



MBIE SPOTLIGHT PAPER

Forest Economic Advisors LLC (“FEA”), a US-based forestry consulting company with offices in four countries, has been engaged by the Ministry of Business Innovation and Employment (“MBIE”) to provide an overview paper on the NZ forestry and forest products sector including a series of brief Spotlight Papers targeting a key theme. The theme of this Spotlight Paper is...

Forestry Innovation Investment – a case study for NZ government investment in market development.

1.0 Introduction

FEA has completed its overview paper to MBIE which examines key factors for consideration in attracting new investment to the sawmilling sector in New Zealand. One of the factors identified is a lack of credible, publicly-available, sawn timber market research and market intelligence to underpin the revenue assumptions in any business case looking for investment in sawmills. The overview paper did identify Forestry Innovation Investment in British Columbia, Canada as one example where the NZ government might find some interesting parallels. As such, it was agreed that this Spotlight would take a more in-depth look at the B.C. government-funded, Forestry Innovation Investment business model.

2.0 Background

British Columbia (B.C.) is the westernmost province in Canada bordering the Pacific Ocean. It has a long and proud history in the forestry and forest products industry. Key indicators comparing New Zealand and B.C. and their forestry sectors are shown in Table 1. Points of interest are:

- The two regions have a similar population and GDP.
- The B.C. government owns around 96% of the available forested land for timber harvesting compared to 4% in New Zealand owned collectively by central government, local government and state-owned enterprises. For the two regions, the public/private forest ownership ratios are extreme and identically opposite to each other.
- B.C. harvests just over twice the volume of timber as in New Zealand (65.7 million m³ versus 30.5 million m³ in 2016).
- B.C exports only 10% of its harvest compared to New Zealand at 57% for 2016.

Table 1. Key indicators comparing New Zealand with British Columbia

Indicator (as at 2016)	Unit	New Zealand	British Columbia
Population (indicative)	million people	4.693	4.648
Total Land Area	million hectares	26.8	94.5
GDP	US\$ billion	185	218
Total Forest Land	million hectares	9.5	55
Harvestable Forest Land	million hectares	1.7	23
> Government Owned	%	4%	96%
> Privately Owned	%	96%	4%
Area harvested	hectares	45,000	≈180,000
Roundwood removal	million m ³	30.5	65.7
Log exports	million m ³	17.4	6.3
Domestic processing	million m ³	13.1	59.4
Logs exports of total	%	57%	10%
Logs processed domestically of total	%	43%	90%
Forest Products Exports ⁽¹⁾	\$ billion FOB	5.1 NZ\$	13.7 C\$
> Logs	\$ billion FOB	2.5 NZ\$	0.8 C\$
> Manufactured Forest Products	\$ billion FOB	2.6 NZ\$	12.9 C\$
Employment - Forestry/Logging	total people	19,500	40,500
Employment - Manufacturing	total people	6,500	19,400
Employment - Total Sector	total people	26,000	59,900

Note (1): 1.00 C\$ is broadly equivalent to 1.10 NZ\$

Data sourced from:

- (1) "Facts & Figures 2016/17 New Zealand Plantation Forest Industry" published by NZ Forest Owners Association. Available at www.nzfoa.org.nz
- (2) "2016 Economic State of the B.C. Forest Sector" published by Ministry of Forests, Lands, Natural Research Operations and Rural Development. Available at www2.gov.bc.ca

In a nutshell, B.C. has a much greater value-add approach to its forestry industry. As a proxy, if we double the New Zealand data above to approximate the B.C. harvesting levels, the comparison would be (B.C values first, then New Zealand):

- Almost 50% greater export earnings across all forest products (NZ\$15.1 versus NZ\$10.2)
- Over Two and a half times more export earnings for just the manufactured forest products segment (NZ\$14.2 versus NZ\$5.2)
- An additional 6,400 jobs due to greater value-add manufacturing (19,400 versus 13,000).

Forest Product exports accounted for 34% of all B.C. exports in 2016. Note that manufactured forest products include sawn timber, other wood products (e.g. plywood, OSB), pulp and paper products.

3.0 Forestry Innovation Investment - www.bcfii.ca

3.1 Overview

Established in April 2003, Forestry Innovation Investment (FII) is the provincial agency charged with maintaining, creating and diversifying markets for B.C. forest products. FII works with the forest industry, provincial ministries, other levels of government and the research community to develop and diversify markets for the B.C. forest sector while promoting B.C. as a world-class supplier of environmentally friendly forest products.

The mandate of FII is to:

- Position British Columbia as a global supplier of world-class, environmentally friendly, forest products
- Actively maintain, create and diversify demand for B.C. forest products in Canada and in key world markets
- Help break down non-tariff trade and market barriers to ensure opportunities for B.C. forest products
- Work with the forest industry to promote B.C.'s forest products and forest management to the global marketplace
- Help ensure that the forest sector, through product development and strong international sales, continues to be a leading contributor to the B.C. economy

The Mission Statement of FII is to strengthen and grow the forest sector in British Columbia by working with industry, government and institutional partners to develop and diversify markets for the province's traditional and next generation forest products.

FII has organized its efforts under three programs:

1. Market Outreach—communicating the benefits of wood, and positioning B.C. as a global leader in the supply of environmentally friendly products from sustainably managed forests (delivered by FII on behalf of, and in consultation with, industry and government partners).
2. Wood First—advancing wood use and innovative wood construction technologies at home in B.C. (primarily delivered by third-party organizations with funding managed through an annual competitive Wood First Call for Proposals process).
3. Market Initiatives—developing and expanding markets for B.C. wood products internationally (delivered by third-party organizations in overseas markets with funding managed through an annual Market Initiatives Call for Proposals, as well as by FII in selected markets).

Each program has an Advisory Group with industry representation to provide recommendations on program priorities.

This Spotlight is concerned specifically with the third program – Market Initiatives – and how the work undertaken in this program could be replicated in some way in New Zealand to support business cases for increased investment in sawmilling.

3.2 Governance

FII is a B.C. Government Crown corporation governed by a Board of Directors that is accountable to the B.C. Ministry of Jobs, Trade and Technology. The Government appoints the Board to set operational policy for the organization and, in cooperation with senior management, to set strategic direction. In all cases, FII's activities and approach are aligned with the international and domestic market development objectives of both the Ministry of Jobs, Trade and Technology, and the Ministry of Forests, Lands, Natural Resource Operations and Rural Development (FLNRORD). The Board is chaired by the Deputy Minister of FLNRORD and vice chaired by the Deputy Minister of Advanced Education and Skills Training, ensures consistency with government strategic priorities.

The Board also monitors FII's performance based on the Province's planning and reporting principles. The Minister provides annual direction to the Board through issuing a mandate letter.

The Board is responsible for appointing the Chief Executive Officer and for overseeing FII's policies, priorities and strategies.

3.3 Funding

As a B.C. Government Crown corporation, FII receives its funding from the B.C. Ministry of Jobs, Trade and Technology. This funding is only ever guaranteed for one year in advance but FII does operate under a rolling three-year plan in anticipation of these funds being ongoing.

The 2018/19 Budget shows total revenues of **C\$22.8 million dollars**. This is made up of the following components:

- C\$19.6 million (≈86%) from the Province of B.C.
- C\$ 0.6 million (≈ 3%) from the Federal Government
- C\$ 2.6 million (≈11%) from Other Revenue e.g. industry and other contributions

Approximately **60%** of these funds (≈**C\$13.7 million**) are used for the Market Initiatives program including:

- sharing the cost of industry-led market initiatives (through a C\$6.5 million Call for Proposals funding round resulting in tremendous leverage – see below)
- direct management of FII market development offices in China (C\$2.3 million) and India (C\$4.3 million) as well as other pre-commercial activities run directly by FII where risk is too great for industry

3.4 Market Initiatives Program

A central objective of the FII suite of programs is to identify and pursue opportunities outside the province that generate demand for B.C. forest products, further diversifying and strengthening the B.C. economy. To accomplish this objective, FII is mandated to conduct research and deliver and/or facilitate market development activities that help the forest industry capitalize on high-potential market opportunities.

The Market Initiatives program encourages the development of export markets and new market segments. Expanding B.C.'s trade relationships to fast growing markets in Asia helps to diversify the sector, open up new opportunities and sustains forest sector employment. Recognizing the long-standing importance of the North American market, FII is also prepared to invest in high-potential market segments to grow demand for B.C. wood products closer to home. FII works collaboratively with the forest industry, the federal government and the research community, focusing activities and leveraging resources to maximize results. Market Initiatives focuses on:

- Researching opportunities in emerging and potential future markets, and initiating early market development activities
- Supporting industry trade associations in developing and/or expanding markets and market segments for B.C. forest products
- Supporting industry efforts to mitigate market access and plant health issues.

Typically, FII uses a small portion of its Market Initiatives budget to lead market research efforts to evaluate high-potential emerging opportunities for the sector. In this pre-commercial phase, FII may also initiate early market development activities where opportunities to introduce B.C. forest products in a region or market segment look particularly promising. While pre-commercial work is often led by FII, efforts are generally undertaken in conjunction with the federal government and with the engagement and support of the forest industry. When interest and commercial demand has begun to develop and entry risk has been reduced, FII looks to industry and related trade associations to play a more active role in leading market development efforts.

The best examples of such pre-commercial activity currently are two FII subsidiary operations to provide direct support and promotion for the B.C. forest products industry. *FII China* was established in 2003 and works closely with the Canada Wood Group offices in Shanghai and Beijing, China. *FII India* was established in 2012 and includes staff of the Canada Wood Group; it is co-located with staff of the Ministry of Jobs, Trade and Technology.

A Market Priorities Committee of senior industry representatives provides FII with external guidance and advice with respect to establishing priorities for market development programming. Activities under the Market Initiatives program are primarily delivered by third-party organizations on behalf of the industry-government collaborative. Available funding under the program is managed through an annual Call for Proposals process.

A number of Guiding Principles for Investments are noted on the FII website. Two of particular importance are:

- **Fact-based market strategies:** Priorities and strategies must be firmly rooted in current, relevant and comprehensive market information that provides a compelling business case for each market initiative.
- **Generating measured results:** Activities and investments should generate a positive return for the Province of B.C. As a result, FII will continue to give a priority to projects that will generate a financial return well exceeding the initial investment made to support the initiative. Projects must have well-developed performance measures, detail how the project's results and outcomes are measured, and explain how they relate to overall performance objectives.

3.4.1 Call for Proposals

In 2018/19, FII made available C\$6.5 million through the Market Initiatives Call for Proposals process. For 2019/20, FII anticipates investing a similar amount through the Call for Proposals to support activities proposed and delivered by industry and other eligible applicants. The focus of this funding is on priority markets (see Table 2) identified through FII's comprehensive research and market development strategies. A summary of these priorities is available in documents of their website. As examples, it is noted:

- In China, the primary focus is on advancing wood use in construction, with a parallel objective of increasing the unit value of construction lumber imports
- In India, the market development program has identified the domestic manufacturing sector as the priority by positioning Canadian softwood as an alternate to tropical and domestic hardwood for the manufacturing of doors, door frames, windows, architectural millwork and furniture for both domestic and export markets.

Table 2. FII funding allocations by region for their Call for Proposals program

Market	Allocation (in \$ Millions)
China	2.3
USA	1.8
Japan	1.2
South Korea	0.5
India	0.3
Canada (excl. B.C.)	0.1
All/Other Markets	0.3
Totals	6.5

Source: Documents on FII website at www.bcfii.ca

Funded projects delivered by industry and covered by this Call for Proposals include:

- International marketing and promotion
- Market access and phytosanitary issues
- Codes and standards development

Organizations eligible to apply for funding are:

- Groups or associations representing multi-company interests and serving the objectives of a large geographic area, or the majority of producers of a specific species or product category
- Academic institutions
- Forest research institutions
- First Nations regional tribal councils
- B.C. Government Ministries

FII does not provide business loans or small business grants. Individual businesses are not eligible to receive FII funding. Funding is to result in benefits that can be accrued to, or be accessible to, multi-company interests and other industry stakeholders, and not be limited to the proprietary interests of any one organization/company.

FII's Market Initiatives Program is built on the premise of partnerships and industry cost-sharing contributions. Industry cost-sharing is based on cash contributions to the projects in the proposal and is outlined in detail in the proposal budget(s). In-kind contributions will not be recognized in cost-sharing calculations although in-kind contributions over and above the base cost sharing requirement can and should be used to demonstrate additional industry/other support for a project and this will positively affect the evaluation. For 2019/20, the minimum cost-sharing requirements.

- Maximum FII contribution is 34%
- Minimum contribution by funding recipient is 33%

This cost-share rule assumes that one or more third parties, such as the Government of Canada, will contribute 33% of eligible costs. If that is not the case in respect of a given eligible activity, FII would, subject to available funds, match industry's contribution.

In general, projects are being funded with federal government support which means tremendous leverage of FII's C\$6.5 million to up around **C\$20 million** of market development activity under this Call for Proposals process. FII has integrated the funding process with their federal counterparts and although the two programs operate separately for the federal and B.C. governments, they have:

- Joint funding application process - same application for both FII and federal government
- Joint reporting back to both of us on progress – same reports work for both funders
- Joint audits and reviews – one audit process instead of two
- Joint review of funding proposals (selection process). Actual decisions are made separately, but the two parties work collaboratively to align decisions so applicants get funded for the same things

Proponents for FII funding are required to submit their proposals through a web-based online system, www.woodmarketdevelopment.ca. On entering the site new users can request an account. FII will respond to all account requests within 2 business days. Once FII assesses whether the proponent meets the eligibility criteria a User ID and Password will be emailed to the address provided in the account request. This will enable the proponent to access the system. **All subsequent information regarding the Call for Proposals will be directed only to those proponents who have a User ID and Password.** Subsequent information will be distributed by e-mail, to the e-mail address provided by proponents. The online application system has been designed to help proponents provide FII with the requisite information needed for the review, evaluation, and project funding process. The system is intended to help proponents establish a solid basis for planning and enable efficient and effective monitoring and reporting over the course of the project. Proponents must complete all steps of the online application process before submitting proposals to FII. A comprehensive user guide on how to submit and manage proposals in the online funding management system can be downloaded from FII's website. Applications are generally open for a six-week period from the beginning of November until mid-December with delivery starting in April of the following year.

Proposals that meet all mandatory criteria will be assessed against the evaluation criteria by an evaluation panel comprised of representatives from the funding organizations and independent experts. This evaluation panel is not the same as the Advisory Committee (which provides advice on strategic direction of the program). Evaluators are paid their hourly fee (often consultants with industry experience). There is generally a week of prereading and preparation plus a couple of days with the review and evaluation phase. All members of the evaluation panel are "hand-picked" and are subject to conflict of interest guidelines. They cannot be involved in delivery of any of the projects seeking funds, nor on the boards or funders or directly connected with them in anyway.

3.4.2 Major Outcome Sought and KPIs

FII has been operating for 15 years now. The current CEO has advised that the main goal in establishing FII was to diversify markets away from the US¹. The data shows that:

- In 2002, the US was taking 64% of all B.C. lumber exports (C\$9.2 billion of C\$14.4 billion)
- Other key markets in 2002 were Japan (16%) and China (4%)
- In 2017, the US was taking 49% of all B.C. forest products (C\$6.9 billion of C\$14.2 billion)
- Other key markets in 2017 were China (27%) and Japan (9%).

In that intervening 15-year period, a total of C\$2.3 billion in B.C. forest exports was moved from the US market primarily to the Chinese market. It is impossible to know how much of this growth into China would have happened anyway, regardless of the market development efforts of FII over that 15-year time horizon.

FII do have other internal KPIs that are not shared publicly. Their Service Plan document² does outline a number of KPIs with well quantified and measurable targets for their various Goals and Objectives. Three examples are shown below:

Performance Measure	2016/17 Actual	2017/18 Forecast	2018/19 Target	2019/20 Target	2020/21 Target
2.1 Average value (CAD) per cubic metre generated by softwood lumber sales to China ¹	174	196	200	204	208

Performance Measure	2016/17 Actual	2017/18 Forecast	2018/19 Target	2019/20 Target	2020/21 Target
2.2 Total number of product trials of B.C. species undertaken in India ¹	15	18	24	26	30

Performance Measure	2016/17 Actual	2017/18 Forecast	2018/19 Target	2019/20 Target	2020/21 Target
4.1 Other organizations' aggregate contribution to recipient funding program ¹	69%	72%	65%	65%	65%

¹ Personal comment from Michael Loseth, CEO of FII

² FII 2018/19 – 2020/21 Service Plan. February 2018. See www.bcbudget.gov.bc.ca/2018/sp/pdf/agency/fii.pdf

4.0 Summary

The FII Market Initiatives program with external leveraged funding is delivering around C\$27 million annually (almost NZ\$30 million annually). This is made up of “Call for Proposals” projects (C\$20 million – delivered by funded applicants), and support of offices in China and India plus other precommercial activities (\$7 million – delivered directly by FII). The focus is on diversification into new markets as only 10% of B.C.’s harvest is exported as logs.

The goals of any related program in New Zealand would be more focussed on developing new markets to underpin sawmill investment to convert export logs into value-add sawn timber and secondary products like pulp/paper and fibreboard. Nonetheless, the market activities required in terms of research, intelligence and competitor analysis would be similar to the activities carried out by FII and this business model may offer some insight for anything the NZ government may want to consider.

One key difference is that the B.C. Government owns the forests so has a more direct interest in ensuring they extract maximum value from their resource. Nonetheless, an expanded wood processing sector in New Zealand still has benefits for the government in terms of expanded tax take (more value-add processing) and regional economic development (more jobs).

A further major contributing factor surrounding timber processing and value-add manufacturing in B.C. is the historic and ongoing restrictions on log exports enshrined in its Forest Act. This is discussed in more detail in a separate Spotlight paper produced by FEA for MBIE.³ It was noted in this paper that many B.C. sawmills would be non-competitive (as of 2017/Q2) and would be forced to close if they were required to pay export parity pricing as their counterpart sawmills must do in New Zealand. The irony is that, even with this effective subsidy on log prices to make these sawmills globally competitive on a production cost basis, the B.C. government is still funding around C\$20 million for generic market development work to diversify the export markets for sawn timber and other wood products.

³ Spotlight #2 “The impact of B.C. Government log export restrictions on the B.C Sawmilling Industry” July 2018