Forest Stewardship Council Certification in Mexico: Creating Markets for Certified Wood Products

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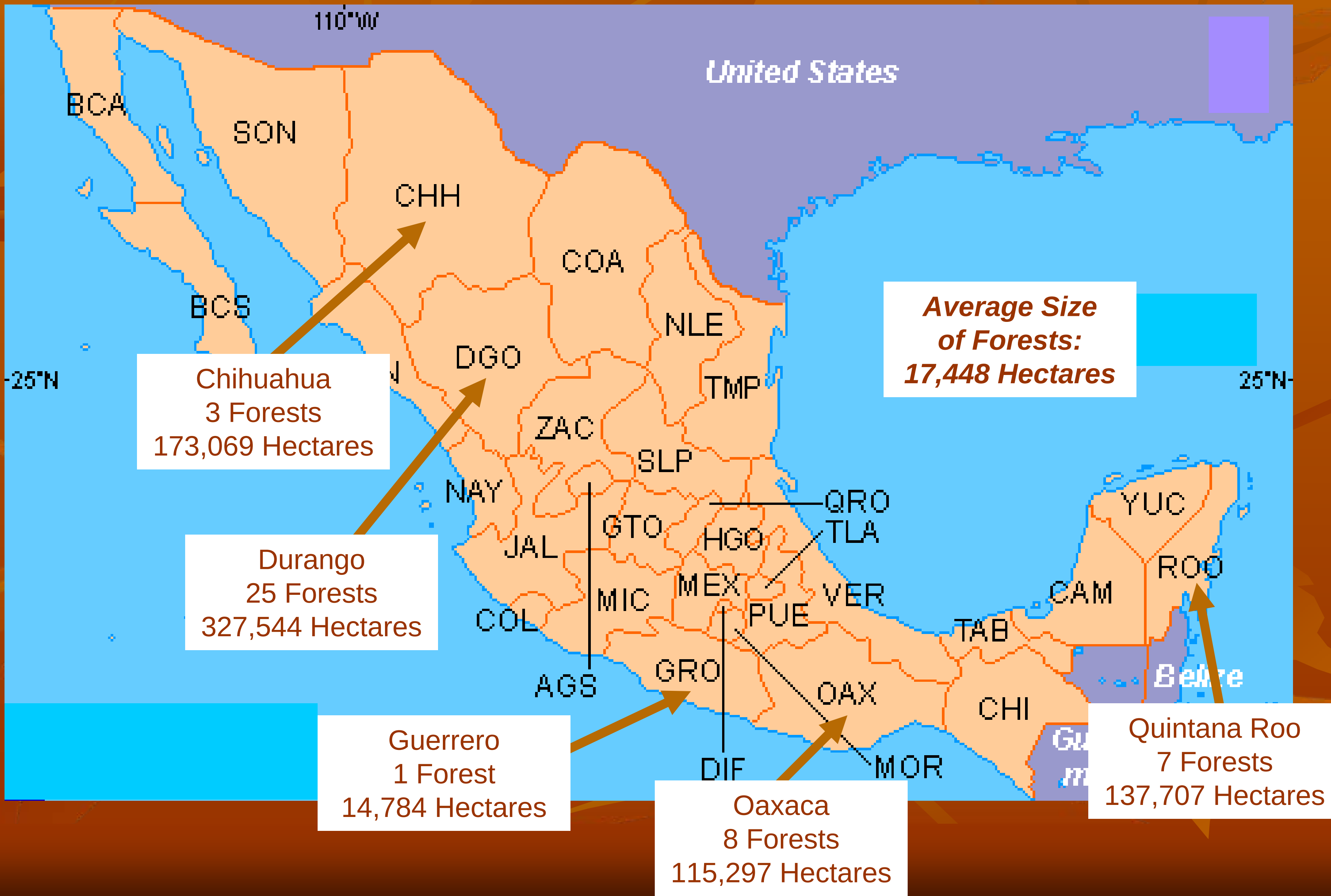
Locations of Certified Forests



The Essence of the Problem

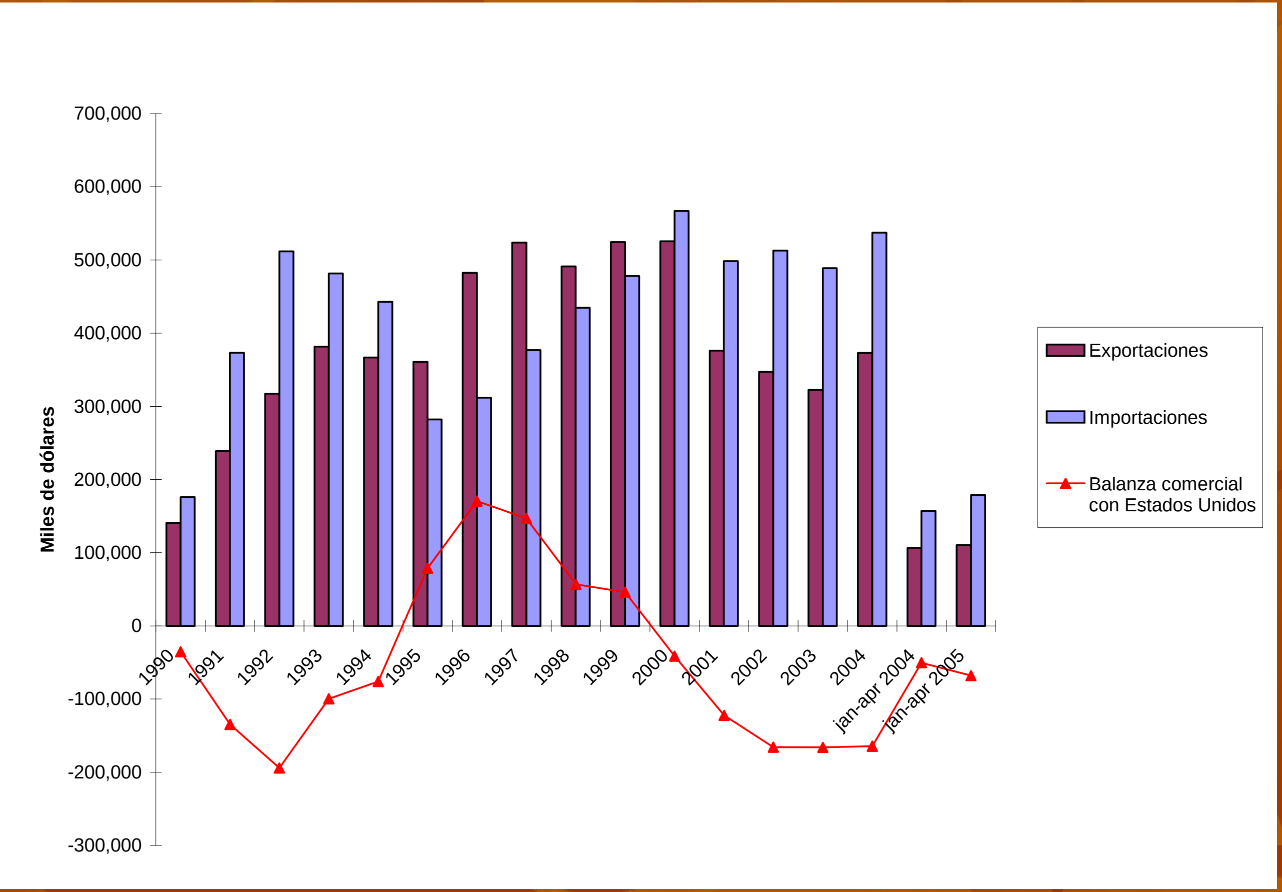
- Since 1995, the Rainforest Alliance has been certifying forests and associated mills
  - Standard: Forest Stewardship Council (FSC)
  - As of early 2007, 44 forests representing 788,000 hectares are certified
- Certification was "sold" as a method to obtain a price premium for wood products
- Except in a few instances, this premium has been illusory
- Because certification creates ongoing costs, the situation is putting pressure on certified operations

Our Mission

- To acquire information about the supply chain for Mexican wood products
  - Assess practices at mills
  - Analyze the flow of production
  - Gain greater appreciation of Mexican consumers
- To propose alternatives for policy-makers

Some Market Fundamentals

- Demand for wood is climbing, but much of this new demand is being met by foreign imports



- Conditions in Mexico are becoming more price competitive

Ejidos and Communities

- Roughly 80% of total forest surface area in Mexico
- Land held as "social property"
- A strong social component underlies decision-making
- Wood from these forests uniformly praised for its quality
- Some instances of significant modernization

Ixtlán de Juárez

Elevation: 1,700 meters

Population: 2000

Communidad Ixtlán de Juárez - Old Mill

Communidad Ixtlán de Juárez - Old Mill

Communidad Ixtlán de Juárez - New Mill

The Mark of Certification

Problems at Ejidos and Communities

- Many organizations are “undermanaged”
  - Few professional managers
  - Little training in business essentials (e.g., accounting)
  - Not inherently entrepreneurial
- Many are chronically short of cash flow
- Some mill practices are below industry best practice
  - Grading of wood is inconsistent
  - Storage practices destroy value

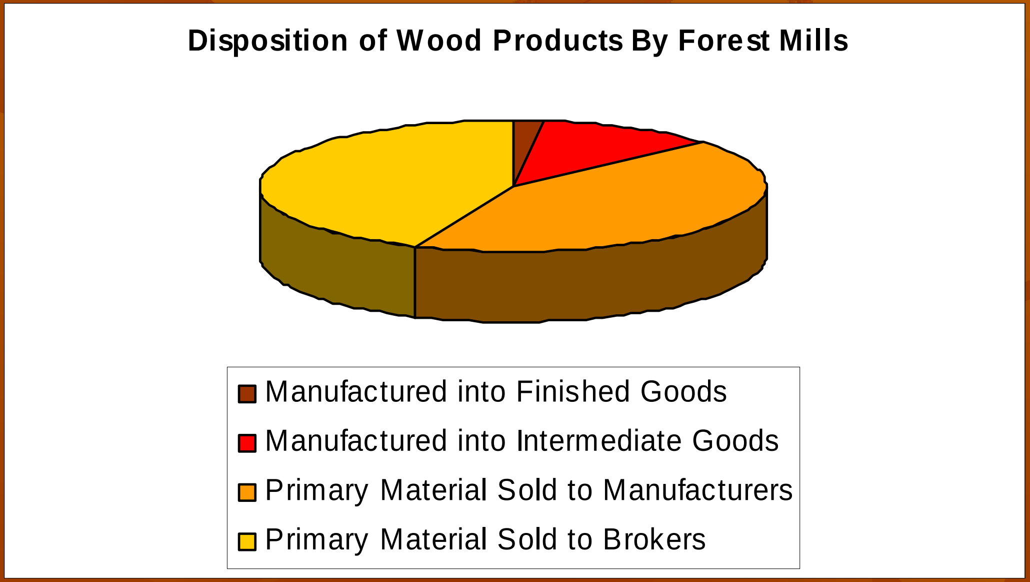
- Freshly-sawn lumber is left in the sun for many days, destroying value

Production Flow Study: Ejidos and Communities

- Based on survey of 17 certified forest mills
- The sample is reasonably representative of the population of all 44 ejidos and communities
- The mills we surveyed are small, averaging about 130 employees and a harvest of 33,000 cubic meters
- As far as we can tell, not even 1% of mill output is exported

Production Flow Study: Ejidos and Communities

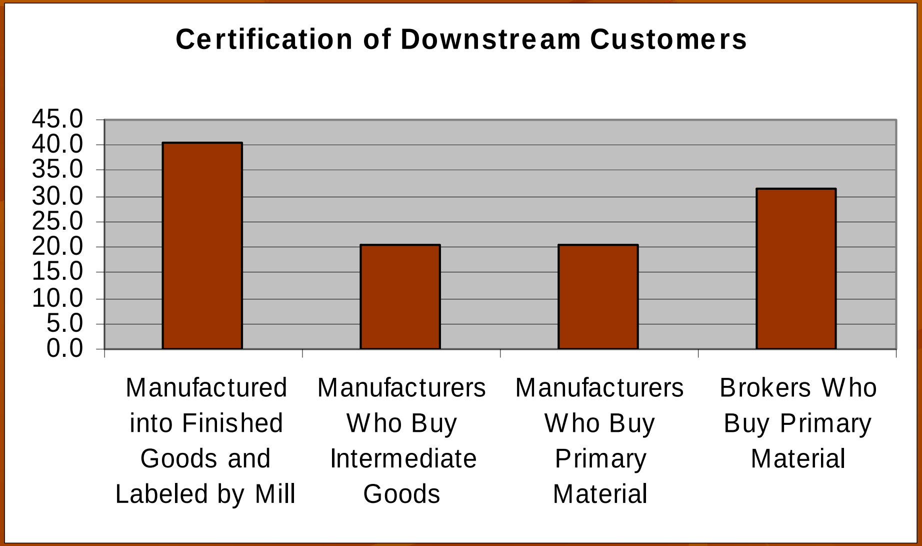
- 86% of wood is sold as primary materials
- There is very little vertical integration on the part of the mills
- An exception: Forestal Alfa in Durango



- Only 2% of the top grade of wood is manufactured into finished goods

Production Flow Study: Ejidos and Communities

- There is strong evidence that wood is intermingled with non-certified wood in the majority of cases

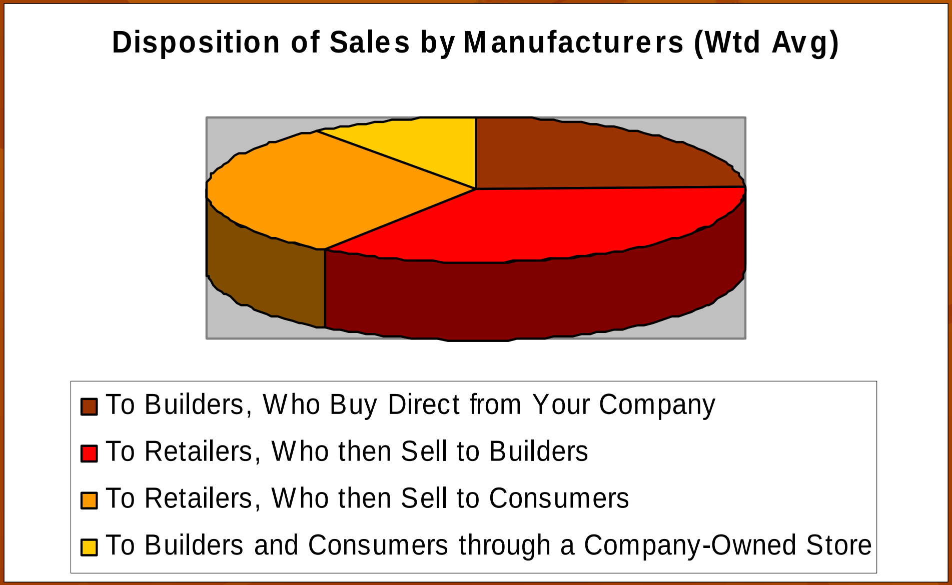


- In no category are more than 40% of downstream customers certified

- Taking into account the volume of wood sold to each customer type, we estimate that *only 25-35% of wood is sold to FSC-certified customers*

Production Flow Study: Manufacturers

- The average amount of certified wood as a percentage of inputs is roughly 30%
- 66% of sales are through retailers
- Only two of the manufacturers label their products as FSC-certified



Production Flow Study: Retailers and Consumers

- A survey of 25 Mexican furniture retailers was conducted by telephone

- In another analysis, we conducted a conjoint analysis and estimated willingness to pay for furniture made from certified wood.

Production Flow Study: Retailers

- Awareness of certification among retailers is under 40%
- Although 21 of 25 retailers would like to sell furniture made with certified wood, only 7 thought they could obtain any price premium for the product
- For unknown reasons, retailers expresses skepticism about the quality of certified wood
- A key: Authenticity, complete with documentation

Toward Policy Options

- So far, markets have not evolved to promote certified wood products
- Partly, this is due to the fact that certified wood is largely identical to non-certified wood
  - Unlike organic lettuce, the green option for wood does not provide private benefits
- Our report discusses seven options for policy-makers, and we highlight three of them here
- These are not exclusive options—several could be implemented and work together well

Policy Option: Work With Large Purchasers

- Advantages
  - Offers potential for large, steady market for certified products with companies like IKEA and Home Depot
  - Can create pressure for market discipline in mills
  - Could lead to sales of value-added products in the future

- Disadvantages
  - Pilot project between Pueblo Nuevo and IKEA was terminated
  - Puts lots of trust in a small number of powerful buyers
  - Terms offered by buyers may be unfair to mills
  - Price premium may be difficult to obtain

Policy Option: Take Steps to Promote Exports

- Advantages
  - Connects with markets in U.S. and Europe where knowledgeable and high-income consumers demand certified wood products
  - Only limited government involvement needed
  - Not disruptive to mill operations
- Disadvantages
  - Certified forests and mills have virtually no experience with exports
  - Will require a new type of broker that can carefully and certifiably segregate certified lumber from other products
  - Ensuring that any price premium is shared with mills

Policy Option: New Centralized Manufacturing

- Advantages
  - Professional management is possible
  - Can replace sales to brokers and be less disruptive to mills
  - Facilitates “Chain of Custody” certification
  - Enjoys scale economies that can promote exports

- Disadvantages
  - How will it be financed?
  - Possible downstream competition with manufactured goods still made by mills
  - Possibly threatening to social mission of ejidos and communities

What is “True North?”

Are we selling to customers
that value environmental certification?