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Increasing legality compliance amongst forest sector MSMEs: creating an enabling environment for responsible forest product trade and socio-economic recovery

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Abstract

Micro, small and medium-sized enterprises (MSMEs) play a critical role in meeting the growing demand for forest products worldwide, with potential to contribute to responsible supply chains that combat illegal logging while promoting economic growth. However, MSMEs have been challenged by the emergence of regulated markets requiring verified legal timber, which involve more stringent regulatory compliance and additional up-front costs. Recognizing the need to ensure MSMEs can benefit from – and are not penalized by – the responsible forest trade, the FAO-EU FLEGT Programme supported 100+ projects in 20 countries between 2016 and 2021 that sought to improve MSME capacity to supply legal timber. These projects employed several strategies:

- Increasing MSME legal compliance through capacity building, mentoring and technical assistance;
- Formalizing MSMEs to achieve legal status and access to benefits such as credit, training programs, and labour protections.
- Strengthening associations that represent MSMEs and provide technical and financial assistance;
- Reducing the regulatory burden through the simplification of existing legal frameworks; and
- Integrating MSMEs into responsible value chains by linking with buyers or manufacturers.

The Programme analyzed the impacts of these projects to determine best practices for supporting MSMEs at scale. It was found that the formation of associations was the most impactful intervention for helping MSMEs to formalize and produce legal timber. Capacity-building efforts also must integrate business skill development with training on legality compliance. The paper discusses options for further deployment of these strategies at scale, emphasizing the importance of building an “ecosystem of support” by forming a variety of mutually supporting partnerships. This will be central to assisting MSMEs negatively impacted by COVID-19 imposed lockdowns and economic slowdown.

Keywords: Illegal logging, timber trade, small and medium-sized enterprises, forest governance, responsible markets

Introduction

Micro, small and medium-sized enterprises (MSMEs), i.e. small-scale timber producers and/or processors, play a critical role in meeting the growing global demand for forest products and contributing to livelihoods and national economies. In some countries, formal and informal small and medium-sized forest enterprises may account for up to 80 to 90 percent of employment in the sector, (World Bank 2016), accounting for about 20 million jobs, that generate approximately USD 130 billion

per year (FAO 2020). Both formal and informal MSMEs in tropical timber producing countries contribute significantly to the domestic market (IIED 2016; PROFOR 2019) and therefore can play a significant role in reducing illegal logging.

However, shifting market trends present challenges for MSMEs by requiring verified legal timber. This creates the risk that these policy and regulatory regimes will discriminate against MSMEs by enacting complex and burdensome compliance requirements that they are unable to meet. This challenge could be turned into an opportunity by providing strategic support that enables MSMEs to supply these markets with legal timber.

Since 2016, the FAO-EU Forest Law Enforcement Governance and Trade (FLEGT) Programme (hereafter the Programme), enacted to implement the EU’s FLEGT Action Plan, has aimed to do just this. Between 2016 and 2020, the Programme supported 105 projects supporting MSMEs in 20 countries. Through these projects, over 5 600 MSMEs received direct support, and 46 associations were created. This paper summarizes lessons learned through these projects, with the objective of helping others to capitalize on the Programme’s experience to boost forest-dependent economies and promote social equality and sustainability within global timber supply chains.

Methodology

The Programme Team conducted an experience capitalization exercise to capture lessons learned across three regions, analysing 105 projects to map out strategies adopted, types of beneficiaries targeted and results achieved. Detailed interviews using context-specific research questions were conducted with 77 stakeholders, including team members, selected service providers and project beneficiaries. The majority of interviews targeted organizations that had previously implemented MSME support projects to analyse the root causes of successes and failures. Interviews were conducted remotely and in local languages when possible.

Results

The projects utilized four main support strategies, within which they demonstrated innovations in deploying these strategies:

1. Increasing MSME legal compliance and formalization through capacity building, mentoring and technical assistance;
2. Strengthening associations that represent and support MSMEs;
3. Reducing the regulatory burden through simplification of existing legal frameworks; and
4. Integrating MSMEs into responsible timber value chains.

70 percent of all projects included a capacity-building component, most of which focused on helping MSMEs achieve legal compliance. In contrast, only 33 percent attempted to foster an enabling policy environment. Regional breakdowns noted that Asia focused less on association strengthening than other regions, whereas Africa focused on association formation and value chain integration.

Table 1: MSME Support projects by theme

THEME	TOTAL	% OF PROJECTS	AFRICA	ASIA	LATIN AMERICA	GLOBAL
Capacity Building for Legal Compliance	74	70%	30	19	24	1
Association Strengthening & Formation	43	41%	20	8	14	1
Enabling Policy & Legal Environment	35	33%	13	15	7	0
Value Chain Integration	34	31%	16	9	9	0

1. Strengthening associations

Experience within and beyond the forestry sector recognizes the power of associations in supporting MSMEs (IIED 2006). Strengthening an association in one area can generate a multitude of ancillary, ‘multi-directional’ benefits such as increased membership, network building, greater credibility, and better representation. These additional benefits and services attract more members and funding, which further solidifies the association, allowing the cycle of benefits and strengthening to continue.

In total, Programme support strengthened 212 associations, ranging from apex federations to small-scale agroforestry cooperatives, benefiting nearly 12 000 members, in the following ways:

- Improved technical knowledge;
- Increased visibility and credibility;
- Enhanced communications with members and understanding of member issues;
- Financial sustainability and continuity of work;
- Development of project management skills;
- Broadening of networks and client relationships;
- “Reinvigoration” of the association; and
- Development of internal institutional policies and practices.

This strengthening increased the services partner associations offered to members, including:

- Capacity building and training opportunities;
- Technical assistance for MSMEs to formalise or pursue legal compliance;
- Information provision, including market intelligence and regulatory updates;
- Access to markets requesting legal products;
- Increased economies of scale in production and marketing, with greater bargaining power;
- Representation of member interests in policy processes;
- Serving as an intermediary between companies and the government;
- Conflict mediation and organizational defence;
- Development of tools or technologies to facilitate legal compliance and/or market access; and
- Fostering networking opportunities and business-to-business learning.

Table 2: How strengthening benefited different types of associations, according to differentiated needs and roles

Intervention	Example
Forming new associations	In Côte d’Ivoire, the Programme helped form the Association GAMBY (Groupement des Artisans des Métiers du Bois de Yopougon), which collected 22 million XAF (~USD 40 000) from its members to collectively purchase a piece of land to set up their workshop and a purchasing centre.
Building up low capacity associations	In Indonesia, the Small-scale Wooden Furniture Association of Jepara (APKJ) received their first grant from the Programme to build member capacity to access global markets. Through a partnership with the Centre for International Forestry Research (CIFOR), APKJ managed the project while building their capacity to provide technical services to members.
Creating new federations	In Mozambique, the Programme supported the establishment of 9 provincial associations, which then formed the Mozambican Federation of Timber Operators (FEDEMOMA). The new Federation represents over 600 enterprises, which will facilitate dialogue between the public and private sectors.

Strengthening national/regional associations	Support to the Colombian National Federation of Wood Industries (FEDEMADERAS) enabled them to train MSMEs, launch awareness-raising campaigns and e-commerce platforms. This success empowered FEDEMADERAS to serve as an example for smaller associations in Colombia and leverage additional donor funding.
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2. Promoting MSMEs legal compliance & formalization

Partners across all regions identified capacity building as a fundamental need. Many MSMEs were not aware of existing requirements to operate legally, nor did they understand the economic benefits of legal compliance. However, feedback indicated that standalone trainings are usually insufficient to solely meet the needs of MSMEs. The most successful projects employed a five-step coaching process:

1. **Awareness Raising** on the need for and benefits of legal compliance, improved business practices or sustainable forestry practices;
2. **Operator Assessment** to identify specific compliance needs;
3. **Targeted Capacity Building** to address the specific needs identified during operator assessment;
4. **On-site Mentoring** to address identified compliance gaps and to verify and recognize progress made towards addressing these gaps; and
5. **Establish Support Structures** where MSMEs continue to have access to technical support (from government, CSOs or private sector associations) in the long term.



Fig. 1: Model MSME Capacity Building Process

The Kumasi Wood Cluster (KWC) in Ghana is one champion of this model. Since 2015, KWC has become a specialized training provider for MSMEs to become compliant with Ghana’s Timber Legality Assurance System (GhLAS). Using the steps outlined above, they have trained over 220 MSMEs, with 70 percent achieving at least satisfactory compliance levels with the GhLAS.

Analyzing the capacity building strategies of 74 projects identified additional best practices that can be undertaken to put this model into practice, and ensure that trainings facilitate legality compliance.

Table 3: Approaches to facilitating legality compliance

Approach	In practice
Combine trainings on legality with trainings on business and improved production skills. This makes trainings more attractive and addresses known challenges facing MSMEs who lack market information, knowledge on product distribution networks, and logistical and processing capacity (DFID, 2020).	Côte d’Ivoire: AVSI trained artisans in both legality and improved processing and woodworking techniques to ensure that artisans received skills that would immediately benefit their businesses

<p>Make events a “one-stop-shop for paperwork” by integrating on-the-spot registration in trainings. This can quickly boost the number of compliant MSMEs and ensure queries are quickly addressed when relevant government officials are present.</p>	<p>Guyana: The Environmental Protection Agency (EPA) helped trainees fill out application forms at trainings on Environmental Authorizations. As a result, the number of Community Forestry Organizations with environmental authorizations in process increased from 7 to 46 percent</p>
<p>Create a multi-stakeholder “ecosystem of support” by involving CSOs and government. This facilitates information sharing, strengthens networks, raises awareness of MSME concerns and enables all actors to fulfil their roles in providing long-term support.</p>	<p>Lao PDR: Government officials attended input-output trainings for small and medium-sized wood processors. This improved their capacity to provide oversight, helped to identify potential master trainers and improved trust between provincial and central government officials.</p>

3. Simplifying existing legal and policy frameworks

Legal frameworks often subject MSMEs to the same requirements as large corporations, despite their lower production capacity. It is well recognized that legal reform, simplification of regulations and/or other efforts to create an “enabling environment” are effective ways to help MSMEs at scale (Cerutti *et al.* 2014; Del Gatto *et al.* 2018; EFI 2020). Foremost reform needs include facilitating access to credit, adjusting MSME tax obligations, simplifying registration procedures, curtailing permit renewal fees, and reducing tariffs and customs fees on importing equipment that would improve production efficiency.

However, less than 50 percent of projects focusing on improving the enabling environment resulted in the successful adoption or revision of the targeted policy or regulatory instrument during the timeframe of this review. This may be because policy and legal reform processes exceed the duration of short-term projects and the mandate for certain reforms often lies with ministries beyond the forest sector.

Change was most often leveraged independently of projects when “windows of opportunity” for policy reform opened, during which Programme partners successfully applied the knowledge acquired through projects to formulate experience-based recommendations for policy reform. For example, in Indonesia, CSOs and the private sector submitted inputs into the revision of the SVLK regulation, led by the Ministry of Environment and Forestry. As a result, MSMEs bear a lower cost burden for certification, can receive subsidies for surveillance audits and V-Legal fees, undergo remote audits, and enjoy extended periods between surveillance audits.

Given the challenges associated with pursuing legal reform, 32 projects opted to create tools to aid legal compliance rather than (or in parallel to) efforts to secure legal reform. These tools comprised specialized guidebooks, software or databases, and supply chain control mechanisms tailored to MSME capacities and practices. Typically custom-designed considering local context, and reliably developed and deployed within project lifecycles, these tools proved to be an effective form of support for MSMEs.

4. Integrating MSMEs into responsible value chains

The analysis noted a shift from “old generation” to “new generation” strategies when attempting to link MSMEs with suppliers or buyers of legal timber and timber products. Old generation strategies included hosting business-to-business events, capacity building on accessing markets, and mediating business arrangements between large industrial companies and MSMEs. Despite initial successes, these arrangements typically turned into “one-off” transactions, not sustained beyond the project due to mutual distrust, lack of incentive for industrial companies to work with MSMEs, and the inability of MSMEs to purchase timber at volumes and prices attractive to industrial companies.

However, one successful partnership from Guatemala identified features of successful partnerships between MSMEs and large companies:

1. They need to be mutually beneficial on a business level;
2. They must be formalized through commercial agreements or memoranda;
3. Guarantors are needed, such as CSOs or government offices; and
4. They will only be sustainable if the cost of legal wood is lower than illegal wood.

The new generation of strategies for integrating MSMEs into responsible value chains relies on achieving economies of scale through forming cooperatives or associations able to make joint purchases, establishing legal timber depots or log yards, and launching e-commerce platforms to sell legal timber products online. While initial results remain pending on the latter two new strategies, Programme partners have found success in joining or forming associations to access raw materials and markets. In Côte d'Ivoire, a CSO organized artisanal chainsaw millers into two professional associations and then enabled these associations to sign seven service agreements with industrial companies. In Cameroon, newly formalized MSMEs organized into an association were able to purchase 15,000 m³ of legal timber from a community forest.

Discussion

While these projects have identified strategies and lessons to advise future support, the next question is – *how can these strategies be deployed to reach MSMEs at scale and improve their resilience to global economic shocks?* On average, projects could train approximately 105 MSMEs per project – a fraction of the MSMEs that would benefit from support. At the same time, some project achievements were rolled back due to the global trade slowdown associated with the COVID-19 pandemic.

Conduct capacity building and commerce in the virtual sphere: The COVID-19 pandemic accelerated uptake of digital technologies, leading to the rollout of remote-based trainings and e-commerce platforms. A virtual training program for MSMEs is being tested in Perú, Colombia, and Guatemala. This open-access course focuses on operation management, production management, and responsible purchasing.

Institutionalize MSME support in government programmes to incentivize legality: Partners recognize the need to move beyond project-based support and institutionalize MSME support in government work plans and annual budget allocation requests, ensuring that governments have the staff and resources to provide the incentives that encourage MSMEs to formalize and/or operate legally. At the same time, interventions need to engage all ministries within governments that support MSMEs, such as ministries of commerce, finance or economic development.

Pursue alternative legal compliance certification models: In Indonesia, partners initiated pilot certification of MSME legal compliance at the forest management unit or district level, meant to certify all MSMEs within a given district as “legal” without requiring individual operators to pursue formal certification of legal compliance. Further piloting of such models would create pathways towards, certifying more MSMEs at lower costs and with less technical assistance. **Expansion of practitioner networks:** A global practitioner community, such as the Programme’s 200 partners, must underpin the scaling up of effective support strategies, allowing members to draw from each other’s experiences. This community would enable the diffusion of solutions to common challenges, such as technological innovations likenew applications, software, databases and online platforms to meet MSME needs. As forestry is a cross-cutting sector; these communities can be further expanded through developing networks with organizations supporting MSMEs in other sectors.

Conclusion

Illegal logging takes a heavy toll on the development potential of countries. Deforestation and forest degradation compound climate change, encroach on wildlife habitats and generate economic losses. FAO figures show that around 1.6 billion people – roughly one-third of humanity – depend on forests for their livelihoods (FAO 2020). Without legal protection of these vital resources, their increased depletion will hinder recovery from the economic damage wrought by the COVID-19 pandemic.

While some may argue that legality compliance is only one of many pressing challenges facing MSMEs, it is evident that legality underpins sustainability. By sourcing legal timber, MSMEs contribute to safeguarding forests. Processes associated with legal timber production and trade increase transparency and dialogue around policy reform, providing a solid foundation for addressing other drivers of deforestation – preserving both livelihoods and resources.

This work aimed to identify strategies to deliver future support to MSMEs effectively and at scale. Given the high number of MSMEs globally and their corresponding needs, the public sector, private sector, and international community must continue to mobilize proportionate financial and technical support, which will increase the ability of MSMEs to operate formally and contribute to increasing legality in the forest sector, while also benefiting from improved livelihoods and reinforcing inclusive economic growth.

The design of future MSME-support programmes should continue strengthening associations and providing capacity and mentoring support to MSMEs while focusing on three additional strategies:

- Development of innovative tools to facilitate access to legal sources of wood and markets and increase MSME competitiveness;
- Lowering barriers to formalization through helping governments develop electronic registration systems and simplify formalization procedures; and
- Creation of support structures for MSMEs, smallholders and forest communities through engaging CSOs networks and local government officials.

The experience of the FAO-EU FLEGT Programme has shown that building the capacity and credibility of its partners allows them to cultivate their relationships with MSMEs, expand their technical knowledge, and pursue increasingly sophisticated and innovative projects that capitalize on previous experiences to continue the critical work of identifying and testing new solutions to emerging challenges.

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