



FOREST
TRENDS



Natural Tropical Forests

Opportunities and Constraints to Investment

Michael Jenkins, Forest Trends

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- **Objective:** Assist ITTO countries to attract investment for enterprises based on sustainable forest management
 - Description of industry based in tropical natural forests
 - Global trends affecting investment in these areas
 - Types of investment and investors
 - Factors influencing investment
 - Experience of SFM funds in 1990s
 - Risk management & investment promotion



Size of the Sector

- Forest products industry: ~3% of world trade
- Value of international trade in wood products US\$150 billion (2003)
- Gross value of sales of paper and pulp alone US\$900 billion (2000)
- Up to 13-15% of national GDP (Gabon, Cameroon)
 - Even more regionally: US\$4 billion exports in Sabah and Sarawak (30% of total gov't revenues)
- Expecting growth in demand, especially developing countries which grew 3.2% per year '61 – '97

Diversity of the Sector



- Informal individuals, micro, small and medium-sized enterprise (SMFEs) to larger-scale operations
 - Locally based vs. multi-national companies
 - Harvesting to processing to trade-related enterprises
- > *All have the potential to invest productively, create jobs and expand – contributing to economic growth and poverty reduction*
- > *All with different investment needs*



Diversity of Investors

Public and private investors

Domestic and international investors

Equity & debt financing

Pension funds and TIMOs

Socially-responsible investors

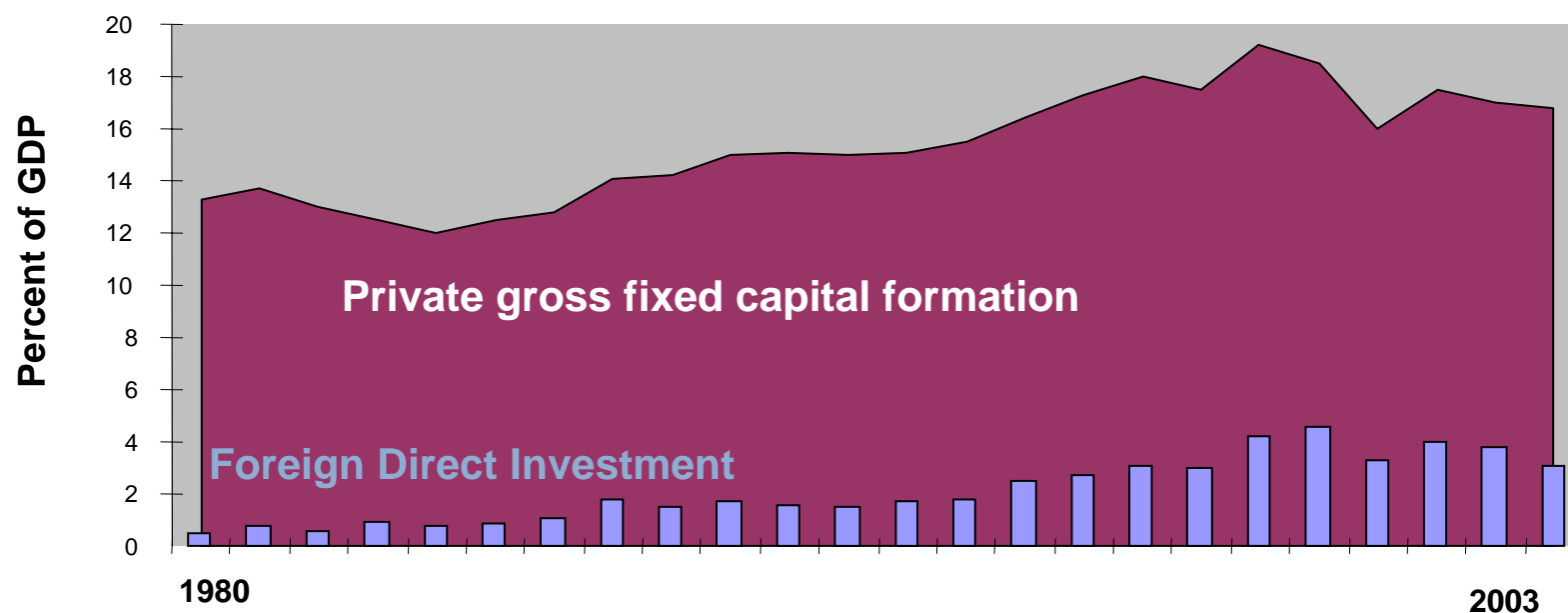
Commercial banks (lenders)

Private equity investors

Venture capitalists

Current Investment Flows

- Globally, domestic investment much larger than foreign direct investment (FDI)
- While there is a huge amount of FDI in emerging countries, very little makes it to the forest sector





Trends: Opportunity

- Global economy is US\$55 trillion and expected to triple in the next 20-30 years
- US\$2.16 billion in professionally managed portfolios with some type of mandate for socially responsible investment in the US alone.
- ***Challenge:*** *to integrate sustainable forest operations into the capital markets and access mainstream private capital*



Opportunity

- Growing appetite for forest investment by innovators
 - Harvard Investment (US\$2 billion in emerging markets)
 - New investment funds (e.g. GEF, SFM2)
- Growing awareness of commercial banks to stop financing illegal operations and work only with sustainable forest operations
 - HSBC, ABN AMRO, Citigroup, JP MorganChase

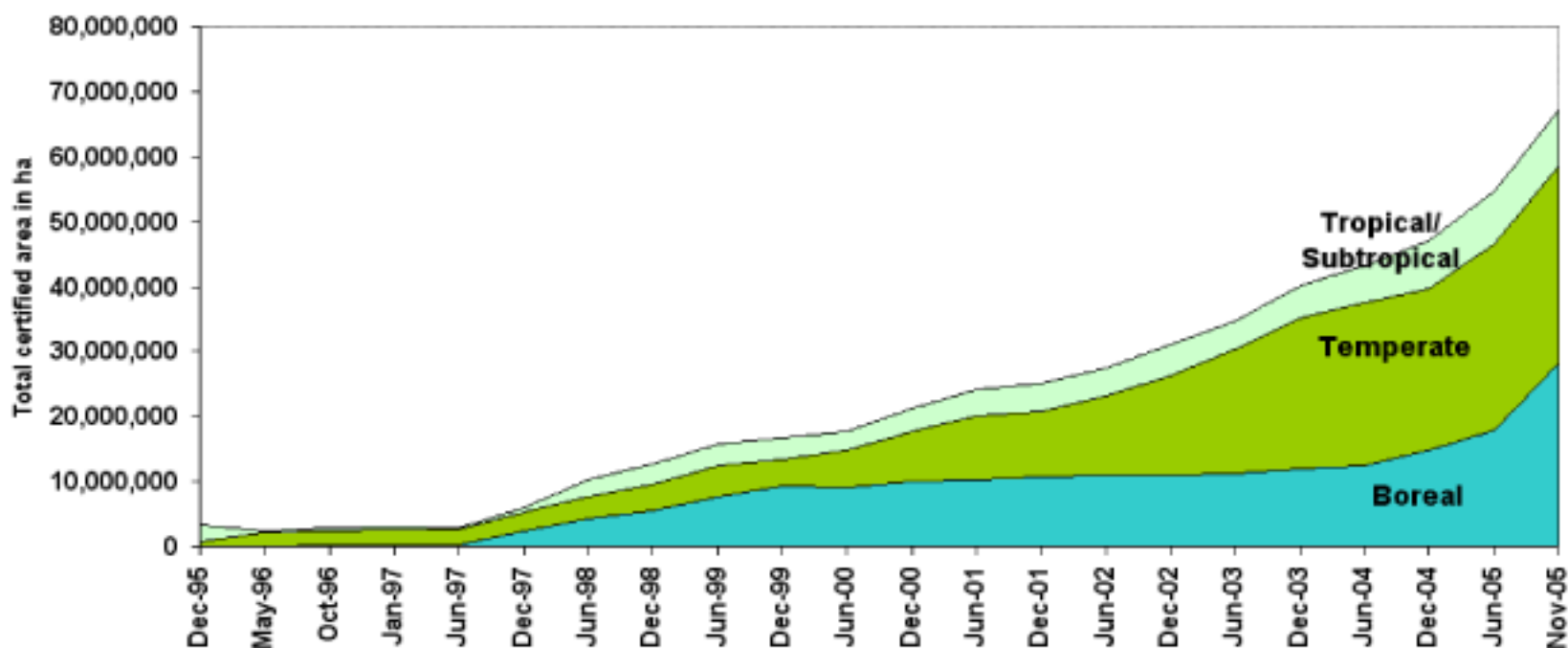




Opportunity

- Growing number of certified forest operations
 - 74 million hectare certified by April 2006 in 72 countries

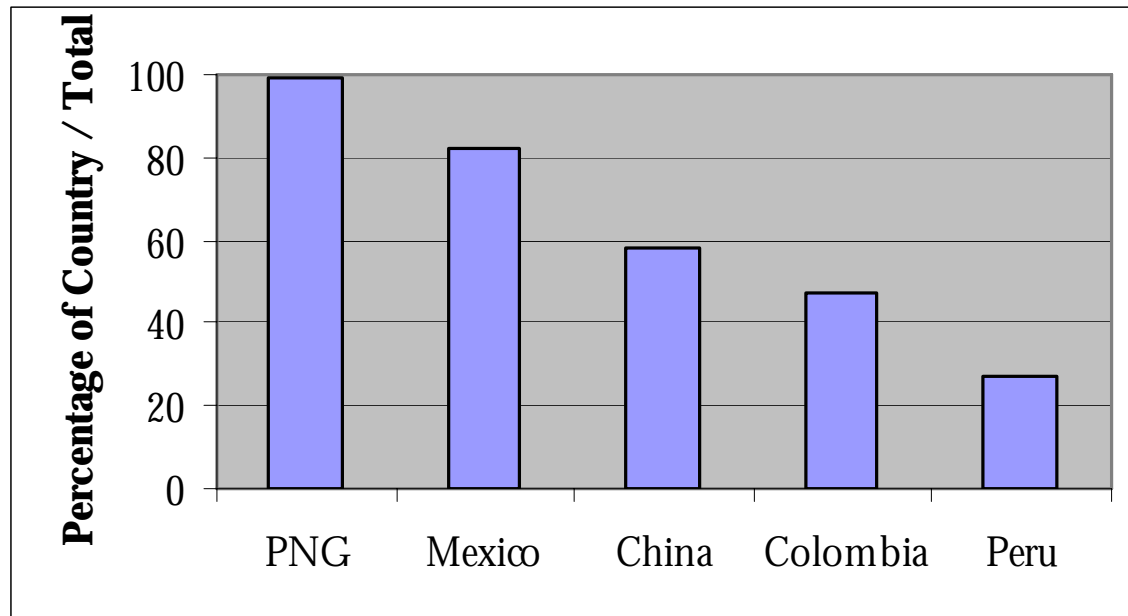
Rate of Increase of FSC Endorsed Forest Over Time
(Dec '95 - Nov '05)



- Public procurement policies for verified legal / certified sustainable wood products is boosting demand and premiums
 - UK, Japan, other EU countries
- Technical assistance available for log tracking & certification systems
 - EU FLEGT VPAs,
 - WWF's GFTN, TFT
- Increased capacity of SMFEs to access certified markets



- Property rights / secure land tenure a historical problem but getting better
 - If property rights are insecure, equity investors require higher returns to compensate
 - entrepreneurs with secure property rights reinvest 14-40% more of their profits than those that do not



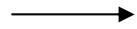
Indigenous and other rural communities now own or control a quarter of all natural forests in tropical developing countries



Opportunity

Services

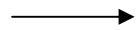
Trees



Revenue

Certified Timber
Botanicals
Wastewood Utilisation

Carbon



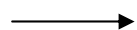
Carbon Credits –
Reforestation/Afforestation
Biofuels
Conservation Carbon

Biodiversity



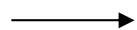
Pharmaceuticals/
Natural Medicine Personal
Care/ Cosmetics

Conservation



Eco-tourism
Biodiversity Credits &
Offsets

Watershed
Conservation &
Restoration

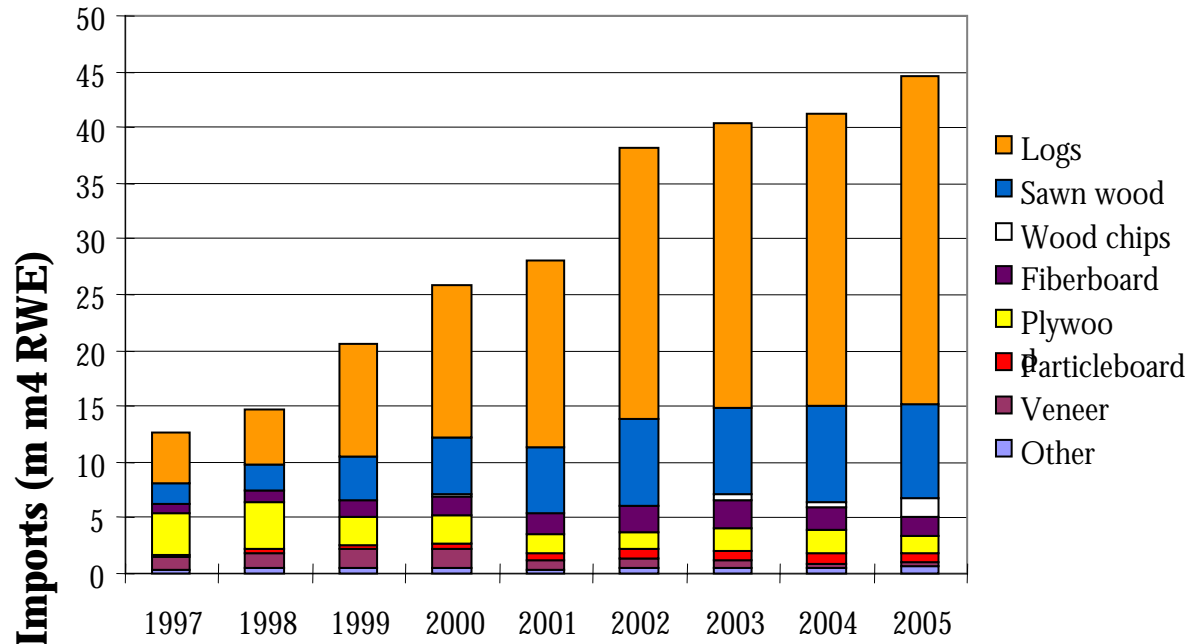


User Fees
Mitigation
Salinity Credits

- Emerging markets for ecosystem services and NTFPs
- *More streams of revenues than just timber accruing to land owners and managers*

Opportunity or Challenge?

- China as a Major Market or Major Competitor
 - Chinese sawnwood imports increased 600% in 7 years
 - Imports of processed wood products decreased
 - 80% of all new investment in pulp & paper has been in China recently
 - Chinese products major competitor in European & American markets (1000% increase in 7 years)





Challenge: Country-Level Investment Risk

- Many investors will stay away from forest operations in natural forests *regardless of the quality of the forest investment opportunity* because of general poor investment climate in country as a whole

CalPERS list of “permissible countries”

Economist Intelligence Unit’s Country Risk Service indices

Euromoney’s Country Credit Ratings



Challenge: Country-Level Investment Risk

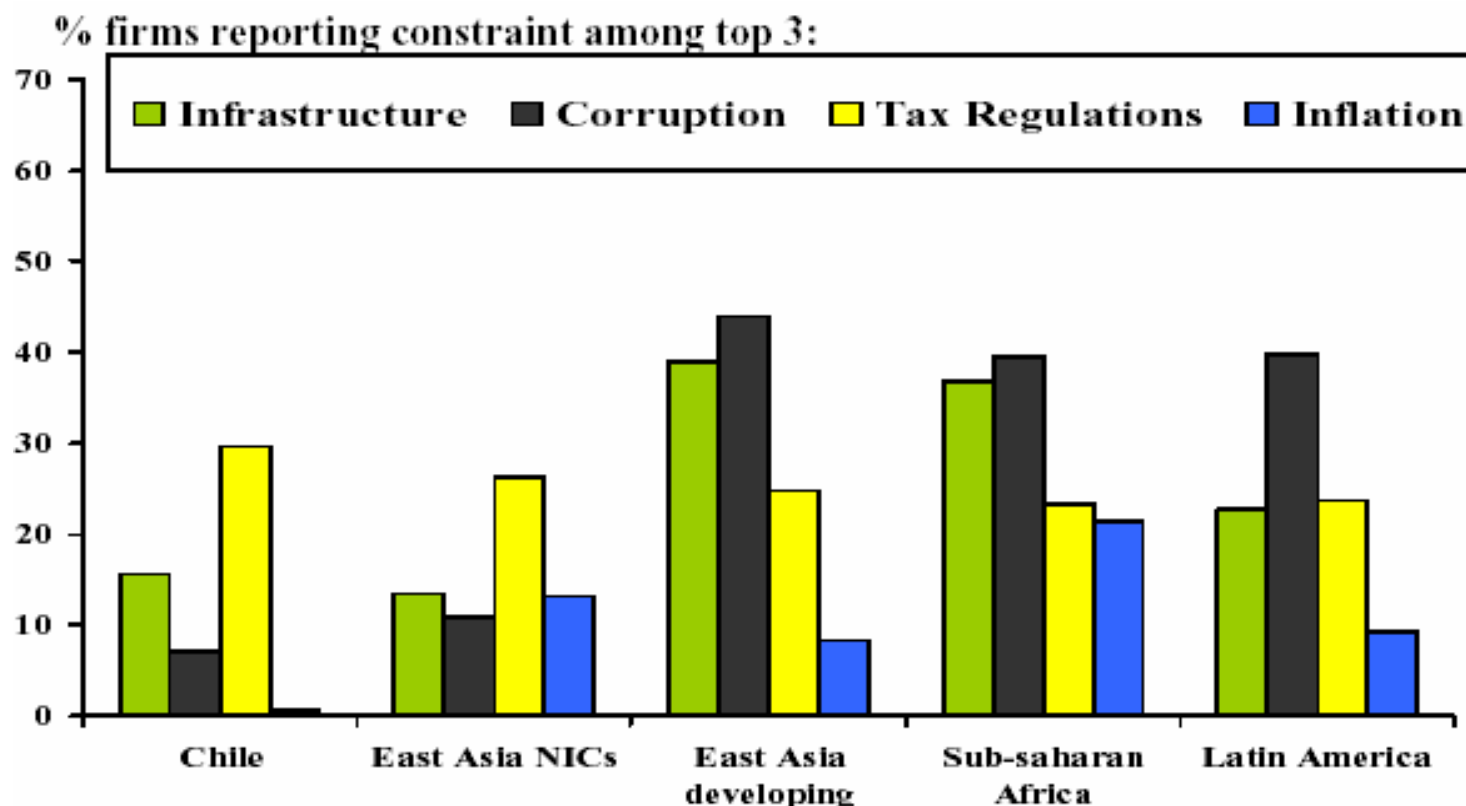
- Only one ITTO producer country (Malaysia) ranks in the top 25% of Transparency International Corruption Perception Index (CPI)
 - CPI indicators important indicators: widely used by international investors during their decision-making processes.

Percentile of All Countries	CPI Scores: ITTO Producer Countries
Top 25%	1
2nd Quartile	10
3rd Quartile	3
Bottom 25%	16



Challenge: Country-Level Investment Risk

- Firms often rank corruption as bigger problem than poor infrastructure, tax regulation and inflation





Challenge: Enterprise Level

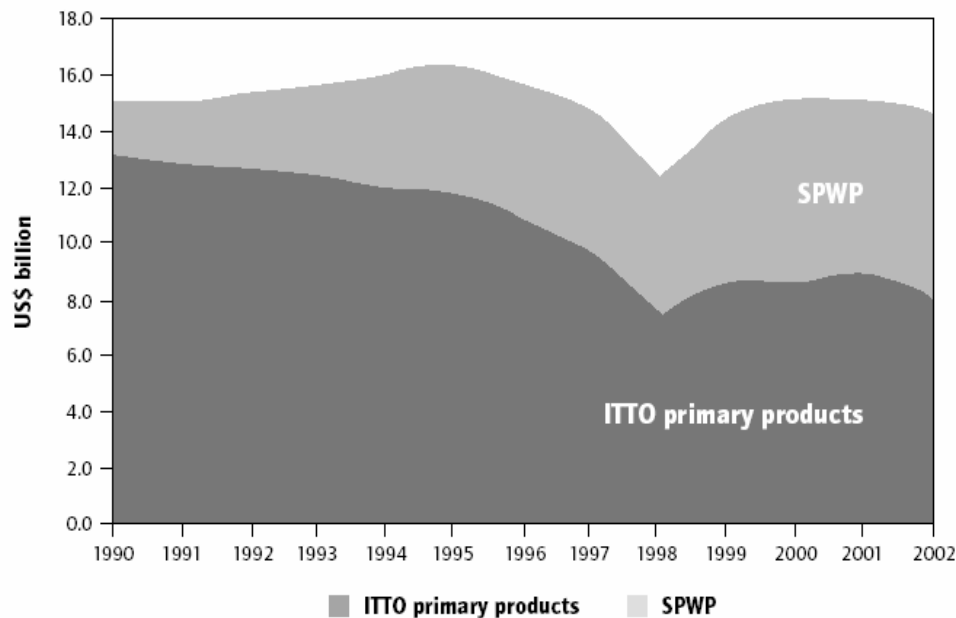
Lack of skilled labor in many emerging markets:

- Export-oriented production requires language and marketing skills
- Ability to access payments for ecosystem services requires special training



Plantations dominate investments

- Fostered by direct subsidies (\$35b '94-'98) and indirect benefits (tax breaks)
- Negatively affecting demand and prices for natural wood products



Export value of primary products from natural forests in ITTO producer countries has declined 40% since 1990



Challenge: Illegal Logging

- Illegal logging depresses world prices for timber products by 7- 16% (AF&PA)
- Creates an unequal playing field for legal operators
- Illegal logging creates reputational risk for forest industry and country as a whole





Recommendations

1. More attention to supporting the growth of small and medium sized enterprises:

Critical role that SMFEs can play in meeting the Millenium Developmetn Goals, economic development, employment and poverty reduction

Development agencies and governments better address barriers to growth for SMFEs. Intermediaries such as WWF's GFTN or Forest Trends' Business Development Fund could help identify where such programs might work.



Recommendations

2. No substitute for good governance in fostering a positive business investment climate

Governmental policies and behaviors need to eliminate uncertainty, risk, and unjustified barriers to competition and ensure their policy interventions are crafted to fit local conditions.

- *Governments need to tackle corruption to build credibility with firms, to foster public trust and legitimacy*
- *Governments and industry can engage in regional Forest Law Enforcement and Governance (FLEG) Ministerial processes to show their support for efforts to combat illegal logging*



Recommendations

3. Investment and risk guarantee mechanisms which work in developed countries need to be adapted to the tropical natural forest context.

- Investment mechanisms in use in developed countries today, such as TIMOs, are not useful in the tropical natural forest-based industry due to long-term country risk.
- *MIGA, Export Credit Agencies (ECAs), the IDB and the World Bank could create funds or concessional financing or help to reduce insurance premia for sustainable forest operations, in recognition of the role that responsible private investment can play in economic and social development*



Recommendations

4. Skilled worker and labor markets are needed

- *Governments can foster a skilled workforce through basic education programs, consider labor market interventions that promote higher skills, and help workers cope with change.*
- *International firms can invest in local workers rather than importing workers.*
- *NGOs and others will continue to provide technical assistance*



Recommendations

5. Support Positive New Markets

- *Markets for legal and sustainable wood products*
 - *Support the development of in-country certification schemes that link to international markets*
 - *Support responsible wood procurement policies*
- *Markets for ecosystem services*
 - *ITTO producer countries can engage in Kyoto negotiations to expand the CDM*
 - *Support the new Rainforest Coalition objectives now being led by Papua New Guinea*
 - *Put into place regulatory structures in-country supporting new markets for biodiversity offsets and watershed protection*



For More Information:

Forest Trends

www.forest-trends.org

Ecosystem Marketplace

www.ecosystemmarketplace.com