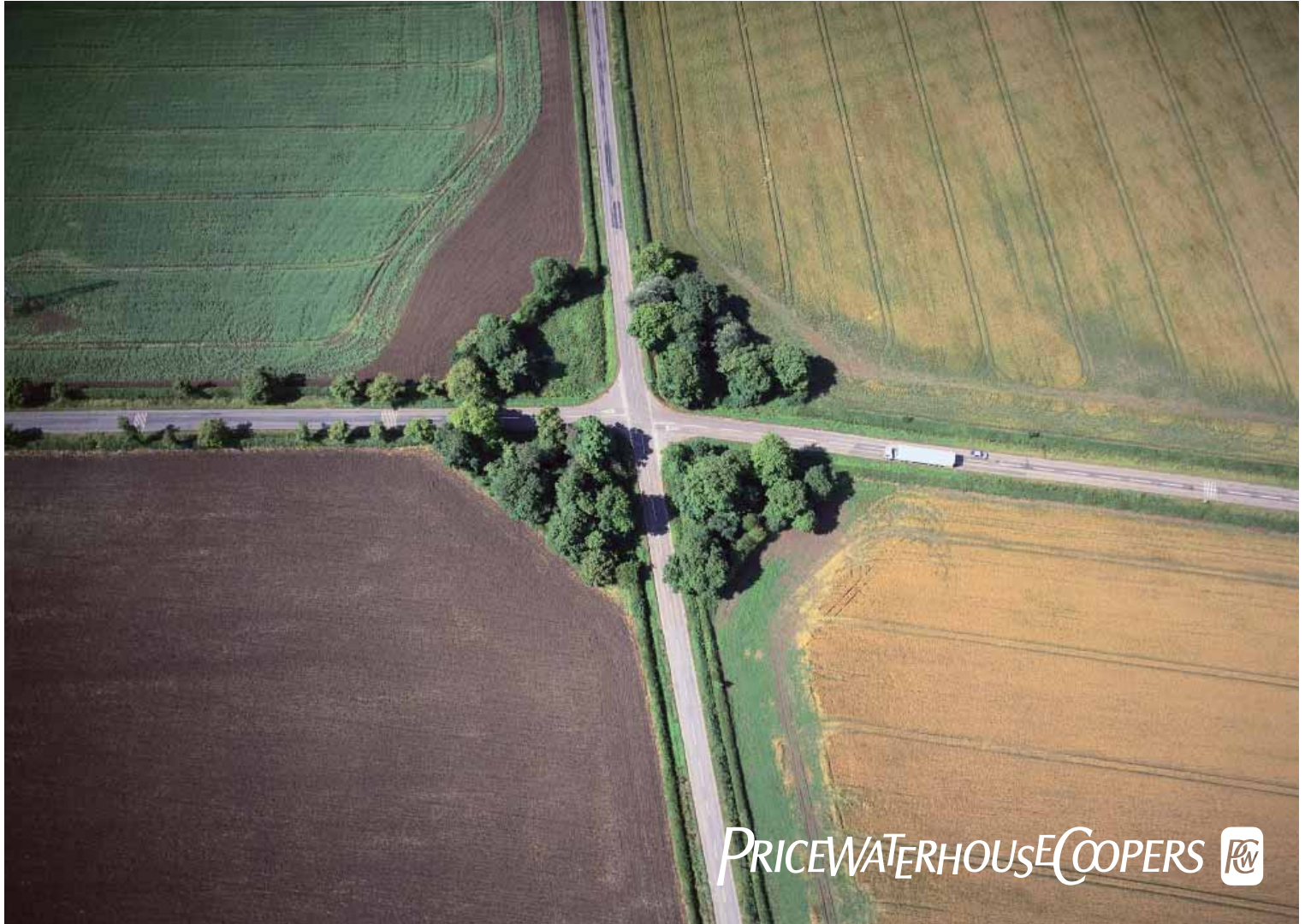


Forest, paper & packaging

CEO Perspectives

Viewpoints of CEOs in the forest, paper
& packaging industry worldwide

2008 Edition



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Methodology:

We interviewed 26 CEOs, or equivalent, from forest, paper and fibre-based packaging companies based in North America; South America; the Middle East, Europe & Africa (EMEA); and Asia; including the CEOs of two major industry trade organisations. The combined sales total of the companies where CEOs were interviewed exceeded US\$120bn for 2006. The data was collected in person and by telephone between August and December 2007. Questions were focused, but not exclusively, on the following topics: cost structure, customers, supply chain and sustainability. The quotations anonymously cited in this document are taken directly from our interviews and represent a broad range of geographical views.

Acknowledgements

We would like to thank the CEOs who participated in this series of interviews for taking the time to share their viewpoints with our team and a special thanks to Mr. Hannu Ryöppönen and Mr. John Williams for allowing us to summarise their conference presentations.

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Welcome

Most of the executives we surveyed believe that the industry has become more efficient, although they are more mixed in their views as to whether it has reached a turning point in its profitability.

PricewaterhouseCoopers recently conducted its second series of interviews with CEOs in the forest, paper and packaging (FPP) industry. We interviewed 26 executives from leading companies and organisations around the world. The objective, as with the first set of interviews in 2006, was to learn more about executives' opinions of the state of the industry, the key issues it faces and its future direction.

Our first edition of CEO Perspectives looked at an industry in the midst of change. In the subsequent 18 months, costs have continued to rise and the impetus to restructure has gained momentum. Most of the executives we surveyed believe that the industry has become more efficient, although they are more mixed in their views as to whether it has reached a turning point in its profitability.

Now, however, it is not only the industry itself, but the world in which it operates, that is changing dramatically. The industry is experiencing major shifts in value distribution throughout the wood-fibre value chain, in global supply and in end-user markets. In addition, new sources of capital and profits are becoming available. These developments, together with the new demands and opportunities presented by the need to be sustainable, are reshaping the industry's strategic agenda.

So, is the industry ready to meet the challenge of reconfiguring itself to operate profitably in a rapidly evolving, carbon-constrained, global economy? We have focused on four key trends in the pages which follow:

1. **Getting back to basics:** Many CEOs are focusing on the development of simpler, more flexible business models, improvements in operating efficiency and the reassessment of their value propositions.
2. **Controlling costs:** Most CEOs are also trying to reduce their major input costs, such as fibre and energy, and welcome the financial discipline private equity involvement has brought. But real concerns remain about overcapacity and lack of supply discipline, particularly in Europe.
3. **Demonstrating sustainability:** The industry is at the forefront of the drive to become more sustainable. But it needs to publicise its achievements much more widely.
4. **Looking for leadership:** Most CEOs are looking for leaders who will show the way in important areas like capacity reduction, price-setting and consolidation. But even if clear leaders emerge, finding the right people to pilot the industry in the future could prove very difficult, since many companies are struggling to recruit the right talent.

In short, there is still much to be done. However, greater collaboration – both within the industry itself and with customers, suppliers, trade organisations, non-governmental organisations (NGOs) and other trade partners, including those in the energy sector – can play a crucial role in helping many executives overcome the hurdles they face. No company can resolve every problem in isolation. It should work with others to address common challenges – and take an active role in determining the industry's future.



A handwritten signature in black ink that reads "Robert Barnden".

Robert Barnden

Global Forest, Paper & Packaging Leader
PricewaterhouseCoopers



Getting back to basics

Focusing more attention on operating efficiency and ensuring a healthy bottom line

“It is all about getting back to basics...We need to fulfil customers’ needs at the right cost to them. We must be commercially driven, not technically driven, and our focus must be on margins and not on volumes.”

Many of the CEOs we interviewed are eager to get back to basics – i.e. ensuring that they are capable of delivering a standard, quality product, on time and as economically as possible. These executives believe that the industry is becoming increasingly commoditised, and do not see extra services or better quality as generating higher margins. Other CEOs, whose companies operate further down the value chain, are focusing on the opportunities for differentiating their products. They are also examining their value propositions to ensure that the extra services they offer are really enhancing their revenues.

CEOs who see their companies as operating in a commodity marketplace are taking a close look at their business models, with a view to driving out unnecessary complexity. Simpler business models can also provide more flexibility, which has a number of advantages – such as facilitating a more active approach to portfolio management as a means of increasing profitability. Rather than focusing on products strictly by grades, for example, one CEO advocates looking at the total value chain. At one end, the available sources of raw materials should be a key driver of what range of products can be competitively produced. At the other, end users should define the offering. In essence, companies need to ensure that they are collaborating with their suppliers and customers in developing their product palettes.

Some executives also comment on the impact of the increasing concentration of suppliers. One executive believes that this shift makes it difficult for any one industry player to move in isolation and adds to the challenge individual companies face in trying to differentiate their products and services. Industry best practices are now widely available, largely driven by the major equipment suppliers. Another executive concurs; in his view, global equipment manufacturers are effectively levelling the playing field by providing players in the emerging markets with state-of-the-art technology and advice informed by earlier projects.

Declining demand is also seen as an issue, particularly in commodity segments like newsprint. In North America, CEOs express deep concerns about the weak building products market, a sector which has been hard-hit by a dramatic slowdown in US housing starts. One European executive is equally troubled. In his words, “We are in a mature industry in the Western world. The big challenge is how to survive. It has been difficult; it has not been profitable even in a time of growth. How an industry can handle [declining demand] and still be profitable when margins are going down every year – that is challenge number one.” But other executives are more positive. They argue that increasing demand in emerging markets, like China, India, Brazil and Central and Eastern Europe, could offset falling demand in more mature markets (see [Preparing for the world in 2050](#)).

Preparing for the world in 2050

PricewaterhouseCoopers’ 2006 report, [The World in 2050: How big will the major emerging market economies get and how can the OECD compete?](#), suggests that, by 2050, the seven largest emerging market economies, or E7 (China, India, Brazil, Russia, Indonesia, Mexico and Turkey) will outstrip the world’s largest developed economies, or G7 (US, Japan, Germany, UK, France, Italy and Canada), using both market rates and purchasing power parity measures. India and Indonesia are projected to have even higher rates of growth than China, due to their relatively younger populations. Brazil is also projected to continue growing strongly and, although Russia’s ageing population will slow down increases, its economy is still expected to grow. Since Brazil, Russia and, to a lesser extent, Indonesia are important fibre suppliers, these projections have serious implications for long-term planning in the industry. Further, they suggest that the industry needs to take a closer look at India. The report is available to download at www.pwc.com/world2050.

Getting back to basics

“I think, going forward, I am very much of the mindset of greater focus, greater clarity – clamping down on some of the product lines. The bottom line is the customer will buy it from you if your quality is right, and your pricing is competitive...I really think we have got to simplify our business model. We are fundamentally in a commodity industry and we are not getting paid for bells and whistles.”

The leading players in the packaging industry have long been able to provide sophisticated services, such as colour printing and graphic design (see [Escaping the “commodity trap” in the packaging segment](#)). However, some executives report that it is often difficult to get customers to recognise and pay for the added value these services bring. Nevertheless, they still see collaborating with customers as a solid strategy for increasing sales – for example, one packager is involved in discussions with major customers on ways to improve sales of specific end products and therefore increase sales of the corresponding product boxes.

For one executive, the production of a range of graphic papers using a high recycled fibre content not only offers an opportunity for differentiation, but also makes basic business sense. Moving into locally-sourced, recovered papers has enabled the company, which is a non-integrated producer, to increase its fibre security, reduce its currency risk and promote its environmental image with its large customers, whose buying decisions are increasingly shaped by carbon issues.

In some cases, supply-chain optimisation offers other real possibilities to partner more closely with customers. Some packagers are able to integrate their supply chains with their customers. In these cases, activities traditionally performed at the point of manufacture actually shift to the packager – for example, when consumer products are shipped directly to packaging plants, where they are inserted into packaging, together with supporting materials such as user manuals that are also provided by the packager.

Another possible differentiator may be the ability to offer a one-stop shop. One executive in the wood products segment reports that his company has improved its information flows, so that customers purchasing various building materials can be treated centrally and receive one invoice, instead of having to deal with five different business units. This co-ordinated approach has dramatically enhanced the quality of the customer service the company can offer. Having sufficient scale to service major contacts can also be a competitive advantage. One packaging executive notes an increasing trend towards sole-sourcing in key segments.

Escaping the “commodity trap” in the packaging segment

While the majority of respondents are looking at the industry primarily as a commodity marketplace, some executives continue to take an alternative view. At our 20th Annual Global Forest & Paper Conference in Vancouver in May 2007, John Williams, President of SCA Packaging Europe, discussed the dynamics of the European paper packaging market. He depicted a market characterised by sluggish demand, rising raw material and energy costs, industry over-capacity and increasing price pressures. As the retail landscape shifts increasingly to discount retail channels and private labels, retail prices are falling. Consumer goods companies are passing these pressures onto packaging suppliers in order to maintain profitability – they want higher added-value packaging, but are unwilling to absorb the related costs.

Mr Williams advocated broadening and deepening the product offering to escape what he termed the “commodity trap”. Companies need not only to think “outside the box” but also to *redefine* the box – as the interface between the consumer and product rather than a mere commodity. He saw enormous potential for design and “on-shelf attractiveness” as tools for strengthening brands and driving sales growth. In helping brand owners achieve these goals, he argued, packaging companies can increase their own sales as well.



Regardless of whether their companies are seeking to position themselves as the most efficient players in a commodity market, or as differentiated full-service providers in more value-added segments, executives increasingly recognise the global nature of the industry. Several executives comment that the industry will need to carefully assess the global landscape when making any future investments. Diverse factors, including currency considerations, access to fibre and labour, and transportation costs, will need to be balanced – and locations like China, India, Eastern Europe and South America may increasingly provide the best returns.

There is one other “basic” that deserves attention – the people who drive organisations. A number of executives acknowledge how important it is to focus on people. As John Kotter, one of the foremost authorities on change leadership, found in the 1990s and a wealth of new evidence supports today, people and personal engagement are the key to the success of change projects.

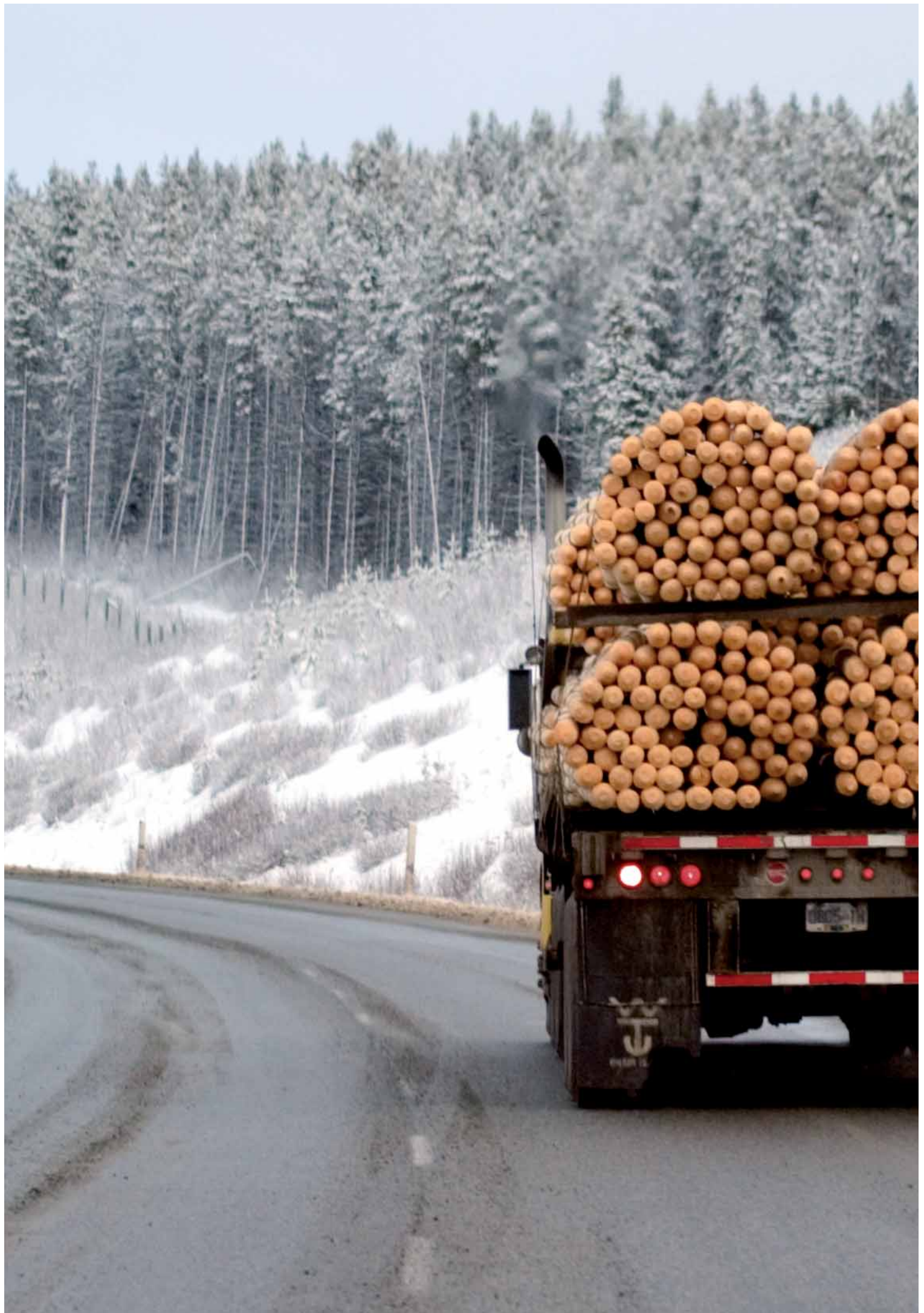
The success with which change is implemented depends on the extent to

which people understand their roles in the bigger picture – how closely they are aligned to a shared vision and can see how their decisions and actions affect the wider context. This requires that leadership teams be fully engaged. Companies which want to change their business strategies, refocus their business models, close plants or implement performance-improvement measures, need to pay close attention to the people issues or risk failing to achieve the results they seek.

“Full service is an issue for us. People have to be willing to pay for that. We can throw a lot of resources at anything we need to, but getting the customer to agree there is value associated with that and willing to pay for it is a real challenge for our sales force.”

Questions for reflection

- Do you place sufficient emphasis on creating products and solutions which address your customers’ needs? In short, are you fully tuned into the voices of your customers?
- Have you looked for opportunities to reduce your Stock Keeping Units (SKUs)?
- Have you considered how you can simplify your business model and processes?
- Do your business processes include sufficient flexibility in areas such as production, materials substitution and outsourcing, in order to respond to and profit from market trends?
- Are you confident that your company can differentiate itself from competitors in a way that adds profitability, or do you need to re-assess extra service offerings?
- Are you trying to specialise in particular market niches or focus on ensuring lean performance in a commodity-market segment?
- Are you confident that the people in your organisation understand your business strategy and are committed to implementing it?



Controlling costs

The continuous struggle against the profit squeeze

“Cost structure is one of [our top priorities]: continuing to drive down costs and doing that in a disciplined and methodical way, which is what we are doing with Lean Six Sigma...We’ve got much more of a database/data-driven system that is really taking a...lot of cost out and really giving us a lot of upside running opportunity.”

“Transportation logistics and costs are a challenge... due to double handling of products from mills to [a] centralised port...and then shipping to customers. Therefore, [we are] faced with high distribution costs – [we] may need to move some production capacity closer to customers.”

FPP companies continue to face huge cost pressures throughout their supply chains. Nonetheless, many CEOs are cautiously optimistic about their own company’s future profitability, thanks to the prevalence of effective cost-cutting measures within the industry. Most executives also think that the private equity sector has introduced greater financial discipline. They themselves are now trying to reduce major input costs, develop leaner and more flexible business models and processes, and tighten expenditure on back-office functions – by, for example, using shared service centres.

However, the single largest cost factor for many players is fibre, the supply of which poses major challenges in some parts of the world. Several CEOs of companies with integrated supply chains describe the access to fibre this gives them as a major competitive advantage. Sourcing fibre cheaply from low-cost regions is critical to keeping costs down – for some Scandinavian producers, this means sourcing from South America, while for US producers, it means sourcing from the US South-East.

Steep export tariff increases in Russia are driving wood prices up dramatically in Finland and elsewhere. The growing Chinese market depends on Russian imports, and shifting procurement to other sources could have a dramatic impact on global fibre supplies. In addition, the impact of the mountain pine beetle in Western Canada has resulted in a short-term increase, but eventually a long-term reduction, in the amount of fibre originating from that region.

Reducing sourcing and production costs requires an understanding of numerous interlinked factors. One executive says that it necessitates an assessment of the entire value chain to determine where a

company can operate most competitively. So, the most sensible option for some grades in specific locations may be local sourcing, production and sale. In other markets, it may be better to source low-cost pulp globally for local production and sale. Another executive adds that transportation costs may offset the savings from using a low-cost supplier for major inputs, such as chemicals.

Energy costs also continue to be a major factor for some players, although others are more sanguine about energy price increases because they are relatively self-sufficient (e.g. running plants on biomass waste) or close to more stably-priced energy sources such as coal. The executives we interviewed report that their main strategy for reducing energy costs is the modernisation of existing assets, and a concomitant decrease in labour costs is an important side-benefit in some cases. Installing new equipment such as efficient recovery boilers also has the potential to provide additional revenue, as some of the energy produced can be sold back into the grid.

However, many of our respondents express greater concern about transportation costs than direct energy costs. Some of them have chosen to focus on refining their supply chains in order to reduce the potential burden of transportation costs – configuring mills to produce multiple grades can reduce transportation costs significantly, by ensuring that paper is produced in the mill most proximate to the customer. Others have adopted strategies such as switching to barge transportation or using trucking fleets more effectively to help reduce the costs of moving pulp. Many executives see transportation and logistics as one of the most important remaining areas in which to secure further cost reductions.

Controlling costs

“Access to state-of-the art technology is available to all global competitors. Will it be better to manufacture in China, India, Eastern Europe, Brazil or Taiwan? This is the crucial decision today and it changes according to the currencies equilibrium and other productivity factors.”

Carbon costs are another potential issue, particularly for paper-makers. Some European executives are worried about future trends in carbon costs and, in particular, possible changes to the EU Emissions Trading Scheme after 2012 (see [The implications of changing the EU Emissions Trading Scheme](#)). One North American executive also expresses anxiety about how carbon emissions will be globally regulated in the future, and about the potential lack of consistency between federal and state government approaches in the US. Collaboration with the key regulators will be essential to inform the policy-making process and ensure the development of consistent standards.

Global warming may have other cost implications for the FPP industry. Natural disasters like Hurricane Cyril and the mountain pine beetle infestation may render sustainable forestry management, such as replanting programmes, much more difficult. This could ultimately increase volatility in fibre availability and costs.

Currency exchange rates are yet another major challenge. One European executive says that the strength of the euro relative to the US dollar is reducing margins to such an extent that some countries are no longer viable manufacturing locations. He reports that his company is deciding which plants to close partly on the basis of currency fluctuations. Other European CEOs are also very concerned by the euro-dollar rate, because it has encouraged US players to sell their surplus capacity into Europe. Any attempts to increase pricing in Europe could therefore backfire and “open the floodgates”. Conversely, some US companies have seen profits rise on the back of the weak dollar, although others have benefited less due to alleged Far East dumping of certain grades. Strength in other currencies such as the Canadian dollar and Brazilian real are also factors in the overall global currency mix.

The implications of changing the EU Emissions Trading Scheme

The EU Emissions Trading Scheme is the world’s largest scheme for using market-based mechanisms to control greenhouse gas emissions. In previous phases of the scheme, the predominant method of allocating allowances has been “grandfathering”, where countries are issued allowances in proportion to their historical emissions. But current discussions within the European Commission suggest that auctioning may increasingly be used as an allocation method after 2012. Auctioning clearly represents an upfront cost to those paper-makers operating under the scheme, and there is uncertainty over how the revenues raised will be used. Many executives fear that auctioning could effectively create a further tax on the industry.



Questions for reflection

- Do you know the true “costs to serve” your customers and whether those costs are necessary to support your product and service propositions?
- Have you considered process improvement strategies such as Six Sigma?
- Do you have a long-term strategy for managing your energy and carbon costs, including appropriate capital investments, supply-chain improvements and hedging?
- Do you have a system for managing currency fluctuations and have you integrated currency analysis into your long-term strategic planning?
- Have you explored all reasonable opportunities to reduce your selling, general and administrative (SG&A) costs – including any further scope for using shared service centres and outsourcing – while maintaining acceptable service levels?



Demonstrating sustainability

The FPP industry has made great strides – but getting the word out remains critical to the industry’s long-term success

“We really look at it from three different standpoints: economic, social and environmental...We believe the products we produce should be very attractive to consumers from a sustainability standpoint. The economics of that has not proven true...That’s where we have to do a better job and convince the consuming public that that’s the right thing to do.”

“[It’s] not enough to be green, you have to tell people about it.”

Sustainability has become part of the business mainstream, and FPP companies are at the forefront of the increased focus on operating in a sustainable manner. In fact, FPP is among the most sustainable industries in existence – as one interviewee points out, it is the world’s biggest producer and consumer of renewable energy, and 50% of the raw materials used in the European paper and packaging sector are derived from recovered paper. Forests are a major binder of carbon and have great potential to offset damage caused by carbon emissions.

Unfortunately, however, the FPP industry still suffers from a poor image as the “destroyer” of the world’s forests. The reality – that the leading companies are actually helping to maintain their health and viability – is little understood by the general public. The CEOs we interviewed generally agree that the industry must therefore do much more to raise awareness of its responsible approach. Effective sustainability reporting may help (see [Sustainability reporting in the forest, paper and packaging industry](#)).

Several CEOs also express frustration that, while demand for “green” products is increasing, customers are often reluctant to pay a premium for such goods. One executive describes the situation as a delicate balancing act between the need to spend money on proving his company’s “green” pedigree and the need to minimise additional costs. He adds that the pressure to include recycled fibre in all products is short-sighted, as the current supply of recycled fibre is inadequate to meet demand, should it be mixed into all papers. Another emphasises the contradictions in how consumers behave. They want “green” products, but they also want convenience, so disposable plastic bottles continue to be the favoured packaging for beverages such as water in the US, despite the negative environmental consequences.

One clearly emerging and significant development – which is being driven by the climate-change and carbon agendas of powerful customers – is the concept of total supply-chain responsibility. One CEO mentions the increasing pressure to ensure that the entire supply chain is “green” – i.e. paper manufacturers not only need to reassure their retail customers about their own practices, they are also considered accountable for the practices of the loggers from which they buy.

Sustainability reporting in the forest, paper & packaging industry

Growth - PricewaterhouseCoopers’ Global Forest, Paper & Packaging Survey 2007 found that nearly two-thirds of the top 100 FPP companies globally are issuing sustainability reports. Although this reflects positively on the industry’s willingness to disclose information regarding its performance, we still saw room for improvement. Many companies only reported consolidated data and selected metrics, and less than 20% obtained third-party assurance on the data. Adoption of a consistent external reporting standard, such as the Global Reporting Initiative (GRI), could help to address many of the current weaknesses.

Demonstrating sustainability

“Look at this business. It is capital-intensive, we have long payback periods and we have assets in developing countries. We have to take a long-term view. To be less than sustainable in environmental terms means that, as a business, we are not sustainable. Several years ago, I concluded that we had to build sustainability into our strategy – anything less, and we would not be fully committed. So I saw it was the right thing to do.”

So what can the industry do to raise its profile as a good corporate citizen? Some executives think that the best approach is to collaborate with NGOs, because this has more potential to effect lasting change than using the customary industry channels or lobbying government (see [Guidance for buyers of wood and paper-based products](#)). One CEO singles out the World Wildlife Fund (WWF), while another praises the Forest Stewardship Council (FSC) for fostering a new model of co-operation between the industry, first nations and NGOs. Such co-operation requires an ongoing commitment. In one executive’s words: “A bit of grass roots work is really what it boils down to here, and that’s not a quick solution.” Many CEOs also see industry trade organisations as important catalysts in communicating what FPP companies do right and representing the industry’s interests, as climate-change regulations evolve.

Forestry certification, such as FSC and PEFC, and the measurement of “carbon footprints” can likewise help to increase public awareness of the advantages of wood and paper products over other materials. Retail buyers generally accept that certification is the simplest way of ensuring that wood and paper products are derived from forests which are managed in a sustainable manner – however, competing certification standards have been the object of significant industry debate in recent years. Again, the use of collaborative business networks could play a valuable role in facilitating the development of common standards. As one executive notes, a coordinated approach is essential to ensure that carbon labels are clear and comparable.

Guidance for buyers of wood and paper-based products

NGOs and other organisations are developing resources designed to provide buyers with information about the sustainable characteristics of the products they are purchasing. The joint World Business Council for Sustainable Development (WBCSD)/World Resource Institute (WRI) [Introduction to Sustainable Procurement of Wood and Paper-based Products](#) is one notable source. It will shortly be followed by a full guide and resource kit. [The WWF Guide to Buying Paper](#) is another noteworthy source.



In fact, most of the executives we surveyed regard climate change as both a threat and an opportunity. Some European CEOs are concerned that stricter climate-change regulations will put European companies at a competitive disadvantage, because developed countries could incur the largest share of the responsibility for reducing carbon emissions and new mills located in emerging markets might not be monitored as stringently (see [Success in Bali – but the real test is still to come](#)). They also view the EU's proposals for a 20% improvement in energy efficiency

and 20% use of renewable sources for primary energy production by 2020 with some trepidation. And one CEO warns that forest products companies risk failing to grasp the opportunities implicit in woody biomass due to lack of vision, money or competition from more innovative organisations in (or entering) the energy value chain.

Success in Bali – but the real test is still to come

Those expecting specific post-2012 targets were undoubtedly disappointed with the outcome of the Bali convention. However, measured by the modest criteria set out in advance by the head of the UN Framework Convention on Climate Change (UNFCCC), the negotiations can be considered a success. The delegates unanimously agreed to a Bali Action Plan which launches a series of negotiations with the aim of finalising a new climate treaty, to succeed the Kyoto Protocol, in Copenhagen in December 2009. But the real test will be whether developed and emerging countries can agree how to allocate responsibility for reducing their carbon output.

FPP businesses should carefully monitor developments over the next two years, as:

- There is clear recognition of the positive role of carbon markets in enhancing mitigation actions, giving a good indication that emissions trading will be part of any post-2012 climate treaty.
- But the framework for reductions post-2012 is still to be developed. The impact on sectors such as FPP and the geographic allocation of required reductions is likely to have fundamental implications on sector competitiveness and investment planning.
- The decision to establish incentives to stop deforestation and forest degradation can be expected to spawn many new business activities around the monetisation of forest carbon. Some FPP companies may benefit directly from these moves, but the sector will need to understand how these moves could directly and indirectly affect the global availability of supplies.

Demonstrating sustainability

“Around emerging markets, the community engagement profile of things is so vitally important. We must fully engage with these local communities – they are entirely reliant on us in most cases for their survival, and real on-the-ground community engagement to create an openness of trust is again a cornerstone for our ability to be successful on a sustainable basis.”

However, many executives recognise that climate change will simultaneously enable the industry to leverage its existing assets and sustainable forest management skills more effectively (see [Climate change risks and opportunities](#)). North and South American executives also mention the growth potential offered by new uses of woody biomass, and several executives suggest that collaboration with energy providers could prove invaluable in this context.

In the US, one company with timber interests is already looking at a joint venture with an energy producer to produce biofuels such as ethanol, largely by using the open space in managed timberlands to grow cellulose material grasses while maintaining forested areas. Developing biomass technologies could likewise provide forestry companies in BC, Canada – where mountain pine beetle

infestation is necessitating increased logging to remove infected trees – with an opportunity to move into energy generation. But as the technology is currently more expensive than hydro-electricity, which is widely and cheaply available in the area, government subsidies may be required.

Executives also see investing in local communities as another critical element in achieving a sustainable business model. Emerging-markets players and companies with interests in emerging markets are particularly sensitive to this aspect of sustainability, which is important in countries with high levels of social inequity. One respondent from a company based in an emerging market describes his company’s efforts to support local landowners by providing financing and technology, as well as advice on combining agriculture with forestry.

Climate change: Risks and opportunities

Some companies are looking at the future role of forest-based industries in a carbon-constrained global economy. At our 20th Global Forest & Paper Conference in Vancouver in May 2007, Hannu Ryöppönen, Stora Enso’s Deputy CEO and CFO, described some of the significant challenges climate change poses for the FPP industry, including the increasing cost of wood, access to affordable and sustainable energy sources, the need for sustainable logistics, new regulations, and the risk of disruptions to infrastructure and supply chains.

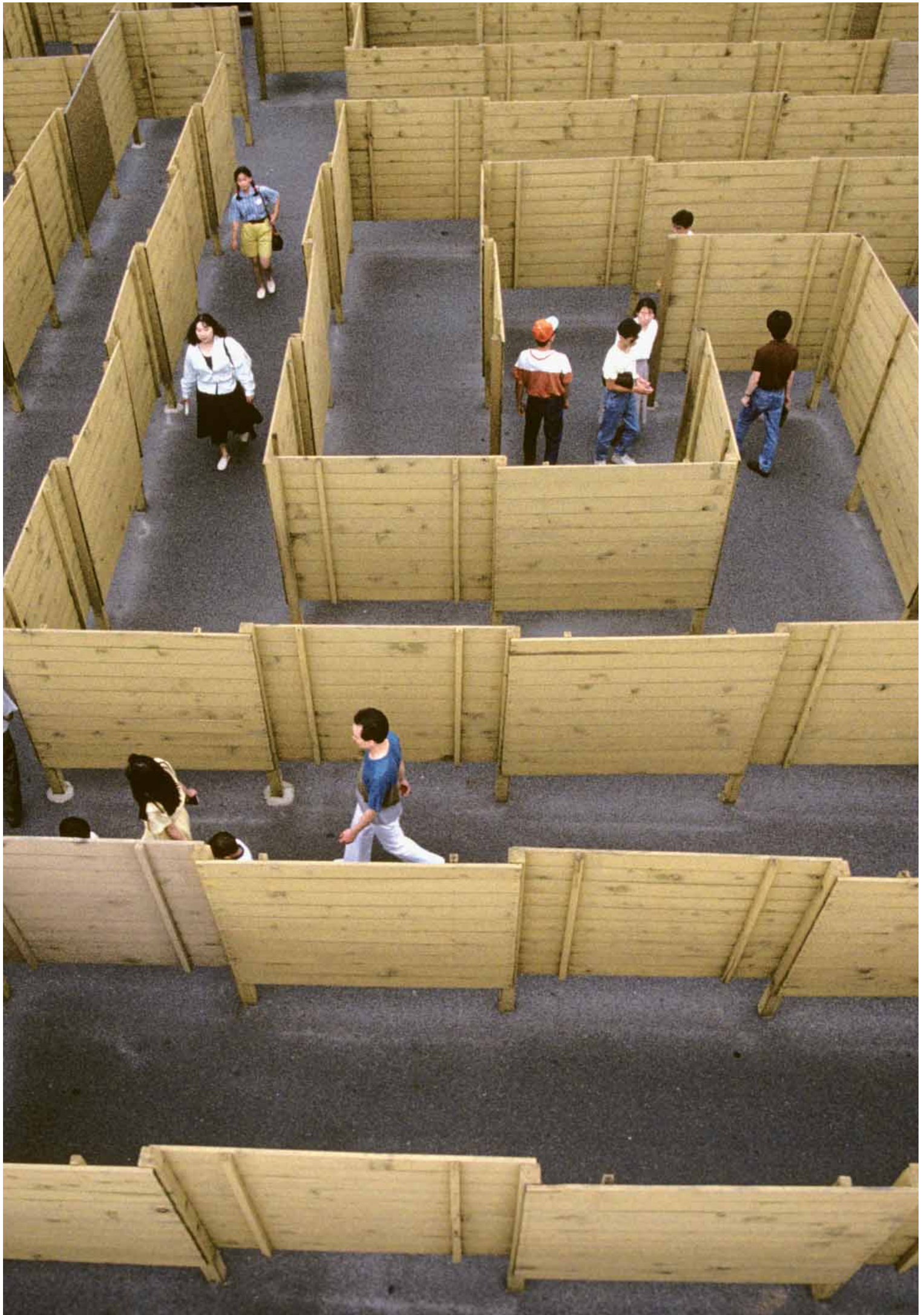
However, Mr. Ryöppönen also saw a number of major opportunities. FPP companies use a lot of carbon-neutral biofuels and renewable resources. Further, forest products are recyclable, and therefore minimise landfill methane emissions, as well as storing carbon throughout their service life. These traits help to give them a lower carbon footprint than many competing products. The forest products industry can also make a contribution to mitigating climate change by sustainably managing forests, which serve as carbon sinks.

Mr. Ryöppönen also described the concept of the bio-refinery – in which renewable, local biomass (bark, wood waste, forest residual, corn, agricultural waste and municipal waste, etc.) would be converted into fuels. Run efficiently, a bio-refinery could utilise all the components (lignin, hemicellulose, cellulose) beyond combustion, using an inherently “green” technology to produce renewable chemicals and materials as well as fuels. This would enable biomass to be converted into higher value products. Although bio-refineries are still at the drawing-board stage, Mr. Ryöppönen believes that they could eventually offer the forest products industry some exciting new revenue streams, as the cost of energy from other sources rises.



Questions for reflection

- How secure are your fibre sources?
- Have you considered how to work more collaboratively, including with suitable NGOs, to get your carbon and broader sustainability messages across more effectively?
- Are you measuring your carbon footprint and planning to communicate information about it in a clear and understandable way?
- Has your organisation developed a climate-change strategy, and is it integrated with your overall business strategy?
- Do you understand and have you attempted to quantify the trade-offs and synergies between cost-effectiveness and sustainability in your supply chain? In short, do you understand how to make your supply chain “lean and green”?
- Are you looking to leverage biomass opportunities not just for your own needs but to develop new revenue streams from biomass-based energy, fuel and chemicals? If so, have you considered the resources and competencies you will need to move into these new businesses, including the supply-chain partners you will need to profitably exploit the opportunities?



Looking for leadership

Who will raise the industry's profile and make the tough choices to ensure current and future profitability?

“I think it's about to happen because if you look at the industry in the last two years or so, nearly all the CEOs have changed. They are now much more financially oriented, and the pressures from their shareholders and the stock market will push them to restructure.”

“We are stimulating a new culture and it starts with me – I need to set the example. It is an old industry and customers have been neglected. We need to change [the mindset of] our people. Our people need to be trained in understanding the cost of the product and getting margin. We must have people who want to get out to the customer and who want to make a deal. It is not magic – we need to have people who love what they are doing.”

“Production capacity in the industry is too high – there is no leadership in production discipline...”

Many of the interviews show that executives are explicitly looking for leaders who will drive the industry forward and show the way in important areas like capacity reduction, price-setting and consolidation. One European CEO expresses frustration at his company's inability to pass on increases in costs – he calls for more consolidation and for someone to take the lead in setting prices. Another agrees – when companies sell tonnage at break-even rates, he argues, they risk damaging the entire industry's pricing structure.

Yet others think that the industry still needs stronger production capacity discipline. However, one CEO believes that high costs and fibre shortages in Scandinavia will have a silver lining, in forcing the region to become more disciplined about production.

Whether further consolidation would create any clear market leaders is another

matter. While most executives agree that capacity reductions are necessary, they express some scepticism as to whether this can be achieved through consolidation. One CEO who has assessed several possible deals reports that the prices vendors are asking for seem unrealistically high. In his opinion, vendors are failing to factor in the costs of capacity rationalisation.

The growing presence of private equity players may have played a part in increasing vendors' expectations; buyouts have accounted for about 20% of total deal values in the sector in recent years. Nevertheless, some executives think that the influx of private equity has had a positive impact on financial discipline (see [Views on the role of Private Equity](#)).

Views on the role of Private Equity

Although views vary, a number of CEOs we surveyed are very positive about the role of private equity:

“You do get up earlier and work later when it is your money. It is a good combination for a mature company.”

“I think it's all very positive. I think they bring a level of discipline, a sense of urgency. And...unlike most forest products companies for the last 30 years, these guys are actually in it to make money, so that drives completely different behaviour.”

“...I think that private equity practices are very positive for the industry. They push to consolidate, they are much more financially oriented, tougher on poor management, on working capital and so on. So I think that, in the end, private equity is very positive for the industry because they are pushing people like us to think about their strategy, the reasons why we need to invest and where...I am very positive.”

And, as reflected by one CEO we interviewed, his biggest lesson learned from private equity:

“Sweat one's assets. I tell my people that we are in the business of making money, not paper.”

Looking for leadership

“The question is not ‘when will we go to attack new markets?’ but ‘when will they attack us?’”

“The focus is on people skill development and developing our organisational capability. We want to be a world-class company.”

Others are more doubtful; they question whether private equity firms can take a sufficiently long-term view in an industry where investments are made for 20 years or more (see [Will private equity take the lead?](#)).

So, if private equity players have not provided the leadership the industry needs, who can? Recently, many major players in the industry have brought in new members of the management board from outside the industry. In some, but not all, cases the entry of fresh blood in the executive suite has been driven by private equity participation. These executives bring fresh perspectives and are likely to increase focus on key financial measures. Whether or not they will be able to provide strong leadership for the industry remains to be seen.

Some companies based in emerging markets are also expressing aspirations to

forgo the industry’s future. One executive talks of his company’s learning and education programmes, and its plan to certify all of its plant management and operators as “world class”. Others are actively promoting sustainability by joining global sustainability initiatives and taking strong measures against issues such as illegal logging and the displacement of native populations in their home territories.

Some US companies are also beginning to collaborate with energy suppliers to capitalise on the opportunities wood-based biomass offers. Wood-based biomass could provide major opportunities to generate new revenues from energy, fuel and chemical products, but it will also increase the pressure on fibre supplies. Such companies therefore need to ensure that they are taking a broad, long-term view and supporting the sustainability of the industry as a whole.

Will private equity take the lead?

Private equity firms have been attracted to the FPP industry for a number of reasons, including the potential inherent in the restructuring of traditional players and the opportunities in emerging markets. This could ultimately transform the management of the industry.

Many executives think the influx of private equity funding has already had a significant effect, and that fresh blood may accelerate the restructuring process, as well as improving the management of cash flows and returns on capital employed. Indeed, some suggest that because private equity executives do not have the same emotional ties as FPP managers, they could make a better job of getting returns out of segments which are in decline.

However, several European CEOs are somewhat disappointed that private equity firms have not made a bigger direct impact in driving rationalisation and consolidation in the sector. They also point to the fact that highly leveraged financing models constrain the ability to invest. But the financial discipline and willingness to face difficult decisions which distinguishes private equity firms may be exactly what is needed in some mature markets.



Even if some leaders emerge from today's industry players, finding the right talent to pilot the industry in the future may prove extremely difficult. Many FPP companies, particularly those in developed markets, are failing to attract the best and brightest new joiners – without a strong contingent of younger people in the pipeline, they will be hard-pressed to fill upper-level management vacancies as they arise. Such companies will therefore need to ensure that they have the right incentive models to appeal to the new “millennials” entering the workforce and robust processes for grooming potential successors. They will also need to consider how they position themselves as employers¹ – and demonstrating a genuine commitment to sustainability may help to make them more attractive in this respect.

Questions for reflection

- Is your company an industry leader or follower?
- How can you enhance your relationships with industry trade organisations and NGOs?
- Will your company show true market leadership, get a grip on capacity and look forward, rather than playing continual catch-up?
- Have you identified new talent and are you investing in developing future leaders? Do you have a clear strategy for attracting top graduates?
- Are you investing in innovation and new sources of revenue, such as bioenergy and new uses of virgin and recovered wood and paper fibre?
- Are you actively promoting the carbon benefits of the industry's products?

¹ For more information on how the HR function may change in the future and how companies may be positioned, please see our thought leadership report: *Managing tomorrow's people - The future of work to 2020*. For further views on improving your company's performance around the people agenda, please see our report, *The people agenda: Optimising Performance at the Front Line*. Both reports are available for download at www.pwc.com/hrs



Concluding thoughts

The FPP industry is at the heart of many of the most important and intense debates taking place in both political and corporate circles, as well as within society at large – such as climate change, sustainable development, the future of the planet's forests and the most appropriate use of fibre resources. In addition to these global environmental and social concerns, the industry must contend with numerous business challenges, including shifts in the pattern of demand and fibre-sourcing; increasing competition from emerging markets; regional oversupply situations; cost pressures; currency fluctuations and the overall need for greater production discipline. The need for clear leadership is accentuating these challenges, as is the need to attract and retain talent of the highest calibre and vision to surmount them going forwards.

The industry has already had to cope with a considerable amount of change, but it remains quite traditional in certain respects. If it is to address the challenges it now faces, it will have to shed these traditions and become much more innovative. It will also have to develop a robust system for managing change. Many executives recognise the need to become more agile, as we noted earlier, but very few have undertaken a fundamental review of their business models or invested in training their people to handle major change.

A long-term view – informed by scenario-planning over time horizons of two, five and 10 years, or even more – is essential, as is a more proactive and strategic stance on sustainability. Quite apart from any regulatory moves, retailers and consumers around the globe will increasingly want to be sure that the products they purchase are not damaging the environment.

The industry has previously responded tactically to such concerns by focusing

on legal compliance and certification standards. This reactive approach may be enough to address single issues or immediate risks, but it is not sufficient to manage global risks. Collaboration – with other industries, governments, NGOs and trade bodies – will be critical in developing a strategic approach to problems the FPP sector cannot solve by itself.

FPP companies will also have to develop climate-change strategies and embed them in their values, cultures and processes; learn from best practice elsewhere; and provide detailed reports on their progress, using an increasingly consistent range of measures. And, given the interconnected, global nature of their supply chains, they will have to be vigilant in monitoring the progress of their suppliers as well.

Lastly, they will have to learn how to tap into new markets, such as biomass-based energy, fuels and chemicals production, without jeopardising future supplies of wood fibre. These new businesses have different value chains and markets, and demand different skills from those to which the FPP industry is accustomed. But for those companies that can make the transition, the rewards could be significant.

The major challenges facing the industry, when taken together, mean that its position within society is changing both rapidly and fundamentally. It can play a key role in helping us to operate within the limits of our ecological systems. But surmounting these obstacles will require a collective approach, not just a series of unrelated individual initiatives. It will also require leadership of the highest order. Today's senior executives will thus need to invest time and effort in identifying and attracting their successors. Only by attracting and retaining the best talent will they ensure that their companies can prosper tomorrow.

“I believe that the forest-based industry is the most environmentally-friendly sector. I am confident that society will increasingly realise the need for this adjustment and will provide support to the long-term growth of the forest-based industry...[I] believe that the forest-based industry is the industry of the future.”

Further reading

Publications from PricewaterhouseCoopers Forest, Paper & Packaging Industry practice are available to download from www.pwc.com/fpp

PricewaterhouseCoopers provides thoughtful analysis of the challenges and opportunities facing business leaders in the forest, paper and packaging industry. Our thought leadership publications help inform the strategic decisions guiding many of the industry's leading organisations.

Global forest, paper & packaging industry survey

Comprises an analysis of the financial results of the PwC Top 100 – the 100 largest forest, paper and paperbased packaging companies in the world, ranked by sales revenue.

As the industry's performance on sustainability issues is increasingly under the spotlight, the survey also includes an article reviewing the sustainability reporting practices of the PwC Top 100.

Branching out – Global deals activity in the forest, paper & packaging industry

Reviews the recent deals activity in the forestry, paper and fibre packaging sectors, examines the last twelve months' activity in detail, exploring the key drivers behind transactions in the industry, including the key role of non-traditional investors, in particular private equity.

The publication also focuses on deal activity by key regions, the success of deals and considers the future transactions outlook.

IFRS in FPP – Applying IFRS in the forest, paper & packaging industry

This publication and corresponding website (www.pwc.com/fpp/ifrs) contain our solutions so far to help our clients in understanding the implications of IFRS on the forest, paper & packaging industry.

Risks & rewards – Forest, paper & packaging in South America

Addresses the state of the industry in South America – a series of interesting growth markets for forest, paper and packaging products – and reflects on key considerations for potential investors. With the lowest wood costs of any leading producer region, South America looks set to become a dominant producer of market pulp globally.

The publication includes a major focus on Brazil as well as sections on other key South American markets – Argentina, Chile, Colombia & Uruguay.

Risks & rewards – Forest, paper & packaging in Russia

Addresses the state of the industry in Russia and reflects on the key considerations anyone thinking of investing in the sector there should make. Sets the scene on the background of the Russian marketplace, the regulatory environment and its “forest wars”; provides analysis sector by sector (forestry and logging; processed wood products; pulp, paper and paperboard; paper/non-paper packaging); and explores the risks and rewards of doing business in Russia.

Risks & rewards – Paper & packaging industry in China

Presents an overview of the impact of China on the paper and packaging sectors including an in-depth look at some key issues of particular importance to companies operating – or looking to invest – in the Chinese marketplace.

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