year I prepared a paper on log exports for the NZIF conference in March. The conclusions I drew were positive: Log exports were viewed to be a strategic step for longer-term industrial development.

What has changed now is a "supply shock" in US lumber markets related to the millwork industry (doors, windows and mouldings). There is a shortage of traditional lumber species – primarily ponderosa pine and related species from the Inter-Mountain region of the US West Coast. Environmental pressures to preserve the "spotted owl" and other environmental values have reduced timber harvests and continue to disrupt lumber supplies. Many mills have shut down. Current lumber prices for millwork lumber grades in ponderosa pine are up to 50% higher than several years ago and higher than prior long-term trends. Whether these environmental concerns are temporary or long-term is unknown, but this is a significant new opportunity for radiata pine, particularly New Zealand clearwood.

I submit that we need to reconsider this US opportunity from a strategic viewpoint and with a traditional marketing orientation, i.e.:

1. market segmentation

2. target markets
3. market strategy
 - (a) Product and positioning
 - (b) Pricing
 - (c) Promotion
 - (d) Place
4. distribution channels

With regard to attracting capital, that is a follow-on aspect. In some ways it is a detail. Good marketing and strategic planning determine viable ventures, and then the capital follows, if the financial returns are adequate.

Strategic Implications

From my perspective, the New Zealand industry needs to develop its forest products manufacturing on a world-scale basis with increasing vertical integration. Costs are moderately low in New Zealand by world standards but not at the same level as Chile, Brazil and Argentina. It is the Latin American countries that are becoming the low-cost commodity producers of market pulp and similar commodities. The implication for New Zealand is value-added products and vertical integration: more solid wood products, with wood chip by-products, for pulp and paper and/or board products. Like Chile, more wood chips are required at home to develop truly world-scale pulp and paper facilities.

Log exporting can help New Zealand in the development process. It is the best opportunity available to collect market intelligence on log conversion practices overseas. Log marketing teams should include sawn timber and plywood manufacturing expertise. At the same time, we should anticipate that trade barriers which support log exports to mature economies (like Japan) are being eliminated.

In terms of this type of market intelligence, Japan is one of the countries that has developed a systems approach to extracting lumber value. Logs are sawn "inside out" (taper sawn) to maximise clear recovery. Normally, trimming precedes edging and logs are cut to lengths that maximise clear recovery values, prior to processing.

Similarly, the US western pine sawmills are based upon high-grade recovery concepts. Pine logs are also sawn "inside out" (taper sawn) to achieve high recovery. Large logs are cut on conventional band headrigs to recover all the clear lumber – "rolled on four sides". Next the intermediate quality industrial lumber is recovered – the so called shop/factory grades. These are long-length, wide random-width pieces; they contain knots, some wane and other defects permitted for remanufacturing – ripping and cross-cutting. The remainder of the log is lower grade commons (box) and dimension (framing). The pine clears and shop and factory grades are all kiln dried.

A strong secondary manufacturing industry has been established in the US to process shop and factory lumber. Primarily, this is identified under the generic terminology of millwork. This industry is largely independent of the sawmill industry. It is geographically diverse, but tends to be located close to the forest or the end-use markets. In terms of operating efficiency and technology, these smaller US firms rank very high on an international scale of performance.

The top US millwork firms achieve excellence: This involves the latest manufacturing technology, intensive utilisation of wood resources (finger jointing, laminating and veneer wrapping) plus management systems to attain the highest production and quality standards. Their performance dominates both Japanese and European competitors.

Reflecting on the New Zealand industry prior to 1992, there has not been the availability of pruned logs to support this type of high-value sawmill recovery. There are severe kiln capacity limitations, as most of the timber is air-dried. And the concept of a timber remanufacturing industry for export markets, like the US, is missing. However, there are headrig sawmills, particularly among the independent sawmillers, well suited for the US market. More kilns are being installed. And some of the large mills are working to meet US demands, but the industry seemingly lacks a "vision" of its future in remanufacturing.

These comments on the New Zealand industry are supported by the observations of US radiata pine customers (remanufacturers) who have visited during the past six months.

Market Segmentation

Returning to the marketing aspects, the US lumber market is large by New Zealand standards: 3.3 billion m³ of softwood lumber consumption per year under normal conditions. Ponderosa

pine lumber has averaged around 8 million m³.

Despite its size, the US lumber market is highly segmented. Millwork, where radiata pine is being utilised, is a good example. The standard categories by end-use are:

- doors
- windows
- moulding
- other, including furniture/novelties.

However, these categories can be subdivided by other aspects: geographic regions and sub-regions, product construction, product quality, size of firm, distribution channels (Table 1).

Table 1
SEGMENTATION FRAMEWORK
FOR US MILLWORK
MARKET

1. End-Use Categories
 - Doors
 - Windows
 - Moulding
 - Other (furniture and novelties)
2. Geographic Region
 - West Coast
 - Midwest
 - South
 - Northeast
3. Sub-Regions
 - States (e.g. California and Texas)
 - State Groupings (e.g. Pacific Northwest, Rocky Mountain, and Middle Atlantic)
4. Firm Characteristics
 - Product-mix
 - Size
 - Ownership
 - Objectives
5. Product Characteristics
 - Specification
 - Quality
 - Construction
 - Positioning
6. Distribution Channels
 - Direct
 - One step
 - Two step

And for a more complete description, this breakdown can be overlaid by the channels of distribution for all US lumber consumption – considerations beyond the scope of this paper.

It should be noted that there are significant regional differences and sensitivities: Typically, Southerners have some antipathy for Northerners. Westerners are newcomers.

And Canadians come in for criticism due to the recent countervailing duty controversy and duties on softwood lumber exported to the US. These sensi-

tivities need to be considered in approaching the market. As an example, employing Northerners to sell radiata lumber in the South would be insensitive, and it is likely that the same applies to associating with Canadian companies today.

There has been some concern that the market is too large for New Zealand producers. Yet given the high degree of market segmentation, it is feasible to supply a smaller regional customer that only wants to purchase one to two containers/month (35-80 m³) or to scale up to larger volumes (1000m³/mo). And in many instances, with smaller sub-regional customers, there is limited competition from other radiata suppliers.

The New Zealand industry has undertaken a number of studies of the US lumber market. The studies and market development work over the past one to three years should have established a preliminary market segmentation adequate for initial shipments. The US customers are asking when will the market studies stop and the trial shipments start. Reportedly, the researchers want to do more studies. But it is time for the New Zealand industry to recognise the situation and move on to selling products on a trial basis.

Target Markets

Developing target markets in the US: it would appear that this is where the action is today. Who and what are the best US market/customer "targets"? It is more than choosing a US agent or distributor. In my viewpoint, some criteria should be applied in making these decisions, such as:

- Value-added products
- Product-mix to balance mill and forest production
- Customer compatibility

It is difficult to argue against these criteria, but are they necessary?

It is likely that the most important criterion is finding compatible customers. The US millwork industry, as described, largely involves remanufacturers who are non-aligned with sawmills and forest ownership. They tend to be smaller companies with long-established lumber buying patterns. Typically, they buy directly from smaller independent sawmills. Most often there are long-term buy-sell relationships based on mutual understanding. There is a sense of give and take. It is important in the "targeting" process to consider how we meet the customers. But is it important to build similar supply relationships as exist today? I believe it is.

Product-mix balance is another issue. The following two examples illustrate the point:

One is lumber length – The US market/sawmill standard for softwood is a length specification of 1.3 to 4.8 m, with a predominance of longer lengths. This is in conflict with the 6 m pruning regime in New Zealand. Trimming back 6 m lengths at the sawmill produces an undesirable length out-turn for the US or produces “shorts” that have limited markets. Yet there are US lumber buyers with the potential to utilise some longer lengths or to vary their length requirements. We need to work on this opportunity both in the marketplace and in our forestry operations.

Another example is the defect-core of the pruned log. Finding US market opportunities for the defect-core material, such as cuttings/industrial lumber, needs to be an objective. It helps balance mill production and build export shipment volumes.

Value-added products have been the primary objectives for developing a US customer base. Until recently, extremely high ocean freight rates excluded all but the highest grades of lumber. It cost under US \$30 m³ to ship logs to Japan but US \$100 m³ to ship lumber to the western US, an equivalent distance. Recently, these US rates have been reduced by some 25%. This reduction helps, but there is still room for improvement and for volume-based rates.

The freight cost-base still requires shipping higher-grade material. Typical export products are long-length clear/moulding material, some finished mouldings, and cuttings for remanufacturing, as (dimension) blanks and blocks for finger-jointing.

Market Strategy

Market strategy involves product development, positioning, pricing, promotion and placing products.

Product Development – some work has been done here. Higher grades of clear and moulding grade lumber are being sold successfully in the US, as well as cuttings. But it would appear that the New Zealand industry requires some new grading standards for traditional US shop and factory grades. The radiata log recovery is different from old growth ponderosa pine. Also, there is a need to differentiate between window (sash) cutting material and door (head and jamb) cutting material. Just grading “industrial quality” radiata lumber to US shop lumber grades according to the US rules will probably raise more questions than answers. There is work going on related to new grading systems for radiata utilisation in the US. These new systems should clarify the recovery questions.

More likely, the radiata industrial grades should be converted in New Zealand to improve the value-added potential.

Positioning – similarly, there is a requirement to develop specifications for brand identified radiata products, as opposed to substitutes for ponderosa pine. Longer term, New Zealand pine needs to become an accepted product, based upon its own qualities. Already, some US customers are recognising the advantages of specific New Zealand pine products. (Note the use of the New Zealand pine terminology, dropping out the radiata designation.)

Pricing – currently most radiata sold to the US is priced as a ponderosa pine substitute. There are some interesting questions on pricing, and whether to follow a closely linked commodity approach, with weekly price changes, or to establish an independent radiata pricing.

Promotion – there is limited promotion of the radiata product in the US. It is largely word-of-mouth. And as others have pointed out, this is both a problem and an opportunity, if the supply increases.

Placing the product – today this involves the distribution aspects as outlined under distribution channels.

Distribution Channels

Imported lumber for the US industrial markets has typically moved through one or two step distribution channels (primary, and/or secondary, user). Often a US agent or merchant wholesaler imports the products and sells them to the industrial user. The smaller industrial users, may buy from a distributor or stocking wholesaler. Large industrial users may import directly from overseas.

This type of distribution system will work for New Zealand radiata, but there are significant imperfections. It is a way of getting started on an introductory basis with radiata exports, as has been the case for Chile. But New Zealand faces the difficulties of new clearwood products, the associated market development, and the technology transfer to achieve value-added objectives. How will the market strategy evolve? The US industry hopes it is not like Chile.

In Chile, radiata lumber exports started four to five years ago, largely through US agents. But there was a certain Chilean disenchantment: either the product-mix was limited, or prices were reduced and quality standards were set too high. Perhaps, it was inevitable, but the major Chilean sawmillers reacted by installing downstream processing facilities and today are manufacturing value-added products for the US market as well, including mouldings, door jambs and some new wooden door products. These changes have not endeared the

Chileans in the US marketplace. And whether the Chileans are more successful in competing with commodity-type value-added products is problematical. It is commonly felt that the Chileans subsidise their lumber remanufacturing operations and lose sawmill efficiency.

The point about distribution channels is that they are not fixed and immutable. Along with globalisation, there are institutional changes. And there is a requirement to transcend old systems. If the purpose of business, as Drucker pointed out, is to create and keep customers, then we must be innovative. This means offering preferred products in such a way that customers give relative preference to individual New Zealand suppliers. Distribution becomes a variable in the marketing equation and not a set way of doing business.

From my perspective, there are several alternative distribution options for the New Zealand industry to consider:

- Selling on a direct basis to US customers – This offers the relationship advantages, discussed previously. It is more costly, however, and time-consuming. There is an initial element of cultural shock, but it provides long-term benefits.
- Marketing Referral Organisations – These groups, as the RPRA (Radiata Pine Remanufacturers Association), can refer product inquiries to individual manufacturers and promote New Zealand at trade development shows. This reduces the marketing costs and can be more effective for some suppliers.
- New Zealand Based Pine Marketing Companies – This type of organisation could develop US markets for independent sawmillers and for special “niche market” products. It could provide services to the New Zealand industry related to lumber grading, technology transfer, shipping and in developing positive customer-supplier relationships. It provides a cost-effective solution for both smaller companies and for larger companies, in marketing and for niche markets, respectively.

I would submit that there is no one way of marketing, but that several options should be developed. These should leave space for New Zealand initiatives. One of the outcomes to encourage is the development of an independent, or semi-independent, remanufacturing industry.

As a final caveat, it is reported that the same US agents selling Chilean radiata are moving into New Zealand and in some cases the same old problems are resurfacing – excessive quality and low returns.

(Concluded on page 25)