Achievements in the forest industry

"Global Challenges and Local Opportunities: Achievements and Prospects in the Baltic States"

Kristaps Klauss
Executive Director
Latvian Forest Industry Federation
kristaps.klauss@latvianwood.lv
www.latvianwood.lv
Telephone no. +371 67067371
Contents of the presentation

- Sectoral background
- Export markets profile
- The need to increase the value added of export products
- Achievements, challenges and solutions for export growth
Forest sector has to be viewed as one whole

*Ekonomists*, 15 April 1938

It has to be noted that *forestry, timber trade, particularly exports, and forest industry* form a set of organically inter-linked issues, and any changes in one of the above sub-sectors affect the position of other sub-sectors as well.
Interaction of forest sector organisations
Forest sector plays an important role in Latvia's exports of goods

*Ekonomists, 31 May 1936*

<table>
<thead>
<tr>
<th>Gads</th>
<th>Eksports kopsumma</th>
<th>Ku materiālu eksports</th>
<th>% no visa eksp.</th>
<th>Finierī, cellulūza, papīrs u. c.</th>
<th>% no visa eksp.</th>
<th>Kopā</th>
<th>% no visa eksp.</th>
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<td>1930</td>
<td>247.877</td>
<td>77.784</td>
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<td>1931</td>
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<td>33.691</td>
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<td>16.089</td>
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<td>49.780</td>
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<td>1932</td>
<td>96.528</td>
<td>19.063</td>
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<td>11.078</td>
<td>11,5</td>
<td>30.141</td>
<td>31,2</td>
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<td>1933</td>
<td>81.526</td>
<td>28.280</td>
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<td>10.490</td>
<td>12,9</td>
<td>38.770</td>
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<td>1934</td>
<td>85.267</td>
<td>30.532</td>
<td>35,8</td>
<td>11.739</td>
<td>13,8</td>
<td>42.271</td>
<td>49,6</td>
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<td>1935</td>
<td>98.716</td>
<td>25.224</td>
<td>25,5</td>
<td>13.619</td>
<td>13,8</td>
<td>38.843</td>
<td>39,3</td>
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</table>
Has the forest industry spent the last 20 years drifting?

In a free market, centralised management of the economy cannot exist! Nevertheless, the shaping of the business environment is also in the hands of the businesses themselves; therefore, their behaviour has resulted in the given "rules of the game''.

– In order not to fall behind the global development, instruments to promote fair competition in the sector are supported.

– Long-term thinking and business approach are supported, i.e.:
  • resource availability planning;
  • human resource development;
  • investment in more modern equipment from the point of view of efficiency, labour safety and environmental friendliness.

– Measures and companies stabilising the sector are supported.

– Common sectoral support and development organisations are established:
  • VMF Latvia, MeKA, Forest Sector Information Centre, Forest Sector Competence Centre, LFIF, LFOA etc.

– Sustainable forest management requirement is supported, as the aim is to process only the wood grown and harvested in forests where the environmental, social and business interests are reasonably balanced; therefore, within the scope of their competence, they participate in:
  • FSC and PEFC system development in Latvia;
  • drafting of legal acts.
## Instruments to reduce the grey economy

<table>
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<tr>
<th>Activity</th>
<th>Time</th>
<th>Initiator</th>
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<tr>
<td>Reverse VAT</td>
<td>1996; vairākkārt aizstāvēts</td>
<td>Forest sector organisations</td>
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<tr>
<td>Proportionate PIT for forest owners</td>
<td>2005; “damaged” and “corrected” several times</td>
<td>Forest sector organisations</td>
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<td>Independent surveyor</td>
<td>2006</td>
<td>Forest sector organisations</td>
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<td>70% average wage criterion in “public” procurement</td>
<td>August 2010</td>
<td>SRS, MoF, Forest sector organisations</td>
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<tr>
<td>Average wage criterion when selling LVM roundwood</td>
<td>November 2010</td>
<td>Forest sector organisations, SRS</td>
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<tr>
<td>Felling reports must disclose the price and buyer</td>
<td>January 2011</td>
<td>SRS, MoF</td>
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![Graph showing wage comparison over time](image)
.. and it has allowed us to develop rapidly for a longer period of time..
.. as well as overcoming the crisis

The recovery of Latvia’s forest industry was the fastest! (common understanding of the sector)

2007 = 100%; 3-month adjusted

Source: EUROSTAT, Volume index of woodworking output by country.
Thus, as we see, Latvia's timber exports are in an excellent condition and we should expect no threats to the exports. Unfortunately, this is not true. The interests of Swedish and Finnish timber exporters are under a threat on the English import market already since this May. English timber imports are strongly affected by Russian exports. Russia's foreign trade board is highly secretive as to how much timber has been prepared for exports.
Who are the buyers of our exports?

Eksportēto koksnes produktu pircēju "juridiskās adreses"

- Pārejās valsts 46%
- Zviedrija 17%
- Lielbritānija 12%
- Vācija 11%
- Somija 6%
- Igaunija 8%

Eksportēto apalokoku pircēju "juridiskās adreses"

- Zviedrija 56%
- Somija 18%
- Igaunija 17%
- Pārejās valsts 9%

Eksportēto zāģmateriālu pircēju "juridiskās adreses"

- Pārejās valsts 35%
- Lielbritānija 30%
- Eiropa 10%
- Vācija 10%
- Niderlande 8%
- Japāna 7%

Eksportēto mēbeļu pircēju "juridiskās adreses"

- Vācija 24%
- Pārejās valsts 45%
- Lielbritānija 11%
- Dānija 8%
- Francija 6%
- Zviedrija 6%
Were are our exports used?

**MARKETS**

- **Building sector market**
  - Sawnwood
  - Moulded sawnwood
  - OSB, particle board
  - Joinery and carpentry products
  - Construction timber

- **Energy market**
  - Firewood
  - Chips for heating
  - Sawdust and products thereof

- **Paper industry market**
  - Pulpwood
  - Pulp chips
  - Paper and cardboard articles
  - Pulp and recycled paper

- **Other**
  - Furniture and furniture components
  - Products for transport sector
  - Other

<table>
<thead>
<tr>
<th>2010</th>
<th>1 222 mln Ls =</th>
<th>404 mln Ls</th>
<th>208 mln Ls</th>
<th>210 mln Ls</th>
<th>400 mln Ls</th>
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<tbody>
<tr>
<td>incl. exp.</td>
<td>1 051 mln Ls =</td>
<td>380 mln Ls</td>
<td>115 mln Ls</td>
<td>196 mln Ls</td>
<td>360 mln Ls</td>
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</tbody>
</table>

Sources: CSB and LFIF.
How much and what do we export?

Sources: CSB and LFIF.
What are the factors limiting the exports of energy and pulp production inputs?

Market demand, i.e. we produce more than the market requires.

Insufficient competitiveness:
1) uncompetitive price (costs);
2) inability to satisfy other customer demands.

Resource availability, i.e. shortage of inputs to produce more.
What are the factors limiting the exports for primary processing?

- Market demand, i.e. we produce more than the market requires.
- Resource availability, i.e. shortage of inputs to produce more.
- Insufficient competitiveness:
  1) uncompetitive price (costs);
  2) inability to satisfy other customer demands.

Latvia produces only ~3% of all sawnwood produced in the EU.
What are the factors limiting the exports for secondary processing?

**Intermediate products, e.g. window, door and furniture scantlings**

- Market demand, i.e. we produce more than the market requires.
- Insufficient competitiveness:
  - 1) uncompetitive price (costs);
  - 2) inability to satisfy other customer demands.
- Resource availability, i.e. shortage of inputs to produce more.

**Final products, e.g. windows, doors, houses and furniture**

- Market demand, i.e. we produce more than the market requires.
- Insufficient competitiveness:
  - 1) uncompetitive price (costs);
  - 2) inability to satisfy other customer demands.
- Resource availability, i.e. shortage of inputs to produce more.
It is necessary to increase the value added

*Ekonomists*, 15 July 1925

We cannot keep silent about some general negative phenomena here as well, and particularly in connection with these specific groups. Export figures for flax as well as timber are still too high in the groups of raw materials and semi-finished goods and too low in the group of finished goods. This just represents the fact that our industry is far from a phase in its development where all raw materials would be processed into finished goods domestically.

*Ekonomists*, 31 May 1936

This industrial sector can be considered one of natural sectors, as it consumes our raw materials and processes them for exports. One could only wish that timber processing would develop more widely, as currently timber is still primarily exported in the form of semi-finished goods, such as boards and planks.
Value added products in exports

- 2010. I-VI: 124 Tālākapstrādes produkti, 78 Plātnes, 26 Granulas, briketes, 140 Zāģmateriāli jeb dēļi, 15 Zāģballķi, 88 Malka, papīrmalka un šķelda

- 2010. I-VI: 52% Tālākapstrādes produkti, 26% Granulas, briketes, 22% Malka, papīrmalka un šķelda
- 2011. I-VI: 52% Tālākapstrādes produkti, 26% Granulas, briketes, 22% Malka, papīrmalka un šķelda
Do we all have the same thing in mind when we use the term "value added"?!

Value added = depreciation + profit + wages + taxes

From the point of view of the state and community

Primary focus is not on the VA, but on a sustainable increase of money spent on hiring labour force:
- well-paid jobs;
- more jobs.

Secondary focus:
- development in one sector may trigger development in other sectors;
- prestige.

Value added=
+ depreciation → Almost nothing stays in Latvia
+ profit → Partly stays in Latvia
+ wages → Almost entirely stays in Latvia
+ taxes

From the point of view of a business

Primary focus is not on the VA, but on competitiveness.
But does the VA satisfy these primary interests?

Reply: Not always! VA is a good thing, yet not a panacea.
Encouraging secondary processing in the long-term

Small and medium-sized enterprises (SMEs)
Specific feature: prior to becoming a serious exporter, it needs a longer "take-off" phase when the domestic market accounts for 60%–100% of the sales.

Pre-requisites for establishment and development
- Production inputs available on the domestic market (sawnwood, board, fittings)
- R & D support
- Qualified labour
- Sufficiently large domestic market with purchasing power

Large enterprises
Specific features: capital-intensive and export-oriented, often a part of a large concern (only one production unit in Latvia, strategic decisions are taken by the parent company).

Pre-requisites for establishment and development
- Production inputs available on the domestic market (sawnwood, board, fittings)
- Infrastructure
- Qualified labour
- Cost competitiveness with other regions

Latvia's forest sector has made its contribution: availability of inputs, R & D (MeKA)

Further development of the secondary processing sector in Latvia requires active involvement of other stakeholders (basically, the state and local governments), domestic market incentives (cultural and public buildings), infrastructure and business environment, competitive education system.
Insufficient domestic market in Latvia as an obstacle to achieving a higher value added

- If we compare the **export** structure of the core Latvian and Finnish forest industry products (except chips, sawdust etc.) in 2009 and income per 1 m³ of industrial timber used in export production, the results for both economies are similar!!!

- If we compare the **domestic market + export** structure of the core Latvian and Finnish forest industry products in 2009 and income per 1 m³ of industrial timber used in export production, Latvia has a considerably lower value added!!!

Sources: LFIF, CSB, Statistics Finland and EOS.
Encouraging secondary processing in the long-term

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- Cost competitiveness with other regions
Less talk, more action

Ekonomists, 15 July 1931

There is a complete disagreement among our politicians concerning the forest management principles; nevertheless, we have to find a solution, as it would be a crime against our state and nation to look for loans abroad and pay substantial interest on them, at the same time letting our own forests rot uncut just because we cannot come to an agreement among ourselves as to how they should be managed.
MARKETS

Affected by market

Building sector market
- Sawnwood
- Moulded sawnwood
- OSB, particle board
- Joinery and carpentry products
- Construction timber

Energy market
- Firewood
- Chips for heating
- Sawdust and products thereof

Paper industry market
- Pulpwood
- Pulp chips
- Paper and cardboard articles
- Pulp and recycled paper

Other
- Furniture and furniture components
- Products for transport sector
- Other

Affected by support to REP

Audit affected by policies of Nordic concerns

Audit affected by market

2010

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<td></td>
<td>1 222 mln Ls</td>
<td>1 051 mln Ls</td>
<td>1 340 mln Ls</td>
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<td>404 mln Ls</td>
<td>380 mln Ls</td>
<td>470 mln Ls</td>
<td>455 mln Ls</td>
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<td>208 mln Ls</td>
<td>115 mln Ls</td>
<td>230 mln Ls</td>
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<td>210 mln Ls</td>
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<td>400 mln Ls</td>
<td>360 mln Ls</td>
<td>410 mln Ls</td>
<td>370 mln Ls</td>
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</tbody>
</table>

Sources: CSB and LFIF.
Resource availability forecast
Improved utilisation of wood

Formerly:
- malka: 20%
- papir-malka: 30%
- zagbalki: 50%

MODERN APPROACH:
- 10% ENERGY
- 25% WOOD FIBRE
- +15% GREEN MASS FOR ENERGY

THE LATEST WOODWORKING TECHNOLOGIES ENABLE TO USE AS TIMBER OF THE TREE TRUNK

SHRUBS, SMALL TREES, STUMPS, ROOTS
Competitive advantages of Latvia's forest industry sector

• The market share of Latvia's producers is small; therefore, we shall be able to sell the "physical volume", provided that we have:
  – an adequate price;
  – an adequate "service".

• We are ready to face a potential new crisis from a much better position than in 2007 and 2008, because:
  – the goods markets have been diversified;
  – the structure of costs has been balanced;
  – in 2011, none of the markets have exceeded reasonable prices;
  – successful and adequate actions during the previous crisis prevented a significant decline in the potential. The staff also accept the need to respond accordingly.

Currently the competitiveness will be more affected by the actions of stakeholders in Latvia rather than the external market factors.
Rapid improvement in productivity and competitiveness. Banking policy?

In the circumstances of shortage of labour and expensiveness, businesses sharply expand investment in more effective equipment.

Some time ago…
Long-term loan 1 million lats
Current asset loan 1 million lats
Collateral: fixed assets 2.2 million lats worth

Now…
Long-term loan 1 million lats
Current asset loan 1 million lats
 Additional collateral: EBITDA 1 million lats

\[
\text{EBITDA} = \text{Amortisation} + \text{earnings} \\
= 0.5 \text{ million lats} + 0.5 \text{ million lats} - 0.2 \text{ million lats}
\]

Source: CSB and LFFI.
Interaction of forest sector organisations

- Latvian Forest Industry Federation
  - Latvian Association of Independent Timber Harvesting Companies
  - Latvian Union of Timber Harvesting Companies
  - Latvian Association of Wood Processing Companies and Exporters
  - Association "Latvijas Koks"
  - Association "Latvijas Mēbeles"

- Latvian Timber Producers' & Traders' Association

- Latvian Biomass Association

- Latvia University of Agriculture
  - Institute of Wood Chemistry
  - Forestry Research Institute "Silava"

- Latvian Timber Producers' & Traders' Association

- Latvian Association of Forest Owners and Managers

- Community representatives

- State and local governments

- Environmental organisations

- Latvian private forest owners and unions

- JSC "Latvijas Valsts meži" – manager of state-owned forests

- Forest Sector Information Centre
  - Forest and Wood Products Research and Development Institute
  - Management of Measurement and Inventory of Latvian Timber Products
  - Technological platform of Latvian forest sector
  - Competence Centre

- Latvia University of Agriculture
Development scenario

**Scenario A** – the issues concerning forest sector as a priority sector are addressed using an integrated approach.

- **2009**
  - Sector size: 0.8 billion Ls

- **2010**
  - Sector size: 1.2 billion Ls

- **2013**
  - Sector size: 1.4 billion Ls

- **2015**
  - Sector size: 1.9 billion Ls