# RECOGNIZING TRANSFORMATIONAL CHANGE BEFORE IT RESHAPES THE FOREST SECTOR

*An introduction to strategic risk management*

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**An entire industry can be quietly transformed while everyone in it is looking the other way – and the wood products sector has already lived through it more than once. Strategic risk is what we call this: the risk that, over time, different forces in our environment combine to remake our sector, and we get left behind because we didn't see change coming, or failed to adapt once we did. It's already reshaped the pulp and paper business and BC's lumber industry – and the ground is still shifting. That makes this a good time to get familiar with both the concept and the practical work of managing it.**

A lot of the risks we deal with are quite easy to grasp. Something can happen and directly affect performance. Think of a rail strike that affects our logistics. A situation can arise and eventually affect costs and demand. The Iran War is a good example. With these more discrete, event-like risks, if I keep an eye on a risk's drivers, I can get a reasonable sense of how likely the risk is, what it could do, and hence when and how I should start doing something about it. There's plenty of room for misjudgements and for misinterpreting signs, but the thought process itself isn't ambiguous.

Strategic risk is a very different beast. It's too complex, long-term and multifaceted to be captured through conventional risk assessment or forecasting. One would think that because it's related to significant changes, we'd still be able to see it well in advance. However, we're always in the middle of change, so there's no vantage point from which we can pause and take stock. We can look back 10 or 15 years and notice how remarkably different things are, but along the way nothing seemed particularly new. Thus, strategic risk can creep up on us. If it does, it's fiendishly hard to find our groove again and rebuild our confidence, since our strategy and the way we do things are misaligned with the rules of the new game we're competing in.

Before we consider how to get a handle on strategic risk, to help illustrate the challenge in contexts most Tree Frog readers are familiar with, we'll briefly look at a couple of cases in the wood products sector. One concerns pulp and paper, from the perspective of North American and European firms. The other is about British Columbia's lumber industry. Both of these are complicated stories with a number of subplots. What follows is necessarily top-level and won't be the full stories, but hopefully they'll help to illustrate what we're talking about. In each case, watch for how several separate, seemingly unrelated forces combined over years to quietly remake the whole industry – and how little any of it looked like a single unfolding story while it was happening.

## Strategic risk in pulp and paper, from a North American and European perspective

For over a century, North American and Scandinavian firms were practically synonymous with pulp and paper. In the 1990s, it would have seemed inconceivable that Chinese players could ever dominate in paper and that China would become the centre of gravity for the whole, global industry.

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China's post-Mao economic transformation was given a strong boost by its ascension to the World Trade Organization (WTO) in 2001. Observers at the time pondered whether China would become "the next Japan" by making the leap to technological exports. Something as quotidian as paper hardly figured into geoeconomic musings. Yet not only was paper required for industrial packaging, but as economic growth led to a more vibrant consumer economy, e-commerce and the boom in China's food delivery industry drove demand for consumer packaging. The government recognised paper's enabling role in economic growth, and has heavily subsidised the industry's development. As with many industries in China, government support delayed consolidation, and led to overcapacity and fierce price competition at home. That drove aggressively priced exports and paved the way for the Chinese industry's internationalisation.

In fewer than 20 years, the global pulp and paper industry has become China-centric. Chinese firms dominate in the highest volume paper segments. Price competition from China has forced consolidation among foreign competitors and restructured the market. Integrated North American and European wood product firms retain a foothold in higher value paper segments, but have had to relinquish share in commodity segments and instead shift emphasis to pulp, for which China is the biggest market and by extension the principal price setter. Overseas mills and even whole companies that couldn't withstand Chinese price pressure gave Chinese firms cost-effective acquisition targets to gain toeholds in foreign markets, secure more of the wider value chain, and reduce vulnerability to trade restrictions. Chinese players also moved upstream into fibre supply, through plantations in China and stakes in timber concessions in Asia and South America.

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Non-Chinese wood product companies facing these changes have had to adapt to minimise exposure to price competition and make the most of the opportunities presented by Chinese demand for fibre and pulp. Integrated firms have faced hard choices about where to invest and sustain a grip in the wider value chain, and firms that depend on paper have increasingly been compelled to focus on niche segments to avoid being steamrolled. There have been casualties, both in terms of companies and jobs.

As we noted, strategic risk is hard to see because it's always there, lurking in the constant change going on around us. That remains the case today. New uncertainties are being generated by US-China tensions and US trade protectionism. These combine to create difficult choices for governments and companies alike. For example, there's an opportunity for Canadian companies to join forces with the US industry to call out subsidised Chinese competition, thereby potentially benefiting from coordinated trade restrictions. But with the US itself being such a problematic trading partner, China is starting to look like a safer long-term bet, and alienating it could backfire in the long run.

China's need for softwood fibre and pulp from North America and Europe is another question. Chinese producers continue to improve the productivity and pulp characteristics of eucalyptus fibre, while China also has access to large supplies of eucalyptus pulp from South America. Nearer-term, if or when Russia re-enters the global economy, Chinese firms will likely pick up where they left off in developing softwood timber concessions in Russia's far east.

Another issue is that with the global pulp market oriented around China, China's domestic regulations have become a major variable in market conditions. For example, restrictions on imports of recycled pulp caused considerable disruption. Evolving Chinese regulations will continue to cause periodic upsets.

Finally, China's economy isn't sound and for the whole industry there's no new normal in sight. Strategic risk remains high.

## Strategic risk in British Columbia's lumber industry

The second example of strategic risk concerns British Columbia's softwood lumber industry. For decades, forestry was BC's trademark industry. In the 1990s there was hardly any suggestion that the industry would become a shadow of its former self, and a niche in terms of the province's overall economic activity. In recent years, and especially in Trump's second term, there's been a lot of concern about the effects of US trade barriers. They certainly matter given that approximately 75% of BC's lumber goes to the US, but the industry's decline has deeper roots.

From 2000, British Columbia's pine beetle infestation was followed by increasingly frequent, serious forest fires. The combined effects severely depleted timber stocks. Had the industry suffered such serious setbacks in prior decades, provincial governments' responses might have been urgent and supportive. However, starting in the 1990s, in sync with developed economies around the world, the province's economy began the shift to services. Forestry became far less important to provincial employment and GDP as BC's economy grew and diversified. This weakened the political imperative to help ease the industry's pain, and gave governments the headroom to accommodate growing environmentalist sentiment. Thus, while not abandoning lumber, BC governments' responses have emphasised conservation. This has meant old growth deferrals, reductions in allowable cuts, permit delays, and higher regulatory hurdles. The policy environment has not been conducive to recovery.

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While BC's lumber industry was declining, there was an opposite trend in the US. Lumber and mill capacity significantly expanded. The US south alone now produces more softwood lumber than all of Canada combined. While US southern yellow pine (SYP) is not suitable for every application served by Canadian spruce-pine-fir (SPF), its wide availability and accepted performance make it a formidable competitor.

These broader changes form the context of recent US trade restrictions. Trade barriers didn't create the current crisis in BC's exports, but rather are accelerating a long-term decline. Trade restrictions will likely fluctuate, not just depending on who sits in the White House, but on the state of the US housing market and political pressure to ease new home affordability. The US south's capacity advantage, on the other hand, is here to stay. That isn't just driven by BC's tribulations with natural hazards, nor by SYP's relatively quick growth cycles. It's also a result of different regional cost structures and regulatory environments. And there's also a question of differences in political will. The US lumber lobby is powerful and it appeals to traditional American values associated with working the land, rural jobs and defending against "unfair" foreign (Canadian) competition. Thus, it has a strong political constituency at state and federal levels. Canada's lobby, by contrast, is more fragmented and there aren't the same nationalistic and emotive levers available to it. Even if BC's capacity recovered, which is unlikely, it would be an uphill struggle to regain lost ground in the US.

Despite having unfolded over time, the decline of BC's lumber industry still snuck up on firms and communities. The decline severely affected smaller, provincial producers and rural communities that depended on lumber jobs. The larger, integrated players have fared better, partly by going to the US and applying their expertise to compete well against their American peers. But they, too, have seen declining profits, and are currently stuck between adjusting to structural changes and a prolonged slump in the North American market. If, 25 or 30 years ago, the industry had foreseen what happened, would things be different for BC's lumber industry? There have been serious efforts to create demand through value-added wood products and to diversify geographically, and hindsight is a luxury, but more effort and experimentation back when it was affordable could have mitigated, although not averted, current stresses. On a social level, with foreknowledge, local and provincial governments could have better planned for the loss of lumber-related jobs to mitigate the effects on rural communities.

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As with pulp and paper, for BC's lumber industry there's no new normal on the horizon. US duties will fluctuate but there's a chance that US protectionism is a long-term shift. The Trump administration has planned to open US public forests for logging and to the extent that this occurs, US lumber firms will be positioned to expand capacity in the same wood species imported from BC. There's also considerable uncertainty around the recovery of the US housing market, the main driver of demand for BC's lumber. Finally, climate change, which is driving heatwaves and fires, remains unmitigated as global tensions prevent cooperation on the issue, and severe wildfires could become a regular occurrence. Thus, for BC's lumber industry too, strategic risk remains high.

This raises the obvious question: if strategic risk can only be understood clearly in hindsight, how can companies improve their chances of seeing it before it's too late?

## Strategic risk management – sensing and positioning for the future

Sensing disruptive transformation earlier is possible, but it takes a deliberate discipline rather than instinct. The wood products sector was never boring, but prior to 2000, change was usually incremental. Since then, the sector has had an increasingly tumultuous ride, partly for the reasons we looked at in the two examples – shifts in economic centres of gravity, socio-political moods, and the natural environment (and a storyline we left out was the internet's effect on newsprint, so technology was a factor too). Strategic risk management will be critical to navigating the future. In this final part of the article, we'll get a sense of what strategic risk management entails, and how it can help.

First, we need to develop a sense of what the future of the industry and our place in it might look like. We can start with known pressures and change drivers, such as US protectionism, nationalist populism in general (it often drives protectionist sentiment), China-US relations, China's economic health, climate change and AI, and extrapolate these into the future. Such dynamics don't just appear and disappear, rather they evolve and transmute. As they interact they'll inevitably take new forms and generate new forces. Alongside extrapolating from known forces, we can use horizon scanning to sense what could become new change drivers down the road. This involves looking for what are known as weak signals. We can think of these as reverberations in time, but in reverse. Think of US protectionism now, and then imagine the ripples that it casts back 15 years ago. Horizon scanning is about picking up these signals from the future. They might manifest in fringe political discourse, nascent technologies, scientific hypotheses, or minor socio-political tremors. Once we've articulated change drivers and signals, we have raw material for story building, the next step in the thought process.

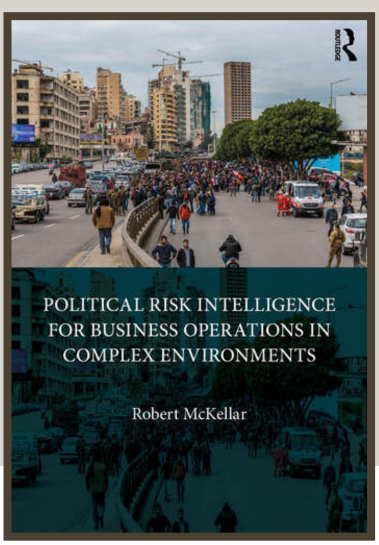
When exploring the future, 10 to 20 years is a ballpark range (actually, Shell, which was among the first companies to plan with scenarios, has scenarios as far out as 50 years, but we'll stick with something more imaginable here). So, what's our industry going to look like in, say, 15 years, and how might it get there? There's no magic formula for deriving answers. Approaches range from complex modelling to "back of the envelope" thought experiments. At this level of uncertainty, complex modelling is probably a waste of time and it over-relies on extrapolating from facts, which are ephemeral on these timescales. Structured discussion is a better bet. I'd suggest a workshop format where different teams, combining company managers and outside experts, tackle the question independently and then share and discuss the results. We can test each resulting story for the strength of causal connections and alignment with the available evidence, and then refine the winners into a small set of potential industry futures.

Using this kind of analysis in planning is often a bigger challenge than deriving our stories, mainly because of a mindset problem. We have very tangible reasons to keep doing what we're doing, including customer and shareholder expectations and near-term obligations. Our change stories will seem fluffy compared to the day-to-day business reality. We need to remind ourselves that the industry has already seen significant change and that at various points we had to scramble to adapt. At some point, we'll be looking back 15 or 20 years, contemplating how different the situation is, and probably regretting some missed opportunities for better decisions. It's hard to feel it in the midst of immediate pressures, but the future is as real as the present. It will inevitably be here, and if our strategy and positioning are misaligned with the opportunities and obstacles it presents, we'll be stuck in a dark corner.

Once we accept the future's reality, it's still highly uncertain, especially at the timescales we're talking about here. We'll still need near to medium-term assessment to guide decision making over shorter periods. However, without a sense of the future, we can overreact to risk, shelving initiatives that could position us well for the future, and we can overcommit to opportunities, launching full-scale invasions that tie us up for years instead of tactical raids that retain strategic agility. There's so much pressure for short-term performance that companies can become like rats in a maze, taking the pathways of least resistance with no idea if the obvious roads are heading to long-term success. The long view gives us some idea of the shape of the maze, or at least the forms it could take. Less tangibly but just as importantly, simply having a long temporal perspective drives curiosity and a healthy fear of stagnation. This can subtly affect organisational culture, making the company more perceptive and open to change. There are specific processes for long-range planning in uncertainty, like sustaining a portfolio of options and shifting emphasis depending on how the future unfolds, but the principal benefit is a change in our thinking.

Before wrapping up, it's worth mentioning the practical matter of when or how frequently future-gazing is done. We'll be dealing with short to medium-term challenges separately, and they'd get their own review and response cycles, which might be as tight as weekly or daily depending on an issue's volatility (like Trump's tariff flipflopping in early 2025). With strategic risk assessment, an annual cycle is probably sensible. We shouldn't just update past findings, though. That's a formula for incrementalism and getting stuck in the past. Each retake should be from a blank slate with no preconceptions. In between retakes, we can monitor change drivers and signals for signs of movement (that should be harmonised with routine market and political intelligence or it's duplicated effort). Strategic risk management, on the other hand, is ongoing, and manifests as adjustments to decisions, and as new ideas, based on our sense of future opportunities and constraints.

The wood products sector is facing significant pressure and volatility. Conventional risk management can help to weather next week's storm, but it's more about avoiding or limiting damage than it is about finding pathways to enduring performance. Strategic risk management is an essential complement. With an eye on the future, we'll be better at spotting cul-de-sacs and dead ends, and at positioning ourselves for opportunities that we wouldn't be able to sense if we only looked one or two steps ahead.

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