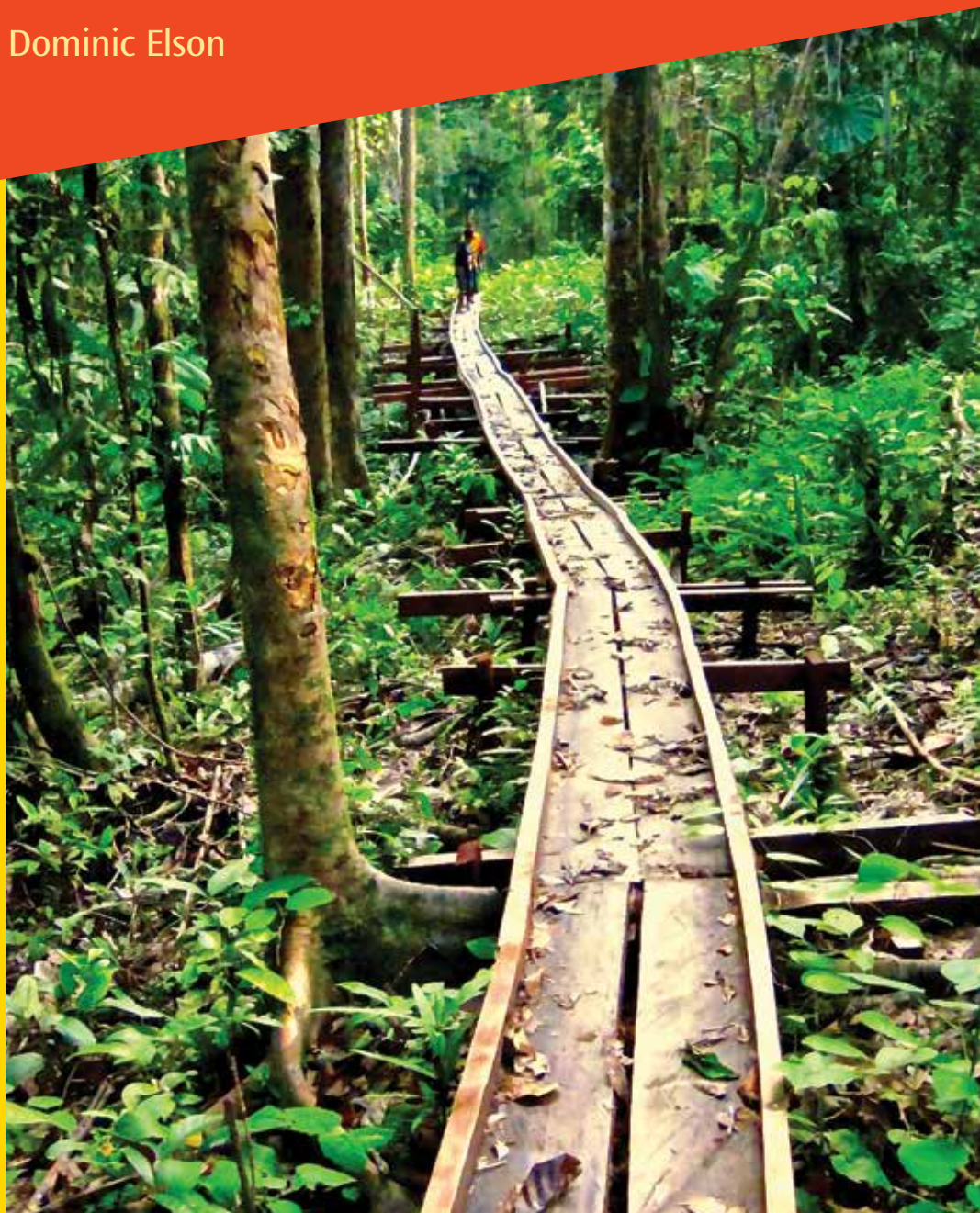


# Guide to investing in locally controlled forestry

Dominic Elson





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# Executive Summary

Locally controlled forests involve one billion people and one quarter of the world's forests, providing \$75 – \$100 billion per year in goods and services and a broad range of other economic, environmental, social, cultural and spiritual benefits.

This guide to Investing in Locally Controlled Forestry (ILCF) is an outcome of the Growing Forest Partnerships initiative that engaged The Forests Dialogue to co-ordinate 11 wide-ranging dialogues involving investors, rights-holders, governments, donors and others on this topic. It is primarily a tool for practical action and its advice draws on strong evidence showing that locally-controlled forestry enterprises can be successful, sustainable and profitable for all stakeholders. It offers a market-based view of development, rooted in an understanding of the globalised, free-market economy, and concentrates on a role for SMEs – the 'missing middle' of many developing economies.

**The case for ILCF** (covered in Section 2 of the guide) recognises that forest landscapes are not unclaimed wilderness. They are inhabited by rights-holders who seek genuine business partnerships for managing their natural resources, not patronage schemes. Investing in locally controlled forestry is all about achieving acceptable returns while putting local people 'in the driving seat', developing and implementing projects (and often, but not necessarily, working within them).

ILCF offers investors secure access, a 'social licence to operate', reduced risks and better long term management opportunities, as well as evidence of social and environmental sustainability. Rights-holders gain from reinforced tenure rights that in turn underpin resilient local economies. Governments stand to gain better asset protection, and bottom-up rural economic development that, in time, contributes to tax revenues. Internationally, locally controlled forestry holds the key to a better approach to reducing carbon emissions in the land use sector and thereby offers a way forward for REDD+.

Section 3 of this guide sets out a **framework for categorising investments**, in terms of the returns investors seek and the risks they consider. It lets investors (including rights-holders), donors and philanthropists place themselves in the 'investor universe', and will help all stakeholders understand what motivates different types of investor. In particular, the framework helps match the goals of the investor and enterprise by distinguishing between **enabling investments** that prepare the ground for commercial success (with no expectation of direct financial reward), and **asset investments** (that seek a return, usually as profit or products).

Strong businesses generate profits worthy of asset investment. But growing those businesses may need enabling investments from NGOs, philanthropists or governments for infrastructure or capacity building. Recognising these two investment roles offers a credible way to bridge the 'SME funding' gap, where enterprises that are too big for microfinance often struggle with the step change needed to attract conventional investment or financial services. Distinguishing between enabling and asset investments is essential in packaging investments that are acceptable to all parties.

Section 4 gives structured **tactical advice for building the alliances and partnerships needed for successful ILCF**, both among rights-holders and between rights-holders, their investors, intermediaries and governments. These partnerships in turn rely on **essential ‘favourable conditions’, both internally and externally**, and the guide sets these out in detail. For example, enterprises need strong enough internal organisational and management strategies to attract investors, and here capacity building from specialist Business Development Service Providers can help. Externally, **sufficient clarity of tenure** is essential for investment, and this can only come about by bringing together rights-holders, government and investors. Clarity of tenure requires **‘good enough governance’**, and that needs investors, donors and companies to actively support, and not undermine, governance institutions.

Yet however essential, alliances are not without risks and drawbacks for enterprises, and the guide covers the issues of ‘co-dependency’ with NGO and donor intermediaries, and the balance of initial help and long term limitations hidden within company-community partnerships – often set up when local enterprises are not yet strong enough to attract their own investment.

**Section 5** sets out a **Roadmap to successful ILCF**, covering the business stages of: **Proposition, Establishment, Validation, Preparation, Negotiation and Performance**; with specific advice on the challenges of ILCF for both investors and enterprises. It assumes the long-term aim is asset investment, but that some enabling investment will usually be needed first. The stages are the essential ‘stepping stones’ to successful enterprises, and this section gives a detailed breakdown of the complex and often iterative growth process, effectively offering a ‘work book’ or template for project managing a new ILCF enterprise from start-up to scaling up.

Section 6 offers **17 case studies from across the world**, from start-ups to long established businesses, in both developed and developing countries. They offer a flavour of the huge opportunities for investing in locally controlled forestry. The Forests Dialogue hopes this guide will inspire and support many more.

Section 7 provides **useful further information** in a series of appendices that lay out a framework for the business concept document, key points in a written contract, a tool for assessing organisational capacity and links to other resources and partners.

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Responsibility for the views expressed, and for any errors, lies entirely with the author.

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# Abbreviations

BDSP	Business Development Service Provider
CAPEX	Capital expenditure
CFE	Community Forest Enterprise
CSR	Corporate Social Responsibility
EITI	Extractive Industries Transparency Initiative
ESIA	Environmental and Social Impact Assessment
FAST	Financial Alliance for Sustainable Trade
FLEGT	Forest Law Enforcement Governance and Trade
FPIC	Free, Prior and Informed Consent
FSC	Forest Stewardship Council
FUG	Forest User Group
G3	Alliance of the three rights-holder groups: GACF, IFFA and IAITPTF
GACF	Gobal Alliance of Community Forestry
GDP	Gross Domestic Product
GFP	Growing Forest Partnerships
IAITPTF	International Alliance of Indigenous and Tribal Peoples of Tropical Forests
IFC	International Finance Corporation
IFFA	International Family Forestry Alliance
ILCF	Investing in Locally Controlled Forestry
IRR	Internal Rate of Return
MFI	Microfinance Institution
NFP	National Forest Programme
NGO	Non-governmental organisation
NTFP	Non-Timber Forest Product
OECD	Organisation for Economic Co-operation and Development (an organisation of 34 mainly high income countries)
OPEX	Operational expenditure (working capital)
PEFC	Programme for the Endorsement of Forest Certification
R&D	Research and Development
REDD	Reducing Emissions from Deforestation and forest Degradation, referring to the reduction of greenhouse gas emissions from forest loss. REDD+ includes additional mitigation activities, such as the conservation, sustainable management, and enhancement of forest carbon stocks
RSPO	Roundtable for Sustainable Palm Oil
SFM	Sustainable Forest Management
SME	Small and Medium sized Enterprise
SMFE	Small and Medium Forest Enterprise
SOP	Standard Operating Procedures
SWF	Sovereign Wealth Fund
SWOT	Strengths, weaknesses, opportunities and threats
TFD	The Forests Dialogue
VPA	Voluntary Partnership Agreement

# Glossary

*Asset investment* – an investment that aims to create tangible value, thus creating private assets.

*Bond* – a debt-based financial instrument that a government or financial institution can sell into private capital markets to raise finance.

*Carbon credit* – a certificate or instrument that represents reduced emissions of greenhouse gases equivalent to one tonne of carbon dioxide relative to an agreed baseline.

*Collateral* – the assets used as security for a loan. If the loan cannot be repaid, these assets are claimed by the holder of the loan (e.g. a bank).

*Corporate Social Responsibility* – a form of corporate self-regulation, or philanthropy. In order to minimise local conflicts and/or avoid interference in their business through taxation or regulations, the business may take voluntary steps that persuade governments and the wider public that they are taking issues such as health and safety, diversity or the environment seriously.

*Due diligence* – the process through which an investor (or funder) researches an organisation's financial health and organisational capacity, in order to guide an investment (or grant-making) decision.

*Enabling investment* – investments made to create public goods, and thus the conditions for productive investments in assets.

*Enterprise philanthropy* – aims to establish models for inclusive business into which return-seeking capital can be invested.

*Equator Principles* – a voluntary set of banking standards for determining, assessing and managing social and environmental risk in project financing.

*Equity investment* – whereby an investor owns a portion of the enterprise, usually through owning shares. Eligible to receive dividends, but equity holders have the lowest priority in the event of liquidation of the assets.

*Fairtrade* – a certification system designed to allow buyers to identify products that meet agreed environmental, labour and social welfare standards.

*Impact investments* – investments intended to create positive impact beyond financial return.

*Institutional investor* – an investor, such as a pension fund, insurance company or bank, which generally has substantial assets and experience in investments, and pools and invests capital on behalf of corporations or private individuals.

*Insurance* – a contract whereby an individual or organisation receives financial compensation if the terms of the insurance contract are met, for instance in the event of fire or theft.

*Internal Rate of Return* – a way of comparing investment propositions by calculating the effective annualised rate of return, while ignoring external factors such as interest rates and currency fluctuation.

*Liquidity* – the ease with which an asset can be sold at a price close to its true value.

*Maturity* – the age at which a bond expires and must repay the principal value.

*Negative list* – many countries allow foreign direct investment except to the ‘negative list’ of certain industries and sectors that are deemed to be strategically important and thus not available to foreign investors.

*Principal* – the original amount of money borrowed, excluding any interest payments.

*Private equity* – finance invested by private equity funds in companies that are not publicly traded on a stock exchange, or invested in publicly traded companies in order to make them private companies.

*Resource-led system* – the conventional investment paradigm whereby capital is invested in order to extract natural resources, with local rights-holders either being sidelined, compensated with royalties or employed as labour.

*Rights-based system* – an improved investment paradigm (in contrast to the ‘resource-led system’) whereby rights-holders seek investors and partnerships in order to manage the sustainable use of natural resource assets they command.

*Rights-holders* – people who claim some lands rights, which could refer to both ownership or other legally enforceable rights of an individual or a community over land (de jure rights); and occupancy and use rights (de facto rights).

*Small and Medium Enterprises (SME)* – many institutions and countries define SMEs differently, but often the size of an enterprise is determined by the number of employees or the annual sales generated by the business. The World Bank defines SMEs as meeting two out of the following three criteria: minimum 50 employees, under \$3m in either assets or under \$3m in sales.

*Socially Responsible Investing (SRI)* – investment in organisations or assets that are believed to have a positive benefit to society, whilst screening out socially harmful investments such as tobacco and arms manufacture.

*Sovereign Wealth Fund (SWF)* – a state-owned investment fund aiming for long term return, usually using money accumulated from foreign exchange assets, for instance from natural resource royalties.

*Sustainable Forest Management (SFM)* – the process of managing a forest to achieve a continuous flow of forest products and services without undue reduction of the forest’s inherent value and future productivity and without undue undesirable effects on the physical and social environment.

*Working capital* – liquid cash available to the business, not tied up in plant and equipment, that is available to cover running costs such as overheads, wages and purchase of inputs.

# 1 Introduction

This guide aims to make it easier for forest rights-holders and investors to form mutually beneficial partnerships. It is not intended to be another policy brief, or form part of the growing body of academic literature about indigenous family or community forestry.<sup>1</sup> It is designed to be a practical tool for action. It not only suggests some ingredients for successful investment in locally controlled forestry, it also demonstrates how those ingredients can be best combined to ensure enterprises are successful, sustainable and meet the aspirations of forest communities. The insights and suggestions in this document arise from dialogue between many different types of stakeholder, from Indigenous People to family foresters and from investment bankers to philanthropists. Reflecting this diverse parentage, the guide attempts to be neutral in tone. It does not attempt to build a moral or rights-based platform for supporting locally controlled forestry, but instead assembles evidence to make a strong practical case. To the extent that it reveals any particular world view, it is written with the belief that forests can be managed so they yield sustainable economic and financial returns; and that almost any individual or group of people possessing imagination, enthusiasm and access to expertise can build a successful forest enterprise.

## 1.1 Who is this guide for and how will they benefit?

This guide will be useful to anyone involved in managing, governing, owning and providing stewardship for forests. Local people – as rights-holders – are closest to forest resources, and therefore well placed, to manage them efficiently. But local people often need to attract capital investment so their management achieves economic development, social welfare and environmental sustainability. So other actors come into play, notably investors but also governments (who shape the rights and rules of engagement) and supportive intermediaries, such as NGOs and donors (who can help link local people to, and prepare them for, investment). This guide aims to meet the needs of each actor.

**Investors** will learn how to balance social and environmental goals with the need for a financial return, forming a realistic sense of the constraints facing locally controlled forestry and how overcoming such barriers opens up a new asset class. This will help investors:

- ▶ Understand what it is that local forest right-holders prioritise within the broad framework of 'locally controlled forestry', such as more secure resource rights, the need to develop local organisations, and the importance of building capacity for those organisations to do business and make a profit.
- ▶ Define goals that meet investment standards whilst also being compatible with the goals of local people and partners.
- ▶ Determine how a decent financial return is compatible with achieving positive social and environmental impact.
- ▶ Ensure that business proposals from rights-holders are developed in an understandable format, so due diligence process is easier and transaction costs are reduced.
- ▶ Coordinate the different types of investments – including grants – to ensure a correct sequence of funding that shepherds small enterprises through the business planning process.
- ▶ Aim for genuine sustainability – all parties are aiming to build a high quality business that has long term resilience, managing both natural resources and waste in an efficient manner.

**Rights-holders** will be able to understand what different investors are looking for, and learn how best to design and package a business proposal so it is feasible and attractive. The guide will help rights-holders:

- ▶ Weigh up the benefits – including financial – of different types of investment and any trade offs for rights, wellbeing, security, social relationships, decent work, environmental impact and cultural identity.
- ▶ Make appropriate preparations for attracting desirable investment.
- ▶ Be confident that they are attracting the kind of investor that is the most suitable partner for this stage in their development.
- ▶ Appreciate the network of partnerships and alliances that need to be forged and maintained in order to help them achieve their long-term goals.
- ▶ Understand how developing sustainable and profitable businesses can not only strengthen their environmental resource rights, but also contribute to their broader social agenda.

**Governments** will find evidence of how supporting the locally controlled forestry sector – particularly through tenure reform – will help reduce poverty, boost economic competitiveness, and bring social progress. They will also see practical steps they can take to improve the conditions for investment. These steps include:

- ▶ Nurturing the locally controlled forestry sector so it can benefit jobs, local public revenues, ‘green’ economic growth and social welfare.
- ▶ Reforming planning policy to install the pre-conditions for investment (with particular focus on specifying clear and accessible commercial resource rights for local people), while recognising that tenure reform is an ongoing process rather than a one-off policy action.
- ▶ Providing a focus for improving the conditions for small and medium sized businesses, whilst developing extension support alongside financial and business development services.
- ▶ Providing a policy framework that adequately addresses environmental sustainability, poverty reduction and social justice.
- ▶ Improving their understanding of why investments in locally controlled forestry are an essential component of REDD+, FLEGT and other agricultural and forest landscape projects.

**NGOs and donors** will see how to ensure their activities integrate with financial investors without ‘crowding out’ the private sector. Instead, their role can help create the conditions for investments and help small forest enterprises thrive. This is through:

- ▶ Understanding how ‘enabling investments’, such as grants and soft loans, fit into a sequence that prepares locally controlled forest enterprises to become investible, bankable and financially self-sufficient.
- ▶ Making projects more focused and goal-oriented to ensure resources are directed effectively.
- ▶ Clarifying best practice against which to hold investments accountable.
- ▶ Directing advocacy and policy development work to the most appropriate areas.

### Box 1: What are ‘rights-holders’?

The term ‘rights-holders’ refers to people who have some form of rights over the forest. This may be formal freehold of private land, but in many parts of the world the forest tenure systems are complicated. Local people may have customary rights without formal title. They may have usage rights to forest resources but not much say over management and disposition of forest lands. In an increasing number of cases, local people are operating under some form of lease or licence from the state. In all cases, to a greater or lesser extent, these people can be referred to as ‘rights-holders’

## 1.2 Background and context

Locally controlled forests involve one billion people and one quarter of the world's forests, providing \$75 – \$100 billion per year in goods and services and a broad range of other economic, environmental, social, cultural and spiritual benefits. Rights-holder organisations such as the Global Alliance of Community Forestry (GACF), the International Family Forestry Alliance (IFFA) and the International Alliance of Indigenous and Tribal Peoples of Tropical Forests (IAITPTF), known collectively as the G3, define locally controlled forestry as follows:

*“The local right for forest owner families and communities to make decisions on commercial forest management and land use, with secure tenure rights, freedom of association and access to markets and technology.”*

Local forest ‘rights-holders’ have substantial (and growing) decision-making power and control over forestland but not necessarily tenure or ownership rights. Although forestry in developing countries is the main focus of attention, there are also 25 million forest owners in North America, Australia and Europe who fit the description of locally controlled forestry.<sup>2</sup> For instance, Scandinavian forests are locally controlled and supply raw materials and capital for some of the world's most advanced pulp and sawn timber mills (see box below), but elsewhere investment in locally controlled forestry is much sparser. Aside from the economic argument, from a pro-poor development perspective, locally controlled forestry does have

### Box 2: Freedom with responsibility in Sweden – the world leader in successful locally controlled forestry<sup>3</sup>

Although Sweden has only 0.6% of the global forest estate, it controls 5% of the global sustainable annual cut and enjoys 10% of the world timber export market by volume. This is in the context of long rotation harvests – up to 120 years in the north of the country.

Yet a large proportion of Sweden's productive forest is owned and managed by 200,000 families, with an average holding of 50 hectares. The conspicuous success of the Swedish Forest Model arises from this culture of **local control** and accountability, combined with sensible regulations.

The forest was badly degraded 130 years ago, and in 1903 new legislation was passed to ensure new planting and more sustainable forest management practices. This law arose from grassroots action by farmers, who fought for their rights and foresaw the damage that a consolidated, corporate owned forest estate would do to their livelihoods, environment and culture. This action led to legislation restricting corporate control over forest lands to 25% in Sweden, thus allowing alternative local models to flourish.

Since then, the standing volume in the forest has doubled. Straight-forward laws decree that owners have rights that are contingent upon recognising the public goods value of forests: so, for instance, owners are obliged to re-plant after felling. Sanctions include a warning and then a fine. In the event of non-compliance, the government can re-plant and recover the cost from the owner, or seize the property. The policy structure is guided by the principle of **‘freedom with responsibility’**, based on management by objectives rather than through prescriptive regulation. In most cases this law has a light touch – the forest farmers are deeply aware of their rights and obligations, and of how a well-managed forest estate has contributed to Sweden's prosperity.

The lesson for both rights-holders and governments in other countries is that acknowledging local control of forests does not confer an inalienable right. Rather, control of important public goods comes with obligations of stewardship. This balance of rights and obligations is more likely to be recognised over the long term by smallholders and communities than it is by large corporate entities.

clear attractions: it implies local participation, decentralisation and equity. It also claims some rationale as a superior forest management system (compared to top-down state or corporate control), as those closest to the forest are more likely to have cultural and practical knowledge of the local landscape, and have a vested interest in the long-term conservation of its ecological services and income-generating features.

Research indicates<sup>4</sup> that there are huge opportunities for investing in locally controlled forestry projects that achieve a decent return on investment whilst advancing certain environmental and developmental goals. However, current financing mechanisms do not yet seem oriented to this sector, except in some specific and quite limited examples.

This may be because forest rights-holders and the investment community don't understand each other's needs and motivations. Nevertheless, all parties are coming to recognise that investing in locally controlled forestry is important for creating resilient economies that are able both to sustain and make returns from forest resources – and the interest in learning more about how to do this has been widely expressed.<sup>5</sup> The rights-holder groups assert (with some substantive evidence to back them up)<sup>6</sup> that locally controlled forestry leads to responsible, long term sustainable forest management, including protection of biodiversity, improved livelihoods, multiple forest products and services, local enterprises and benefits to society.<sup>7</sup>

Sustainable, locally controlled forestry is highly relevant in the context of global efforts to reduce deforestation in order to mitigate climate change. Illegal logging is being tackled through the US Lacey Act and EU FLEGT Action Plan<sup>8</sup> and scaling up local forestry is one way of dealing with the legal ambiguity in the informal domestic sector. Market-based solutions are likely to play a leading role in any global scheme to reduce emissions from forestry (e.g. REDD+) and there is a general consensus that changing the economics of landscape management so there are incentives for managing forests sustainably is a key priority. This will attract more interest in locally controlled forestry, but not necessarily in a manner that benefits rights-holders.

Exactly what **investing in locally controlled forestry** means in practice has been the subject of dialogues<sup>9</sup> hosted by The Forest Dialogue (TFD) and co-chaired by investors and rights-holders. Broad discussions have identified how different types of investments can improve the conditions for locally controlled forestry (such as clarifying rights, strengthening organisations, and building business capacity), or can invest directly in woodlots, landscapes, processing businesses and ancillary services. Dialogue participants prioritised the need for better understanding of how to invest in this sector because of:

- ▶ The comparative success of locally controlled forestry in conserving forests, mitigating and adapting to climate change and reducing poverty compared with state or corporate alternatives.
- ▶ The rather slow uptake of investment in locally controlled forestry to date compared to those alternatives.
- ▶ The need to improve cooperation and mutual understanding between investors and the forest rights-holders themselves.

This guide demonstrates how to achieve forest rights-holders' goals through stimulating investment in locally controlled forestry. But by 'forestry' we really mean small and medium-

sized enterprises (SMEs) that operate in the forestry sector. So, more accurately, this is a guide to **‘investing in locally controlled SMEs’**.<sup>10</sup> It is important to point out that this is a market-based view of development, rooted in an understanding of the globalised, free-market economy.

There may be alternative ways to advance the cause of locally controlled forestry, and perhaps a market-oriented strategy is not the solution for all rights-holders in all situations. However, there is strong evidence that the way many forests have been managed in the past 60 years has not led to good outcomes for either the forests or the people that dwell in them. Carving up forests into large industrial concessions has not usually led to trickle down benefits for forest communities.<sup>11</sup> Conservation areas and national parks have had mixed results, often bypassing local people’s rights and thus failing to build effective partnerships or a model of economically and socially sustainable forest management.<sup>12</sup> Microfinance for tiny boutique businesses serving niche markets, heavily supported by donors, may be useful proving grounds but it is often hard for such enterprises to make the step change to becoming a self-sustaining business.<sup>13</sup> The problem with all these approaches is that when the resources are exhausted or the grants are no longer available, the local people are often left worse off than before. This goes some way to explain the correlation between poverty and forests.<sup>14</sup>

TFD dialogues around the world have discussed the possibility that the answer to building sustainable economies in forests lies in the formation of a thriving SME sector, in which the rights-holders themselves hold a meaningful stake. SMEs are the ‘missing middle’ of many developing economies, and unlike either microenterprises or large-scale land investment, they can provide improved access to goods, services, quality employment opportunities, and markets. They are a way for forest communities to overcome isolation, build self-reliance and stand their ground in the political and economic institutions, thus shaping their own destiny, that of their descendants and of the forests.

### Box 3: What is locally controlled forestry?

Rights-holder groups have agreed on the following explanation for locally controlled forestry:<sup>15</sup>

**Local** means near or in the forest, where you can literally hear and see what goes on, and are therefore able to appreciate on a daily basis the multiple values that forest landscapes provide. Conversely, policy-makers and investors are usually far from the forest and may focus on a narrower subset of forest landscape values (e.g. timber revenues) to the detriment of the integrated whole.

The word **control** is connected to rights and responsibilities, with an emphasis on the idea that local management and political control is good for the people and good for the forest. Taken together, the words local control mean formal or informal ownership, management or use by forest dependent people such as smallholders, local communities and Indigenous Peoples, as opposed to those owned, managed or used by large companies or the state.

Whilst recognising the importance of wood production, **forestry** includes many other forest uses and services, from sacred and recreational uses to environmental services such as the protection of soil and water quality, biodiversity and low carbon emissions. Forestry means livelihoods for local people, and thus commercial use of forests must be based both on the needs of local people and on the considerate use of forest resources, including protecting biodiversity.

The big difference between investment in locally controlled forestry and other forest investments is the concept of **local control**.

Local control means that the local people really have to be in the 'driving seat' of the project and actively engaged in the project. Take, for instance, the principles behind the Nordic forest owners' cooperatives. The local forest owners own a part in their cooperative. They constitute the board and they hire the management. This means they have the 'last word', but do not necessarily have to be the qualified workers.

Of course, in many of the projects for which this guide is designed, it is likely that local people will be actively working in the forest, but that is almost incidental. Local control means that local people have to be *active in developing and implementing the project*. By taking control, local people also take responsibility, and that requires a concerned and active attitude in carrying out the project.

### 1.3 Structure of the guide

This guide is designed to be accessible and easy to use. Investors, donors, rights-holders and policy-makers will find general information as well as specific guidance. The guide does not seek to explain every aspect of indigenous, family or community forestry, or discuss the constraints facing the sector in any detail, as these can be quite specific to each country.

**The case for Investing in Locally Controlled Forestry (ILCF).** The guide starts by making the case for Investing in Locally Controlled Forestry (ILCF), considering the sector's attractions to investors, donors, governments and rights-holders. Governance and regulation plays a large part in making locally controlled forestry a viable investment class, so there is some detailed discussion of the broader macro and micro economic rationale for reforming and opening up this sector. This often involves a shift in common perceptions about the role of local people in relation to land, labour and capital.

**Understanding investment.** Our ILCF dialogue revealed many different types of investor, each with a different role. This section presents a typology of investors that has been used successfully to help investors allocate capital in a way that best meets their objectives and to help rights-holders ensure they attract the investors they deserve.

**Ingredients for success.** The ILCF dialogue also identified 'enabling conditions' that are crucial for successful locally controlled forest enterprises. Some of these are similar to principles, such as those used by forest certification systems. They all lead to practical steps rather than being moral imperatives. Some will be familiar as good business practice in any setting, while others are quite specific to locally controlled forestry.

**Roadmap to success.** This section sets out the steps in the process to making an investment deal, from initial preparation through to benefit sharing and eventual exit of the investor. It provides some examples of investment models and funding structures.

**Links to resources and partners.** There is a great diversity of businesses, social foundations and financial institutions interested in supporting locally controlled forestry. Many of these have emerged in the just the past few years.

## 2 The case for Investing in Locally Controlled Forestry (ILCF)

Now is an opportune time to clarify how to invest in locally controlled forestry. Numerous REDD+ strategies and readiness plans have identified issues that must be tackled to avoid deforestation, but climate change funding organisations show little understanding of how to marshal investments to make that happen. Similarly, a UN report by the Special Rapporteur on the right to food recognises that continued investment in industrial agriculture is unlikely to ensure global food security.<sup>16</sup> Instead, investing in ‘agroecology’, with biodiverse and biomass rich agro-forest production systems, may be key in an ever more variable climate. Understanding the benefits of ILCF could strengthen global initiatives such as REDD+, as well as improve planning for increased food production.

A first step towards mobilising investment in trees and landscape restoration is to recognise that almost all forests and landscapes are inhabited by people with some form of land rights, of varying degrees of formality. Investors are increasingly aware they must respect these rights through some form of Free, Prior and Informed Consent (FPIC) process, although the practicalities have received less attention.<sup>17</sup> The output of a FPIC process, although it may be scrupulously fair, is often simple compensation for loss of access to land or resources, rather than a genuine shared enterprise. This may even become more likely as REDD+ projects proliferate, if they are designed to merely pay communities to ‘avoid deforestation’, rather than find ways to invest in locally-controlled rural economies.

Failure to benefit rights-holders, even after an FPIC process, is usually because investment follows a conventional **‘resource-led’** paradigm in which capital seeks natural resources and, as a side effect, needs some labour (figure one below).<sup>18</sup> But job creation may be limited for local rights-holders – indeed, such projects often attract migrant labour.

Figure 1: The resource-led system



In this paradigm, undeveloped land is ‘empty’ and has no value, and any informal customary rights over the land are subordinate to the wider national interest. Indeed, governments and investors see such traditional rights as pre-modern, inscrutable and an impediment to development. There is also an assumption that because forests are often sparsely populated, the land must be unclaimed wilderness. It seems corporations and conservation NGOs alike often share this assumption. It is this view of an extensive, virtually limitless expanse of land, unfettered by formal boundaries and seemingly devoid of people, which drives this approach to land use and natural resource extraction, and generally brings poor outcomes for forests, landscapes and local people.

In contrast, a **rights-based system** places local control at the heart of the process, as rights-holders seek investors and partnerships for managing their natural resource assets (see figure two). This approach recognises local people’s autonomy and their rights to determine the land’s destiny and to gain income from its effective management.

Figure 2: Rights-based system



A genuine business partnership between investors and local rights-holders is both a result of the rights-based approach and a way to sustain it, so avoiding the failing ‘resource-led’ approach to releasing value from forests and landscapes.

Of course, a deal that recognises pre-existing local rights needs a stronger basis than mere proximity to natural resources. Over-emphasising the inherent rights of rights-holders, such as Indigenous Peoples, focuses attention on the distribution of natural resource rents (or royalties), rather than on the added value of the business venture. Focusing solely on either resources or rights diminishes the importance of labour, skills, markets, capital and institutions. Ironically, by emphasising rights to the natural resource rents, local people may trap themselves in the ‘resource-led’ paradigm, where investors are happy to negotiate compensation for access, and add some corporate social responsibility initiatives (see box below) but never engage in building a true business partnership. In contrast, a rights-based system lets rights-holders both profit from natural resources and drive the deal, deriving multiple benefits from the enterprise.

#### Box 4: Corporate Social Responsibility (CSR) is not the same as local control

Some large companies and investors engage with forest communities through a tactical CSR approach. This may be a pragmatic decision, for instance to avoid conflict with local people, or it may be driven by the ‘social licence’ requirements of certification schemes. However, these CSR projects rarely meet the definition of ‘local control’ because they lack partnerships between the investor and local rights-holders.

For instance, in a recent FAO survey of 42 investors collectively managing USD 36 billion of forestry investments, only one firm confirmed that they had a written social policy that considers relationships with local communities and indigenous people. Several firms noted that they contribute to ‘local community entities or conservation organisations as part of being a responsible corporate citizen’, such as ‘constructing or funding bus shelters, education programs, nutrition, and health clinics.’ The investors saw these activities as ‘part of their serious responsibility as a significant local landowner, and to help attract the best labour for their forest investment.’

These same investors also see the key constraint for investment in emerging markets as the absence of clear land tenure and the barriers to legal foreign ownership of land and forests. The goal for supporters of locally controlled forestry (and for this guide) is to demonstrate to investors how building a proper investment partnership with local rights-holders can ensure stable access to forest assets, without the need for obtaining the freehold. Alienating local people from their land, and compensating them with patronage schemes (for example, by building a bus shelter) is not a substitute for serious engagement, and will not lead to social and economic progress. CSR is an example of the old ‘resource-led system’ described above.

## 2.1 What Locally Controlled Forestry offers investors

There are many types of investors, seeking different rates and types of return (examined in the next chapter). Most types of investor can benefit from locally controlled forestry for one or more of the following reasons:

- ▶ The general argument for sustainable forest management as an attractive uncorrelated asset class holds true for locally controlled woodlots or natural forest as much as it does for large industrial units.<sup>19</sup>
- ▶ A good investment partnership with communities, combined with certification standards such as PEFC or FSC,<sup>20</sup> has been proven to lower the cost of capital for investors, by reducing risk and providing evidence of long-term management quality. It is also part of the 'social licence' to operate in forest areas.
- ▶ Increasingly, investors are taking a more holistic strategic view of the systemic connection between the quality of the environment and long-term economic growth. In a resource constrained world, reliable and sustainable flows of ecosystem services will be crucial if we are to supply the basic resources of food, fuel, fibre and water.
- ▶ Some investors are also philanthropists, whilst some philanthropists (and donors) are moving into making investments. They appreciate the importance of evaluating impacts beyond financial return, such as social, cultural and environmental benefits. Locally controlled forestry is a natural fit for such investors.
- ▶ Some types of investor are interested in improving their supply chain management to secure long term supply of raw material or finished goods, often with credible evidence of social and environmental sustainability.
- ▶ Investors in REDD+ (both financial investors and bilateral or multilateral donors) are becoming aware that including local people and understanding the economic incentives they face plays a crucial role in ensuring a successful REDD+ project (this is explored in more detail below).

### Box 5: Case studies: examples of investments in locally controlled forestry

There are many examples of investment in locally controlled forestry, some of which are included as case studies at the end of this document. Highlights include:

**GreenWood** in Honduras and Peru works closely with communities to ensure a reliable supply of quality timber needed for its musical instrument business. So far GreenWood has purchased US\$ 900,000 worth of guitar parts from communities.

**Planting Empowerment** in Panama is a new company that has raised over US\$180,000 in equity financing for tree planting on lands owned by local people, with a benefit sharing structure.

**Green Gold Forestry** in Peru has found that forming a productive partnership with local communities to manage natural forest sustainably has improved the 'social licence to operate', and has also reduced risk and potentially lowered the cost of capital.

**Cochabamba** in Bolivia has managed to construct a business model that links small investors in the UK to smallholder woodlots in Bolivia, using an innovative finance structure that can pre-finance planting while deferring cash repayments and interest until the harvest.

**Wildlife Works** in Kenya has a project that protects over 500,000 acres of forest and shares benefits from direct carbon financing with local communities whilst securing a corridor between the Tsavo National Parks.

**PhytoTrade Africa** is investing US\$150 – 200,000 in a facility in Southern Africa that will process 150 tonnes of baobab powder annually and would involve around 1,000 local people.

**The Lake Taupo Forest Trust** in New Zealand has invested US\$30 million in forest rehabilitation, aiming for a real net return of six to seven per cent.

**PINFOR** was set up by the government of Guatemala, financed using one per cent of state operating expenses. As of 2009, it has provided about US\$134 million to the forest sector and helped establish roughly 100,000 ha of plantations.

## 2.2 Benefits for rights-holders

Rights-holders' advocacy groups and associations, such as the G3 mentioned earlier, have been the driving force behind the ILCF initiative. In many tropical countries the people who live in and around the forests, despite holding strong claims of rights over the land and its resources, are increasingly marginalised by governments and large corporations. Furthermore, they are often the poorest people, isolated from social services, market opportunities and political influence.

Emerging market structures for REDD+, and even some of the mechanisms to reduce illegal logging (such as FLEGT), may not improve forest communities' circumstances. Rather, they could threaten legal or customary rights and the economic status of forest dependent people. Inappropriate targeting of financial support could limit peoples' access to their forest resources, undermine local institutions and erode the ability of local people to maintain their culture and livelihoods.

Local people need to retain control if they are to benefit from these financial mechanisms. Forest dependent people are demanding a key role in designing and implementing investments. Local control lets rights-holders:

- ▶ Reinforce and formalise tenure and rights.
- ▶ Build resilient and viable local economies.
- ▶ Open up fulfilling work options.
- ▶ Manage their natural resource endowment for long term prosperity.
- ▶ Use increased financial capacity to get some autonomy over the development process and manage the complex transition to a market economy, whilst maintaining their cultural identity and social structures.

### Box 6: Tenure shapes everything

"Tenure shapes a country's forest industry and economy. There is ample evidence in some developed forested countries – e.g. the United States, Sweden, and Finland – and developing countries – such as Mexico and China – that the recognition of local rights has a profound effect on the structure of industry and increases the potential for forestry to generate jobs and economic growth and contribute to good governance. Small-scale and community initiatives around forests can also provide invaluable ecosystem services, including climate change mitigation--given the necessary tenure reform." – Rights and Resources Initiative<sup>21</sup>

"...There is rarely a better way [than community forest management] to balance the interests of poor people and forests. But to do a good job, communities need strong property rights..." – The Economist<sup>22</sup>

"At the utmost land and forest tenure reform is about increasing people's welfare and living standard, reducing poverty by providing jobs, and living in harmony with the environment" – Kuntoro Mangkusubroto, Government Minister, Indonesia<sup>23</sup>

## 2.3 Benefits to governments

Many of the pre-conditions for successful investment in locally controlled forestry are under the control of governments. Some governments have already adapted policies to favour locally controlled forestry and enterprises as the cornerstone of sustainable development. However, forest policy in many countries is still on a boom-bust trajectory, whereby the natural capital of forests is converted into financial capital that can finance development. The local people have usually not benefited from this experience, in fact studies show that in many cases they are left worse off than before.<sup>24</sup> Some governments are coming to realise that the old paradigm of centralised control (explained earlier) is incompatible with jobs, growth and welfare, and are taking steps to pass control back to the local people. However, handing over control of such an important strategic asset takes political courage, and should be done with care in order to avoid problems caused by disorderly devolution of authority. As rights-holder groups themselves point out: **‘local control is a process’**.

The benefits of locally controlled forestry are considerable, in terms of economic development, social harmony and environmental sustainability. A global review found that, compared with their private-sector equivalents, community forest enterprises tend to invest more in the local economy, foster greater social cohesion and longer-term equity, and are also positive forces for biodiversity conservation through, for example, investments that lead to significantly fewer forest fires.<sup>25</sup> In short, local control means better asset protection and a higher sustainable income from forest resources in future.

The case for local control of different forest and tree based enterprises across the landscape can be viewed in economic, social and environmental terms:

**Good for the economy.** From a public policy perspective, investment in locally controlled forestry builds productivity and efficiency in the land-use sector, whilst laying the foundation for bottom-up rural economic development. Unlike the vertically integrated industrial model of forest resource management that has dominated for so many years, small-scale industry has specific micro-economic characteristics that generate a ‘multiplier effect’ in rural economies. The effect is enhanced further when businesses are locally controlled, as this brings a diverse array of skills and interactions down to the local level. It means that a rural town is home not only to woodcutters and haulers, but also managers, bookkeepers, drivers, salespeople and silviculturalists. This diversity enhances the communities’ ability to build a local economy that is more skills-based and less reliant on commodity prices.

As these multipliers feed into broader economic growth and more diverse activity, they are accompanied by increased formalisation. This means that micro-enterprises previously in the informal sector make the step change into formally registered businesses. They start to pay tax, which in turn broadens the fiscal space for the local and national government. This is particularly important for countries that derive a large part of their national income from natural resource rents.

Because wealth is accrued locally, resource rights are secured as enterprises develop, social capital is enhanced and local environmental accountability is strengthened.<sup>26</sup> This translates into entrepreneurial skills, higher incomes, higher local consumption and improved terms of trade.

**Good for society.** Local economic development, where it involves active participation by local people, has obvious social benefits. Specialising in small enterprises (such as timber processing) allows households to make a smooth transition from subsistence living to the market economy. Time gained through buying food in the market instead of hunting or gathering can be spent participating in local institutions. For instance, the DFID-funded community forestry programme in Nepal saw an increase in civic engagement by forest communities, leading to stronger institutions, whilst involvement in Forest User Groups helped marginalised people overcome social exclusion.<sup>27</sup> Surplus income is often invested in health and education, improving the welfare of the next generation through better nutrition and broader horizons for fulfillment. Communities with a mosaic of locally owned businesses tend to have more self-confidence, political influence and autonomy.

**Good for the environment.** It is a common generalisation that forest-dwelling people are naturally disposed to be careful stewards of the environment, and where they do collude in forest degradation they do so for understandable economic reasons (the ‘poverty causes deforestation’ argument). Similarly, it is generally true that where forest-dwelling people receive financial benefits from the forest, they have a strong incentive to keep the forest standing.<sup>28</sup> This may not be entirely accurate for all people in all places (just as generalisations about large corporations may overlook the better examples), but widespread evidence from around the world demonstrates that private property holders, including those with communally-held property rights, can and do protect public goods if the appropriate incentive structure is in place. In fact, rural communities own, or administrate under licence, at least one quarter of forests in developing countries; and they invest \$2.6 billion in conservation, exceeding state funding and all forms of international conservation expenditure combined.<sup>29</sup> A recent meta-analysis of case studies found that deforestation rates are substantially higher in forests managed by the state than in community managed forests.<sup>30</sup>

### Box 7: Tenure reform is an essential step in the development process

Some developing countries have embraced forest tenure reform, but with varying degrees of success.<sup>31</sup> A common desire is to improve forest stocks and achieve pro-poor development in remote areas where poverty has hitherto seemed intractable. Property rights are being extended to the communities that live in forests. The resulting economic benefits may be attributable to property rights in general or to the value of forest management in particular.

The evidence for the general economic benefits of property rights is uncontroversial and has been available for some time.<sup>32</sup> However, there has been less consensus over why such rights lead to economic growth, and to what extent benefits can be expected from all forms of property, including forests, and from any form of tenure, such as customary rights.

Nonetheless, the studies do all seem to agree that improved certainty of tenure leads to enhanced value of the asset, whether it be a house in the city, a farm in the hinterland, or, one can surmise, an area of forest. If local communities have a commercial interest in products derived from standing forest, they are likely to invest in keeping the forest standing.<sup>33</sup> The same logic applies to smallholder forestry or agroforestry plantations where commercial outsourcing through contract farming arrangements creates incentives for local communities to restore and manage tree crops on agricultural land.<sup>34</sup>

The debate over the general economic role of tenure reform is relevant to forest policy in the following ways:

a) The role of formal tenure (or any legal method that enhances the legal certainty of the property right) seems to be to enhance the holders’ willingness to make long term investments of labour and capital. This may explain why enhanced tenure can be correlated with better long term forest management.

b) Tenure comes in many forms, and titles such as freehold may not always be appropriate in forestry. Customary forms of land ownership can be just as effective if they are accompanied by wider social and legal recognition. These rights are given form and meaning by the surrounding institutions. As de Soto put it: *'It is not your own mind that gives you certain exclusive rights over a specific asset, but other minds thinking about your rights in the same way you do'*.<sup>35</sup>

c) Tenure reform is a necessary, but not sufficient, condition for improving economic outcomes in either agricultural land or forestry. Other factors are also important, such as decent governance, an enabling environment for enterprise, access to finance and macroeconomic stability. Nevertheless, surveys of investors have made it clear that they will not invest (or lend) if tenure is uncertain, as the risks are not justified by the eventual returns from forestry.<sup>36</sup>

However, these arguments could also be made to justify allocating stronger property rights over the forest to a few companies or private individuals. Governments may be wary of allowing more local control of forestry until they are certain that investment will continue to flow into the sector, and raw materials will still be available for industry. The safest option may seem to be to continue the 'business as usual' model of large-scale commercial forestry, founded on the states' claim to the forest land regardless of pre-existing rights, and allocated by way of concession or lease to large private companies.

The counter-argument to this top-down policy approach is built on four claims:

- ▶ Firstly, research suggests large-scale commercial forestry has at best avoided exacerbating poverty. Evidence that it has reduced poverty is scarce.
- ▶ Secondly, the allocation of concessions, plantations and so-called 'land grabs' leads to poorly compensated loss of assets to both the state and local communities.<sup>38</sup>
- ▶ Thirdly, an analysis of growth in 73 countries in the period 1960–2000 found that countries with relatively equitable initial land distribution achieved growth rates 2–3 times greater than those in which land distribution was less equitable.<sup>39</sup>
- ▶ Lastly, countries with a more successful small and medium sized enterprise (SME) sector tend to enjoy more resilient economic development.<sup>40</sup> This is particularly true for the agriculture sector, where family farms are more productive than those operated by hired labour. Indeed, the major research in this area has concluded that redistribution of land from large farms to smaller family units can increase productivity.<sup>41</sup>

Together, these arguments make a strong case for reforming tenure in order to achieve locally controlled forestry and economic, social and environmental benefits. Some countries (for example, China), have arrived at this insight after attempting less successful methods of landscape and forest management. They have realised that such rights-based reforms are part of what may be called the 'art of government', meaning they seek to maximise peoples' long term benefits from the natural resources; avoiding the seemingly quicker path of alienation, seizure and coercion that diminishes human welfare, undermines liberty and eventually must weaken the state's legitimacy.

## 2.4 Benefits for donors and NGOs

Donors and NGOs approach rural development from several different angles, most recently through a bottom-up perspective that aims to empower people through initiatives such as community-based natural resource management. However, their investments in locally controlled forestry programmes seem to vary depending on their methodological approach, that is, whether the organisation is pragmatic, skeptical of, or advocates locally controlled forestry.<sup>42</sup>

**Pragmatists** believe that local forestry may or may not have market advantages, but is so widespread that they have to engage to improve it.

Pragmatic donors, NGOs and conservation organisations see ILCF as a means to an end, and will be interested in meeting social or environmental goals as well as business goals. They

may require that the business or project accommodate certain cherished themes, such as gender, or species conservation. They may see the project as an opportunity to clarify rights in the local institutional and social context, and solidify them in the national legal system, perhaps as part of a process of governance reform.

**Sceptics** think local forestry rarely has market advantages and suffers disproportionately from market failure – so therefore warrants support.

In many cases, donors feel motivated to support ILCF because they recognise problems in the value chain that constrain local communities from managing enterprises successfully. They may therefore set up parallel markets and differentiation (such as FairTrade), or compress the value chain to capture a greater share of the income, for instance through setting up clearing houses for aggregation and marketing of community products. They may also see their role as shielding communities from the risks associated with private enterprise.

**Advocates** are convinced that local forestry has intrinsic multiplier advantages and so is the preferred economic model.

Many donor-funded initiatives supporting locally controlled forestry demonstrate high commitment and local voluntary investment, as well as good returns on planting materials and labour. Homegrown institutions and practices are maintained and not replaced by imposed, state-sanctioned management systems. And investments in community groups can achieve substantial cost savings when rehabilitating degraded land.

## 2.5 Benefits for low carbon development

Regardless of their attitude to locally controlled forestry, many donors and governments are concerned with climate change and are planning projects that seek to Reduce Emissions from Deforestation and Forest Degradation (REDD+). Investors, meanwhile, are interested in these projects, as they aim to use market or other financial incentives to achieve their goal, for instance through carbon trading.

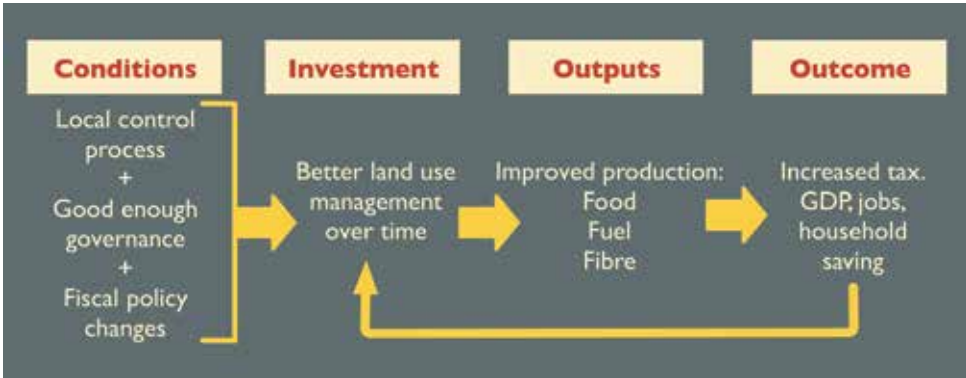
However, critics point out that carbon trading is unlikely to meet REDD+ objectives.<sup>43</sup> They argue that a commodity-based approach is at odds with the developmental benefits that REDD+ will need to generate if it is to work at all. Across many commodities markets it will be intermediaries, rather than producers, whom are likely to gain control of the REDD+ market, leaving governments and local forest owners to capture only a fraction of capital flows. This potentially reinforces the inefficiencies and the inequity that already characterises the land-use sectors in many low income countries, further undermining the position of forest rights-holders.

There is a strong case for concentrating on ILCF in order to ensure successful REDD+ projects. Locally controlled forestry holds the key to a better approach to reducing emissions in the land use sector. The first step is to see carbon as the co-benefit when investment in people and landscapes is combined with on-going improvements to fiscal systems and land tenure. It makes sense to invest in the future cash flow from commodities that have a certain demand and ready market, such as timber, power, food and cash crops. And this is in line

with most governments’ development goals. Figure three below shows a simplified model for how investment in SMEs that produce tangible commodities (food, fuel and fibre) can create a positive feedback loop of improved livelihoods, increased tax revenue and lower emissions.

Re-casting REDD+ as an **investment in locally controlled forestry** not only leads to improved economic outcomes, it also improves the political economy in a manner that can help developing countries shift onto a more sustainable low carbon development path. An improved REDD+ investment model, focused on locally controlled forests and landscapes, could improve the business case for sustainable forest management, reforestation and using trees in landscapes and agroforestry. As jobs and growth improve, political will for further institutional reform will strengthen, which will in turn lead to better land use management and achievement of REDD+ goals. An holistic approach to forests and landscapes, with a blend of investments in locally controlled SMEs, could set up the conditions for sustainable and equitable development.

Figure 3: How investment in SMEs creates a positive feedback loop of improved livelihoods, increased tax revenue and lower emissions





### 3 Understanding Investment

To increase investment in locally controlled forestry, we must first understand who is investing, or might invest in the future. As the case studies in chapter 7 illustrate – and as many rights-holders will know from their own experience – many different types of organisation fund commercial forestry activities. Some of these investments are part of development projects, some may be linked to environmental protection, and many others will simply be ways to access natural resources (using the old ‘resource-led system’).

This section aims to make sense of the situation by setting out a framework for understanding and categorising investments. This should help investors, donors and philanthropists place themselves in the ‘investor universe’, while letting other stakeholders (especially rights-holders) understand what motivates different types of investor. Locally controlled enterprises will find out how best to attract an investor they deserve, in the sequence that best fits their needs.

#### Box 8: What is an ‘investment’?

investment |inves(t)ment| (noun)

1. The action or process of investing money for profit or material result: *a total investment of \$50,000 in a local sawmill.*
2. A thing that is worth buying because it may be profitable or useful in the future: *a private woodlot could be a good investment.*
3. An act of devoting time, effort, or energy to a particular undertaking with the expectation of a worthwhile result: *the time spent in attending a management skills workshop is an investment in our professional futures*

[Based on Oxford American Dictionary]

The term ‘investment’ has a slightly different meaning when used in finance than when used in economics. In **finance**, an investment is generally understood to involve both a tangible cash input and output, as in the dictionary definition above. In **economics**, on the other hand, cash investment of this sort is merely a re-distribution of resources (the money has just passed from one hand to another but the aggregate stock of money has not changed). For an economist, ‘real’ investment refers to the way that the stock of something may be increased, for instance capital goods, infrastructure, or human capital (for example, the government “invests in education”). A private company may be said to be investing in research and development in order to increase the stock of marketable knowledge, or investing in marketing in order to increase brand value.

For the purposes of this guide, our definition of ‘investment’ encompasses both these meanings. An investment is the act of handing over resources (for instance in the form of money, effort or time) with the expectation of some kind of result at some point in the future.

**The act of investment changes the way something works.** The result of this change may lead to financial gain for the investor, but it may lead to benefits being distributed in other ways. Both the inputs and the outputs could be non-financial, in some cases the benefits can be very hard to trace and measure accurately.

#### 3.1 Why we need to think about investment differently

For a locally controlled forest enterprise that is struggling to raise investment capital, like many other SMEs, it may be reasonable to assume that any kind of investment will do. Money is useful wherever it comes from. However, not all investment is the same, and a mismatch between the goals of the investor and those of the enterprise can create problems in the future. Profit-seeking investors have fairly straightforward goals that should also be shared by the enterprise – that is, make a profit. But these investors are also the most demanding, and most SMEs fail to meet their criteria.

Therefore, where investment in locally controlled forestry has taken place, it has often been from governments, donors and philanthropists, working through NGOs or state-run bodies. In some cases investment has also come from the private sector, under the umbrella of a Corporate Social Responsibility scheme. The downside of these kinds of investment is that they usually aim to achieve non-business outcomes, such as social or environmental goals. That may mean they bypass the essential business development steps needed for long-term commercial success.

With a few exceptions, trading companies set-up by NGOs are neither commercially successful nor efficient at meeting social and environmental goals. In the community forestry sector, unused sawmills standing rusting in the forest, the legacy of a well-meaning grant from an NGO or local government department, exemplify failure.<sup>44</sup> Gifts of equipment, or soft loans without conditions, suppress the real underlying viability of the business. Enterprises that might otherwise have been able to achieve self-sufficiency become dependent on subsidy, and capital is misallocated to the visible and easily verifiable items (such as sawmills), rather than the crucial, but hard-to-measure, aspects of business development, such as leadership skills and technical training.

When the non-profit sector makes soft loans in an effort to use commerce to meet their social or environmental goals, or for-profit companies set up CSR schemes in an effort to achieve a ‘social licence’ for their main commercial activities, then both expertise and capital are being poorly allocated. The end result is blurred boundaries, confused goals and, most crucially, mainstream investors remaining on the sidelines, unconvinced and unengaged.

Table 1: Strengths and weaknesses of investors in locally controlled forestry<sup>45</sup>

	Strengths	Weaknesses
<b>Non-profit sector</b> (e.g. governments, donors, NGOs)	<ul style="list-style-type: none"> <li>• Intrepid</li> <li>• Local influence</li> <li>• Seen as legitimate actor</li> <li>• Able to experiment</li> </ul>	<ul style="list-style-type: none"> <li>• Competing goals (e.g. conservation v. livelihoods)</li> <li>• Funding led by trends</li> <li>• Lack of business focus</li> <li>• Misunderstands the value chain (e.g. role of middlemen)</li> <li>• Displaces private investment</li> </ul>
<b>For-profit sector</b> (e.g. banks, investors, foreign direct investment)	<ul style="list-style-type: none"> <li>• Access to large amounts of capital</li> <li>• Long-term view</li> <li>• Focus on the market</li> <li>• Understands the value chain</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of commitment to local rights</li> <li>• Accessing natural resources may be main goal</li> <li>• Not very intrepid</li> <li>• Deterred by uncertainty</li> <li>• Poorly designed CSR projects</li> </ul>

This is why we need to change the way we think about investment. The non-profit sector has valuable expertise on engaging with forest communities, and is intrepid enough to get involved in isolated areas. Governments have the resources to address market failures, improve the conditions for investment (for example, through tenure reform) and reduce transaction costs. Meanwhile, the for-profit sector has a grasp of commercial reality and links to markets, technology and capital. The table above summarises the strengths and weaknesses of these different sectors.

However, this division of investors into ‘non-profit’ versus ‘for-profit’, or ‘soft’ versus ‘hard’, implies a bifurcation that does not really exist in practice. For instance, cooperatives can be aiming to make a surplus in order to remain viable, but their ownership structure of ‘one member, one vote’ is very different from the classic private company shareholder model. Furthermore, some cooperatives have proven to be very shrewd investors in private sector industry, strengthening their organisation’s financial foundation and yet still meeting their social and environmental goals. A good example of this is Södra in Sweden (see case study). Similarly, there are many private sector investors that are interested in making a profit whilst also achieving non-financial goals. Yet these struggle to find an entry point for investing in locally controlled forestry. The challenge is to design an investment framework that can help different investors identify the purpose of their investments, and the particular skills they bring to the venture. Through mitigating the weaknesses and taking advantage of the strengths of each actor, investments can be allocated in the most efficient and effective manner.

### 3.2 Enabling and asset investments, a new framework

For locally controlled forestry – or indeed any SME sector – to succeed, the individual enterprises must aspire to eventually be mainstream clients of banks or desirable investment destinations for equity investors. If they remain dependent on endless subsidy then they are inherently unsustainable. So how can we combine the flexibility and pioneering nature of certain types of grant, with the discipline and scale of profit-seeking investment?

Combining the many discussions at the Forest Dialogue meetings, and the literature on impact investment and enterprise philanthropy, suggests the most appropriate way to characterise investment types is as either ‘enabling’ investments or ‘asset’ investments. In this model, there is no need for a tolerant ‘soft’ investor in the middle, who is neither taking big risks nor getting decent returns. Investment is either channeled to creating the enabling conditions (so it is pure grant), or is engaged in impact investing (where some form of return – however low – is expected). In summary, the enabling investment creates the public goods, which in turn enable asset investments to create private assets. These private assets are not just carried away by the investors, they are the assets formed by the rights-holders themselves: in companies, private savings, physical infrastructure and improved health and education. In the mission to achieve equitable economic growth combined with environmental sustainability, public goods and private assets are co-dependent.

#### a) Enabling investment

Enabling investments are made by governments, donors, NGOs, philanthropists, rights-holders and the private sector in order to create the conditions for productive investments in assets. Enabling investments may be the basic nuts and bolts of institution building, but they could also be pioneering investments that **create public goods** such as SME forestry business models, associations, market linkages and new technology. Enabling investment differs from the usual donor grants as it is made into both public institutions and private businesses. Grants to businesses are not for working capital, but are for a narrowly defined purpose, linked to the main objective of moving the enterprise further towards being self-sufficient and thus capable of attracting capital investment. But in each case there is no expectation of a direct financial return on capital deployed and no financial or physical assets are accrued.

### Box 9: Enterprise philanthropy as an enabling investment

Philanthropy has become increasingly influential in stimulating private enterprise in developing countries, especially in the SME and agricultural sectors. For some philanthropists, intervention is similar to grant funding, whereby they are acting similarly to a large donor, but with a more informed pro-market focus.<sup>46</sup> Others are taking an explicitly private sector investment approach, and expect some form of investment return, perhaps to maintain the capital base of a revolving fund. This is more akin to impact investing. Somewhere in the middle are investors that claim to be seeking some social and environmental impact first and foremost, but then may also be interested in some 'moderate' financial return as well.<sup>47</sup>

However, for impact investing to be possible, private enterprise needs better enabling conditions. **'Enterprise philanthropy'** helps build these conditions, providing seed capital for concept development and validation, while also backing the institutions and specialist intermediaries that are often needed in order to make markets work for SMEs.<sup>48</sup> Enterprise philanthropists also use their private sector expertise to help donors improve their approaches.

*"Enterprise philanthropy aims to establish models for inclusive business into which return-seeking capital can be invested"*<sup>49</sup>

#### b) Asset investment

An asset investment is not expected to lose the nominal value of the underlying capital, even if the anticipated level of financial return may vary according to the needs and attitudes of the investor. The investor deems the capital invested as an asset, which either has immediate tangible value (for instance through the payment of interest on a loan) or gives the right to receive future cash flow. The aim of this kind of investment is to create **private assets**. Asset investments may be made by either income or product investors, each of which are looking for a different type of return:

- ▶ **Profit-oriented** investors are looking for places to invest their money and earn a return on their assets. They include banks,<sup>50</sup> government sovereign wealth funds, private equity funds and pension funds. They also include rights-holders, who may be setting aside their forest land in order to earn future income. Any of these investors may be impact investors – as described above – but they may also be pure **'value investors'**, that is, they are mainly aiming to ensure their financial return is commensurate with the risk of the investment. In the context of forestry, especially in emerging markets, this may require a high level of return. For instance, in a recent survey, investors indicated that they required an internal rate of return (IRR) of 12–20 per cent for tropical forestry investments, or a premium of at least seven per cent over equity returns.<sup>51</sup>
- ▶ **Product-oriented** investors are involved in some kind of manufacturing or sales business and are either seeking raw materials, or products they can sell. They include processing mills, specialist manufacturers and wholesalers. They may be investing in forest businesses in order to stabilise their supply chain. It is most likely that they would be combining their asset investment with 'enabling investments' in order to strengthen the supplier's capacity. In fact, for the purposes of this framework, a company that is only buying product without making any additional investments in the supply chain is not an investor, but is just a buyer.

### Box 10: Impact investing as an example of asset investment

Increasing numbers of investors reject the notion that they face a straight choice between investing for maximum risk-adjusted returns or donating cash for a social purpose.<sup>52</sup> Such investors now want to move beyond ‘socially responsible investment’, which focuses primarily on avoiding investments in harmful companies, and instead seek to actively deploy capital in businesses and projects that can improve human welfare and ecological integrity at scale.<sup>53</sup>

This is now called ‘impact investing’, defined as:

*“Investments intended to create positive impact beyond financial return”<sup>54</sup>*

Note that this does not mean creating positive benefits instead of a financial return. Impact investment operates in the real world of markets, capital, land and labour. Indeed, some philanthropic foundations are explicitly interested in applying free market principles to social and environmental challenges.

### Types of investors

The division into ‘**enabling**’ and ‘**asset**’ investments applies to the way in which the money is used, but is not meant to imply that an investor is engaged in only one type of investment. Although at the extremes we find that, where locally controlled forestry is concerned, governments in general are only make enabling investments, and, at the other end of the scale, banks and return-seeking equity funds are only making asset investments, the table above shows that some investors may at times be making both enabling and asset investments.

It is important to note that the local rights-holders are also investors, as they will be expected to make in-kind contributions of labour, expertise and shared rights over land. These are **asset investments** as they are made in the expectation of a tangible return and should not be sidelined or deemed less important than cash input. However, rights-holders may also make **enabling investments** in order to build the public goods that will be essential for markets to perform adequately. For instance, spending time to set up associations, engage in the management of cooperatives and lobbying government are all enabling investments of various sorts. The combination of enabling and asset investment by rights-holders is probably the most crucial aspect of investment in locally controlled forestry.

Although investors may make both enabling and asset investments, this framework of categorising the investments is important, as the capital is being expected to perform very different functions and obtain types of return that are hard to compare between the two types. An investor, such as an NGO or philanthropist, who made no effort to differentiate between these types of investment, will not be able to accurately evaluate the success of the investment. In general, both types of investments are required for stimulating risky or innovative sectors, such as small forest enterprises. But the money should be kept in separate funds and judged by different criteria. The next section gives an example of how the different types of investment can be blended successfully.

Table 2: The investment framework

Type	Enabling investment			Asset investment			
Investor	Government	Donors Philanthropists	Rights-holders Product investors Philanthropists	Private sector companies	Philanthropists SWFs* Rights-holders	Banks	Private investors and equity funds
Vehicle	Projects	NGOs Research institutions	SMEs Intermediaries	Product purchase	Capital investment	Financial services	Capital investment
Goal	Private sector development		Fill the 'Pioneer Gap'	Sustainable supply chain, quality product	Return on capital plus social/ environmental impact	Payment of interest and return of principal	Risk-adjusted return on capital
Means	Public expenditure, e.g.: Infrastructure Fiscal reform Regulatory reform Subsidies	Grants, e.g. Organisational development, Institutional reform	Enterprise Philanthropy: Grants and seed funding, e.g. demonstrating validity of business model	Product investment via purchase order, prepayments	Impact investment via equity, loans	Loans secured against company or personal assets (e.g. land)	Value investment via: equity, loans
Output	Public goods			Private assets			

\*SWFs: Sovereign Wealth Funds

### 3.3 Layering investments to achieve both public goods and private assets

Many social enterprises and NGOs engage in some commercial activities, such as marketing non-timber forest products, Fairtrade products, timber, and so on. But due to high transaction costs and the organisation's mission to achieve certain social and/or environmental goals, their overheads are too high to be considered a viable business. Furthermore, they may not have the in-house skills to run a profit-making business. Indeed, in many cases these revenue-generating activities are seen as subordinate to the main purpose of the organisation. They may just be a handy way to make some revenue and thus gain from the cross-subsidy.

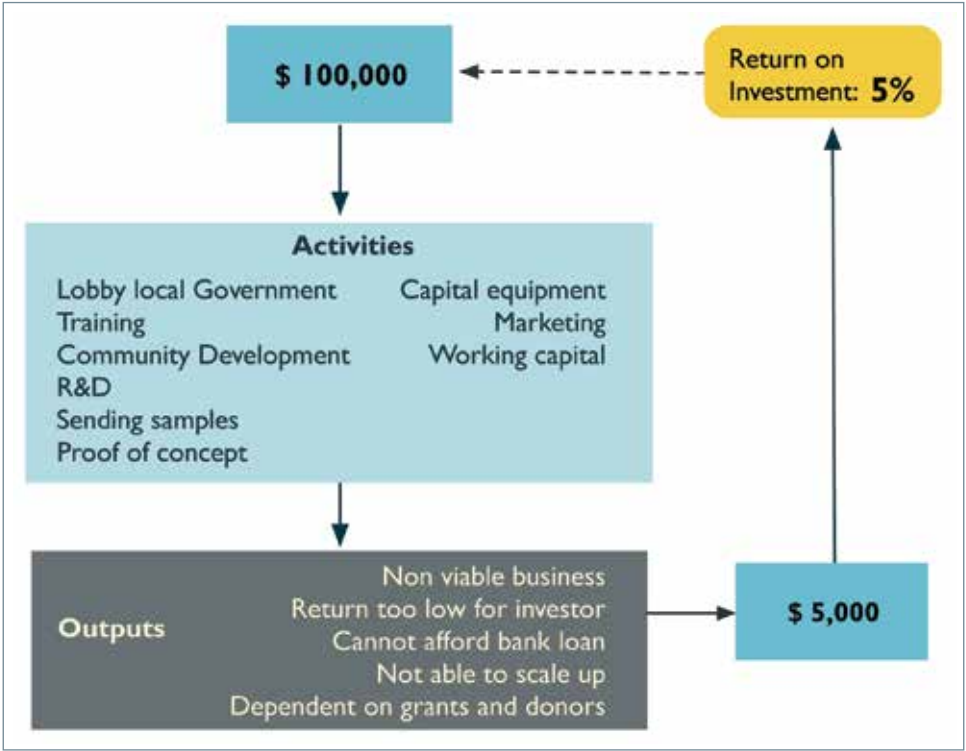
This leads to three main problems:

- ▶ The organisation cannot raise capital to fund the commercial activities as the rate of return is too low.
- ▶ Financial and social goals become muddled, or disguise the real performance of one or both sides to the enterprise, concealing weaknesses until it may be too late to correct them.
- ▶ Privately owned businesses trying to operate in the same region and sector may struggle to compete with what is, in effect, a subsidised enterprise. This could inhibit private enterprise development in the region, which could ironically undermine what the social enterprise or NGO is trying to achieve.

Figure four below illustrates a social enterprise requiring \$100,000 for a small forestry project specialising in processing and selling rainforest honey plans to invest in training, community development, processing equipment and marketing. The expected net surplus (profit) is \$5,000 pa, or five per cent of the investment, which is too low to cover the interest on a commercial loan or satisfy an equity investor. In these cases, a donor or philanthropist generally invests the whole amount required in order to achieve the social and environmental goals, but is less interested in the financial returns that may result. In this case the investor is not clear if the capital committed is an **enabling** investment or an **asset** investment, and has no means of evaluating what will constitute a successful outcome for the investment. There

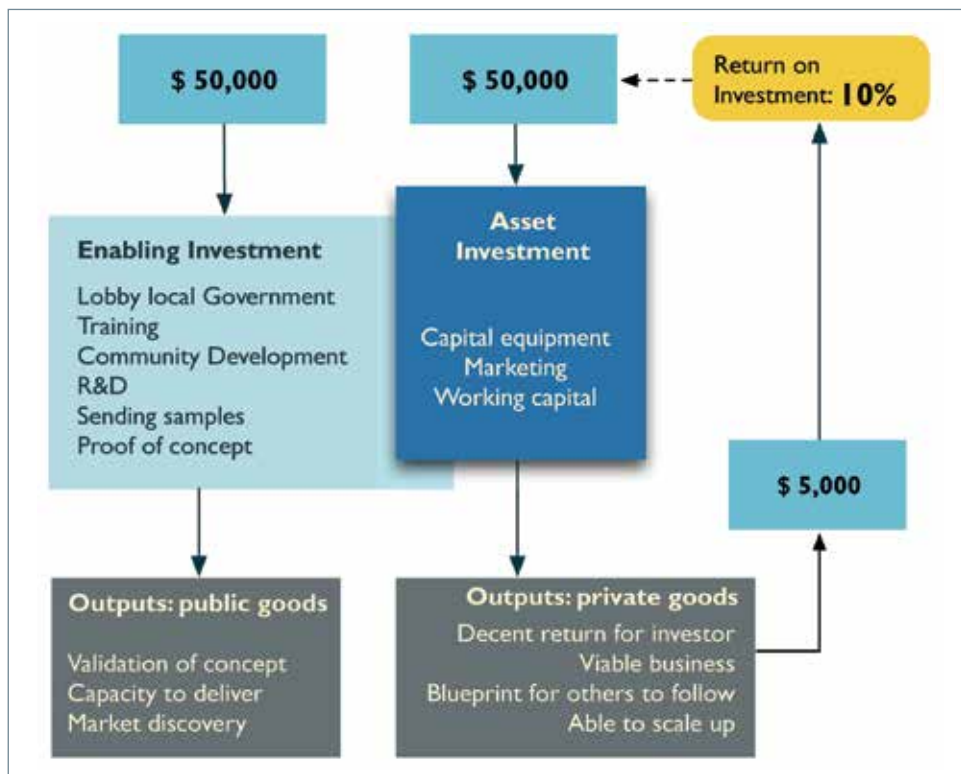
is a strong likelihood of moral hazard, whereby the enterprise fails to meet revenue targets, or misallocates capital, as it is aware that no sanctions will result from failing to service or repay the loan. On the other hand, if the donor attempts to enforce the terms of the loan, the business may be diverted from achieving the kinds of social and environmental outcomes that were the sole reason for the donor making the loan in the first place.

Figure 4: Using grants alone to invest in an enterprise



This is essentially a funding structure challenge,<sup>55</sup> and the solution is to borrow some techniques from the private sector. Figure five shows how this deal could be re-structured so that the commercial aspect of the deal is ring-fenced from the supporting activities. Depending on the size of the enterprise and local regulations, this may entail a separate legal entity being set up (but for smaller organisations this re-structuring deal could still work without that potentially complication). The commercial side of the business needs \$50,000, which can now be raised as a regular **asset investment**, either as a loan, an equity stake or some combination of the two. All the net income will be assigned to these investors, which will now result in a yield of 10 per cent (that is, \$5,000 divided by \$50,000). For certain asset investors this may be sufficient. Meanwhile, the donor is now able to invest the balance of \$50,000 as a grant, in order to achieve the social and environmental benefits of the project. The donor's **enabling investment** achieves the same non-financial impacts as before, but at half the cost, and the \$50,000 saved can be invested in another project. The asset investment achieves a realistic return and can also claim to be leading to the social and environmental 'impact' generated by the enabling investment.

Figure 5: Using layers of enabling and asset investment



This restructuring does not only improve the funding model, it also ensures that different types of investor are aligned with the right sort of investment. The value of the enabling investment will be measured by metrics such as household income, poverty levels, school attendance, maternal and child health. These can be quantified and used to compare the efficiency of this project in comparison to others, a level of evidence of impact that is becoming increasingly demanded by donors and philanthropists. On the business side of the project, the enterprise is able to focus on the financial results that will ensure long term viability and thus sustainability.

### 3.4 How investment decisions are made

Whether investors are looking for financial return alone or a combination of capital recovery and impact, they are generally applying similar criteria when evaluating an **asset** investment. These criteria arise from business convention and years of experience and evidence about how to judge the likelihood that a business will be able to deliver the promise made in the business plan. As the previous section made clear, even 'impact' investors seek impact **as well as** financial return, not instead of it. The first step in evaluating any asset investment is to ensure that the financial return will meet the required threshold (for instance 3% real return, or 10% nominal return – the numbers will vary according to the type of investor). Even if the investor is satisfied with a very low rate of return if other positive impacts will result, the proposition still needs to look financially viable, or else it will also be unlikely to deliver any other desirable long-term benefits, such as social or environmental impact.

It is important that rights-holders seeking investment understand that some kind of positive output is being sought by the investor, regardless of whether this is an ‘asset’ or ‘enabling’ investment. An enabling investment need not imply unfocused goals or lack of business discipline, and donors are increasingly keen to ensure that they demonstrate a (non-financial) return on their investment. However, whilst the science of measuring the social and environmental return from enabling investments is getting more sophisticated, it is harder to directly link effort to performance. With asset investment, on the other hand, the link between capital employed and financial returns obtained is much more visible.

In summary, the investors will be looking to evaluate certain criteria, depending upon the type of investment being considered. These are set out in the table below. Many of the recommendations made in this guide are based on the need to satisfy these criteria, as however compelling the case for investing in locally controlled forestry may be, ultimately mainstream investment will follow only sound business cases. Some of the items in this list are common requirements for both investors and rights-holders (such as ‘compatible goals’), and these are covered in the next chapter on favourable conditions. Those criteria that could be said to be more specific to the investors are discussed in a little more detail in the table below.

Table 3: Investment criteria for different types of investment

Type	Category	Criteria for investment	Target outputs and outcomes
Enabling investment		<ul style="list-style-type: none"> <li>Compatible goals</li> <li>Potential for improvement</li> <li>Flexibility</li> <li>Likely to have positive social and environmental impact</li> <li>Plan to mitigate any negative social and environmental impact</li> </ul>	Transformation Positive social and environmental impact ‘Graduation’ to asset investment
Asset investment	Value	<ul style="list-style-type: none"> <li>Viability of business proposition</li> <li>Measurable risks and returns</li> <li>Status of forest tenure and usage rights</li> <li>Enterprise has sufficient scale</li> <li>Track record of managers</li> <li>External factors (country risk, governance and market constraints)</li> <li>Formal enterprise with permits</li> <li>Organisational capacity to deliver the plan</li> </ul>	Attractive, risk-adjusted, financial return
	Impact	All the above, plus: <ul style="list-style-type: none"> <li>Likely to have positive social and environmental impact</li> <li>Plan to mitigate any negative social and environmental impact</li> </ul>	Some financial return plus positive social and environmental impact (perhaps measured by IRIS) <sup>56</sup>
	Product	<ul style="list-style-type: none"> <li>Potential to produce product to required specifications</li> </ul>	Reliable supply chain
	Banks	<ul style="list-style-type: none"> <li>Liquidity of assets and collateral</li> <li>Sufficient cash flow</li> <li>Formal enterprise with permits</li> <li>Track record of managers</li> <li>Organisational capacity</li> <li>External factors (country risk, governance and market constraints)</li> <li>Sufficient owner’s equity contribution</li> </ul>	Debt is serviced and repaid

### 3.4.1 Measurable risks and returns

Investors do not shy away from risk, but they do need to measure it, be it real or perceived. They need to calculate the minimum rate of return required and ensure the costs of mitigation are included in the business plan. Risks fall into various categories, as listed in the table below.

Table 4: Common investment risks

Category	Risk
Political and economic	<ul style="list-style-type: none"><li>• Capricious, inconsistent and unpredictable governance</li><li>• Regulations favour state owned enterprises or politically-connected persons</li><li>• Export bans, trade embargoes</li><li>• Import controls leading to shortage of imported inputs (spare parts etc.)</li><li>• Fiscal crisis, hyperinflation</li><li>• Currency risk – non convertibility, capital controls, sudden revaluations</li><li>• War, civil unrest</li></ul>
Physical	<ul style="list-style-type: none"><li>• Fire, pest, wind, drought, seismic event</li><li>• Encroachment, theft, malicious damage</li></ul>
Institutional	<ul style="list-style-type: none"><li>• Weak rule of law</li><li>• Poor regulatory / fiscal regime</li><li>• Corruption</li><li>• Blurring the line between state-owned enterprises and the state itself</li><li>• Negative consequences from disruption of current market relations, e.g. middlemen, military/police business interests etc.</li><li>• Health and safety, child labour</li></ul>
Market	<ul style="list-style-type: none"><li>• Fragmented value chain</li><li>• Monopsony practices by big mills</li><li>• Local monopolies distort markets, heavy government or NGO involvement in a sector can stifle competition and innovation.</li><li>• Low-cost competition (illegal / unsustainable)</li><li>• Open access regime undermines plantation business model</li><li>• Uncertainties over carbon markets post expiry of Kyoto</li></ul>

### 3.4.2 Status of forest tenure and usage rights

A forestry business needs legal access to forest resources, or land to plant trees. In order to meet the goals of a business plan, the business (or the rights-holders that collectively own the business) needs to ensure it has legal rights to the resources far into the future. For tree planting it is essential to have clear tenure and unobstructed rights to the future harvest.

Lack of clarity about land ownership is the prime concern of investors.<sup>57</sup> Investors with experience in timberlands in northern countries (especially the USA) may expect a form of unqualified land ownership, such as ‘fee-simple’ or freehold. As this is less common in emerging markets, the Global Environment Fund<sup>58</sup> suggests that ‘investors must be comfortable negotiating long-term leases or concessions.’ The danger with this approach, however, is that the ownership of so much forest around the world (especially in the tropics) is contested, not least by the rights-holders.

Where investors look beyond the tenure on offer from the local government, they may find a tangled nest of issues awaits them, with competing claims to both the land and the standing assets from local rights-holders. Investors may be neither willing nor equipped to deal with these issues. Even where local rights-holders do have recognisable legal rights, for example

as smallholders, it may not be clear how these 'rights' can be monetised or securitised if they are not assignable, and it is most unlikely that Indigenous People can officially grant natural forest leases to investors (though unofficially such deals happen all the time).

Effectiveness in establishing clear tenure and commercial use rights depends to a large extent on the quality of governance.<sup>59</sup> Unfortunately, weak governance is often found in both formal statutory land administrations as well as in informal and customary tenure arrangements. It flourishes because the law is often complex, inconsistent or obsolete; people who work in land agencies lack motivation and are poorly paid; decision-making processes are not transparent and civil society is weak. The issues of governance and tenure are strongly inter-related, and are so fundamental to the likely success of investing in locally controlled forestry that they are the starting point for reforms designed to benefit forest economies.

### 3.4.3 Enterprise has sufficient scale

The main problem with investing in forest enterprises at the locally controlled level is that they are usually small scale, difficult to access and hard to evaluate. This makes the 'due diligence' process expensive and time consuming, raising the transaction costs beyond levels that investors would generally find acceptable. A due diligence investigation into a forest enterprise may cost over \$100,000, regardless of the size of that business. If an investor spends such a sum on a business that needs only \$1 million of investment, the project needs to earn at least 10% just to repay the cost of assessment. As the investor may need to evaluate several opportunities before finding one that is suitable for investment, the average due diligence costs per funded project may be very high.

Scale is important not only from the perspective of project evaluation, it is also a factor in potential profitability and resilience. As a company gets bigger its fixed costs become a smaller proportion of its revenue. This boosts profits and is known as 'economies of scale'. However, the ideal size for a business depends upon many factors. It is too simplistic to conclude that 'bigger is better'; on the contrary, in many cases a smaller business can be more flexible and efficient than a larger one. Yet a small forest enterprise needs to be big enough that its fixed costs do not overwhelm the business. For instance, some businesses will need to buy in technical expertise, and can do this only if they are large enough to cover this additional cost out of profits.

Businesses have different financing needs at various stages in their development, and the issue of scale can only be measured in respect of where the business is now and where it wants to go. A new community woodlot business may be small today, but when the harvest of a few hundred hectares of hardwood takes place, the business will rapidly become much larger.

### 3.4.4 Track record of managers

A business plan is only as good as the people who will be implementing it, and in the right marketplace, at the right time, in a country that does not have excessive risk and uncertainty. In evaluating a business proposition, investors will look at the track record of the country, the enterprise (for example, historic performance in terms of management competencies, planning, implementation and financials), and of the product. This is an area where small forestry enterprises are often weak: business records are not kept; understanding of the market and of competition is incomplete; and project information is often asymmetric.

Where the business is a start-up with no track record, additional funding will be required to cover the cost of technical support and mentoring. It helps reduce risk if the business is dealing in a product (for example, sawn timber) that has a strong local market track record and good price information. Investors will perceive the proposition to be more risky if the enterprise plans to enter a business activity for which it has no track record (for example, making complex finished goods such as furniture).

### 3.4.5 Organisational capacity

A forest enterprise may have all the technical and physical attributes that makes it an attractive business proposition, yet fail to attract investment because of low capacity of the management and staff. For the investor, one of the key factors that will determine if a business is capable of delivering the outcomes predicted in the business plan is the quality of the leadership and capacity of the organisation.

Capacity is not measured in terms of educational certificates or length of service. Investors will be interested in the right combination of knowledge, skills and attitude that indicate a management team has what it takes to be resilient and resourceful. This is not just about assessing the key individuals in the business. They will be working in the context of an organisation that may have social ownership structures with members, boards of trustees and elders that all have some influence on the business. Various cultural and social factors may have some bearing on the ability of the enterprise to reward success and eliminate incompetence or dishonesty. The business could have great people constrained by a poorly designed constitution, or have strong stakeholders let down by bad leadership.

To some extent, these capacity issues are common to all businesses and easily understood by investors (see ‘Assessing organisational capacity’ in the Annex), but there are some specific aspects of locally controlled forestry, such as the social and cultural context, that may make this aspect harder for the investor to evaluate.

### 3.4.6 Liquidity of assets and access to collateral

In seeking credit from a bank or investor, the business needs to put up **collateral** that will act as security for the loan. If the business closes down, or for any reason is unable to meet the terms of the loan, then the lender has the legal right to take possession of the collateral and sell it to pay off the loan. Lenders and investors therefore take time to evaluate the quality of the collateral and the practical costs involved in first obtaining and then selling it. The challenge for community forest enterprises is that their assets may not be capable of being used as collateral. In some countries, the regulations for the community forestry permits in the Permanent Forest Estate expressly forbid its use as collateral, as it cannot be assigned to a third party. Private land, such as smallholder woodlots, may not have proper land title certificates, or smallholders may be reluctant to surrender their birthright to be used as security for a loan. In practical terms, a bank may be reluctant to press a claim on land if other family members object to the original deed of title, and this renders the asset ineligible for use as collateral. In some countries this process is made even more difficult and expensive by cumbersome regulations, poor legal drafting and weak rule of law.

Regardless of whether the investment is short or long term, investors require an exit route and estimated time frame. Some may seek the possibility of an earlier exit, for instance by

selling their equity or debt to a third party. For instance, a loan needs to be repaid within a fixed period of time, or rights-holders may have agreed to buy back shares in an equity investment after an agreed number of years. For these commitments to be met, the business must be able to generate sufficient liquid cash itself, or to organise a 'liquidity event', for instance by selling the company.

Even with young tree stands the future harvest may be tradable between investors, but for creditors (such as banks) the secured asset may need to be tangible, seizable and marketable in the event of a default. In many circumstances, standing trees are only satisfactory bank collateral if a permit exists to fell them immediately, or if a secondary market exists for the future income flow. For investments in processing units, liquidity will depend upon the strength of the balance sheet, which may defer an investor's exit beyond the original time frame predicted by the business plan. There is most unlikely to be a secondary market in the shares of unlisted companies.

A more suitable form of collateral is a claim on the standing trees themselves, although this would generally only be relevant to plantation forestry. Unlike land, the timber is easily identified, can be marked as belonging to a third party, and there is a ready market for sale at the owner's convenience. However, these advantages apply only once the trees are already mature and ready for felling. During the growing period the trees represent the **prospect** of cash flow, but are not a liquid asset. This need not be an impediment – a secondary market exists for growing timber in well-managed woodlots – but for the investor contemplating an investment in smallholder enterprises, it presents a further constraint.

### 3.4.7 Sufficient cash flow

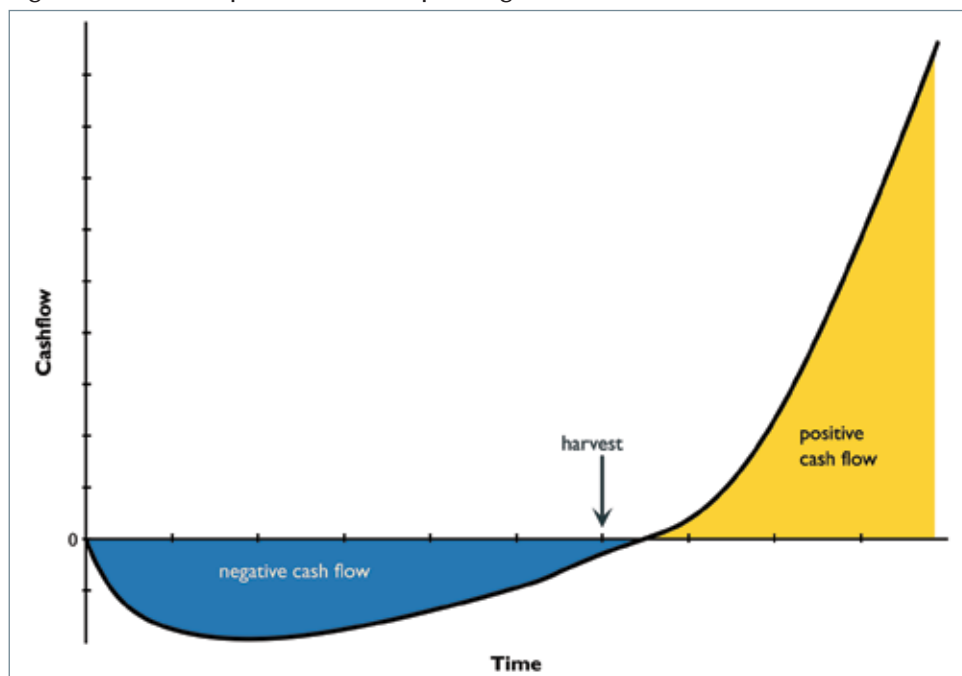
A business plan may look very attractive on paper, but however certain the potential profits, the business will succeed or fail on its ability to generate and sustain cash flow. There are various claimants to this cash flow: suppliers of raw materials, employees, creditors, tax collectors, and so on. Whatever is left over when all these claims are settled becomes the property of the owner of the business.

Profitability, therefore, determines the entrepreneur's willingness to embark on the venture (as it will be the residual profit that she can claim), but interim cash flow dictates if the venture can even start. Different types of business have different cash flow profiles and require different types of finance to make them possible.

For instance, timber plantations are characterised by the 'j-curve' cash flow profile (figure six), with negative cash flow during clearance, planting and maintenance, but with substantial returns upon harvest of the timber. Later cash flow depends on how the plantation is managed and what interest rate is payable on the loan.

In many instances, investors are co-investing with local rights-holders. However, outside investors can factor the delayed cash flow into their business model to calculate the total return over time, whereas local people need cash early on in the scheme as they may not have other sources of income, and the plantation may displace cash crops. With a share structure, you cannot usually distribute profits selectively, all parties must receive any dividend that is declared. The challenge is to design a business model that resolves this challenge equitably.

Figure 6: Cash flow profile for a tree planting business



#### 3.4.8 Sufficient owner's equity contribution

When a bank lends money to a small business, it very rarely lends 100 per cent of the capital required, but will expect the business owner to also make a cash contribution. This is known as 'owner's equity'. In established businesses, there may already be sufficient stock, capital goods (such as machinery) and debtor balance to constitute a buffer of owner's equity, but in new enterprises the equity must come from the founders themselves or from third parties.

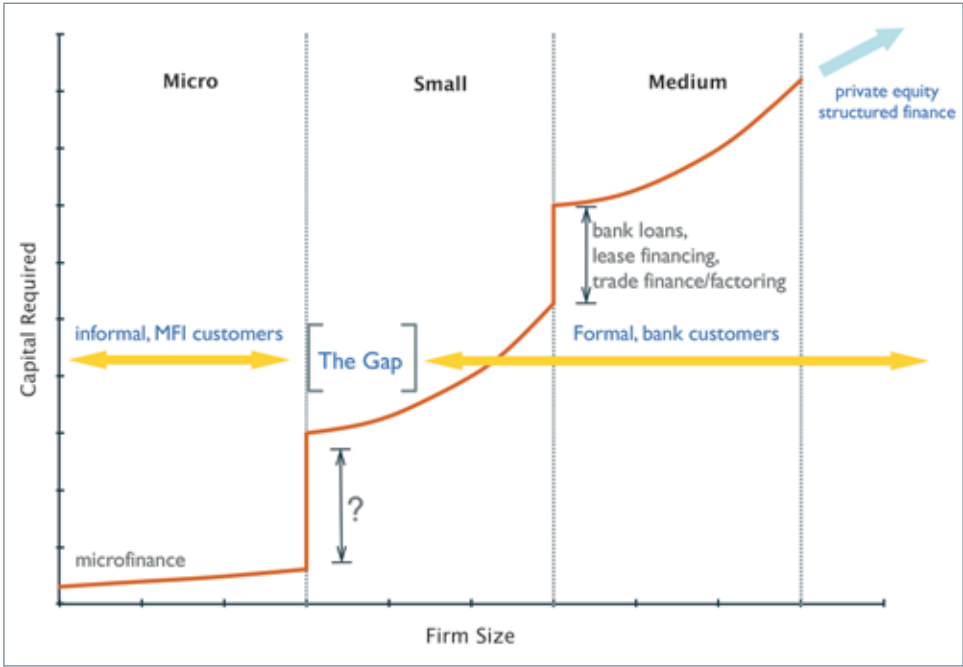
### 3.5 The SME funding gap

One of the arguments made in favour of the SME sector is the 'acorn hypothesis', whereby a mighty oak will eventually result from a small acorn, suggesting that these small companies will grow large in time. But in reality, whilst some small companies will attempt to make that journey, most will not. Indeed, many will prefer to plateau when they are medium sized, as exemplified by Germany's *Mittelstand*: the name given to the large number of SMEs that form the backbone of that country's export strength.

Any enterprise that is serious about building a sustainable business, however, will need to make the transition from informal microenterprise to small company. In developed countries the informal microenterprise sector barely exists (beyond sole traders working on their own account), and entrepreneurs are expected to formalise quickly. In developing countries, however, there is a large microfinance industry (MFI) that services the needs of the microenterprise sector. Some have argued that this inhibits the growth of the SME sector. In any event, making the transition from micro to small enterprise involves a step change rather than gradual transition. It requires formalisation, addressing the investors' criteria (as identified in the previous section) and finding the appropriate form of investment capital.

To attain their optimum size and stability, new enterprises need to navigate the transition from a start-up to a rapidly growing and eventually mature business. Making the transition from one phase of business development to the next is not a straight-line process. As a business scales from a micro-enterprise, to a small and then a medium-sized enterprise, or as it makes the transition from start-up to a rapid growth, then it will face a series of critical step-changes in capitalisation, organisational capacity, leadership and its relationship with the state. This is especially challenging for SMEs in developing countries, where nascent SMEs face a critical gap when they are too big to qualify for microfinance, but not big enough to get support from the formal banking sector. This gap prevents talented and energetic entrepreneurs from getting a foothold, and many slide back into informality and petty trading. This is depicted in figure seven below:

Figure 7: The SME financing gap



Making that step change requires the capacity to integrate with supply chains, organise production and delivery in a systematic way and have sufficient cash flow to survive the delayed payments by customers. Banks often try to judge SMEs as if they are just smaller version of large companies. But this overlooks the superior growth potential of SMEs, and their different financing needs.

How then do SMEs become bankable? This requires dedicated support, including 'enabling' investment by government, donors or other 'angel' investors that give SMEs the capacity to: (a) supply information to banks that is transparent, professional, timely and accurate; (b) offer suitable collateral; and (c) organise with other SMEs in similar or complementary sectors to form clusters.

There is a need for a total investment package that takes into account the fact that locally controlled forestry enterprises very rarely have access to formal banking services such as sales ledger financing, leasing and insurance. This means SMEs need a larger cash float to cover the costs of larger orders and avoid 'over trading',<sup>60</sup> drawdown capital in the event of uninsured risks, and capital expenditure loans to cover the cost of equipment that cannot be leased. The vast majority of businesses in emerging economies are informal micro-enterprises that for various reasons may never break out of that category. In most cases, growth will require step changes in the way the enterprise is managed and resourced. Different layers of investment capital will be required at different stages in the growth cycle.

### Box 11: Why microfinance is unsuitable for locally controlled forestry

The credit provided by Microfinance Institutions (MFIs) to sole traders and microenterprises is an example of poverty alleviation rather than poverty reduction:

**Poverty Alleviation:** relieves symptoms, for instance by boosting consumption, and thus has transitory effects.

**Poverty Reduction:** attacks root causes through boosting investment (both short term productivity and long term human capital), with permanent effects.

The focus on microcredit has been founded on the belief that lending money to poor people will stimulate enterprise and thus reduce poverty. Yet evidence to support this assertion is thin.<sup>61</sup> It seems that what poor people really need is a safe place to deposit savings rather than a source of loans, so that these savings can then be used to smooth cash flow over the year.

Furthermore, there is evidence that microfinance actually displaces SME development,<sup>62</sup> for instance:

- ▶ Microfinance ignores the role of scale economies. It creates lots of very small units that are barely enterprises, yet fails to provide the kind of finance that is needed for growth, for instance to boost long-term agricultural yields.
- ▶ Microfinance diverts capital from productivity and towards consumption; in the process it misallocates capital, starving SMEs of funds.
- ▶ Microfinance Institutions impose terms and conditions that are not suitable for enterprises that wish to expand or make investments in innovation and improving technical processes. So entrepreneurs are forced to downgrade their ideas to suit the purposes of the MFIs, which usually means confining their zeal to petty trading activities and low-tech production.
- ▶ The enterprises encouraged by MFIs tend to be individual efforts, and thus do not create the horizontal linkages (such as clusters) and vertical linkages (such as integration into supply chains) that are required to introduce productivity gains and innovation.

## 3.6 How can 'enabling' and 'asset' investment fill the funding gap?

Many locally controlled forestry businesses find themselves stuck in the 'SME funding gap' described above. There is a mismatch between the scale of potential investment and the professionalism required to secure it, and the scale and capacity at which locally controlled enterprises tend to operate. Since asset investors understandably look for investible value propositions, and are unlikely to shoulder the transaction costs of developing investment preparedness, other actors must step in with **enabling** investment. This can be used to create the right conditions for asset investment.

Enabling investment can create the conditions for asset investment in locally controlled forestry in two ways:

**a) Tackling the obstacles that prevent the LCF business from meeting the investors' criteria.**

Enabling investment can be used to tackle some of the structural issues that inhibit locally controlled forestry, whilst also taking a strategic view of the whole value chain and business model. By concentrating on ways in which the business case can be strengthened, thus preparing the ground for long term asset investment, these interventions can achieve much more than if they just supply cheap capital to selected enterprises. This does require some imagination and flexibility on the part of the donor or philanthropist. Some examples are shown in the table below and in the box that follows.

Table 5: The role of enabling investment in meeting investor needs

Criteria	Role of enabling investment
Risk	<ul style="list-style-type: none"> <li>• Cover the cost of de-risking measures and reduce insurance cost by aggregating projects, and so on.</li> <li>• Offer to take 'first loss' on equity tranche.</li> </ul>
Tenure	<ul style="list-style-type: none"> <li>• Invest in technical advice to governments to demonstrate the economic benefits of tenure reform.</li> </ul>
Scale	<ul style="list-style-type: none"> <li>• Use clusters of SMEs to assemble portfolios that spread risk and achieve sufficient scale. Identifying common types of capital expenditure can lead to lower risk methods of investing, for instance via equipment leasing.</li> </ul>
Track record	<ul style="list-style-type: none"> <li>• Cover the cost of technical expertise and business mentoring.</li> </ul>
Capacity	<ul style="list-style-type: none"> <li>• Invest in appropriate and targeted capacity building and training, especially in finance and management.</li> </ul>
Liquidity and collateral	<ul style="list-style-type: none"> <li>• Create secondary market in the asset (for example by repurchasing bonds), or convert equity into bonds. Stimulate domestic retail investment market to create wider market for the assets.</li> </ul>
Cash flow	<ul style="list-style-type: none"> <li>• Supply the tranche of 'patient capital' that can cover long periods before harvest. Give cash advances on purchase orders.</li> </ul>
Sufficient owner's equity contribution	<ul style="list-style-type: none"> <li>• Cover the cost of designing and setting up special equity funds that can take an equity position in small forest enterprises.</li> </ul>

**b) Shepherding businesses through scaling up – from start-up or microbusiness into sustainable enterprise**

In order to make the step change from microbusiness or start-up to a formal and investible sustainable enterprise, the business will need to be guided through a number of steps. The earlier stages, where the business is formulating a concept and getting established, will need to be funded by the rights-holders own resources with additional support from enabling investment. This process is shown in figure eight below and is explained in more detail in chapter 5 and figure 10.

**Box 12: How the African Agricultural Capital fund uses enabling and asset investment**

The African Agricultural Capital Fund uses enabling investment from USAID to design and set up special purpose equity funds, also taking a ‘first loss’ position that reduces the risk for other investors. Also, USAID provides separate funding for a technical assistance facility that will help small companies upgrade their capacity and become investible. A professional fund manager manages the fund on ordinary commercial terms, managing asset investments in the form of a loan by JP Morgan (half of which is underwritten by USAID) and equity investments by various philanthropic foundations.

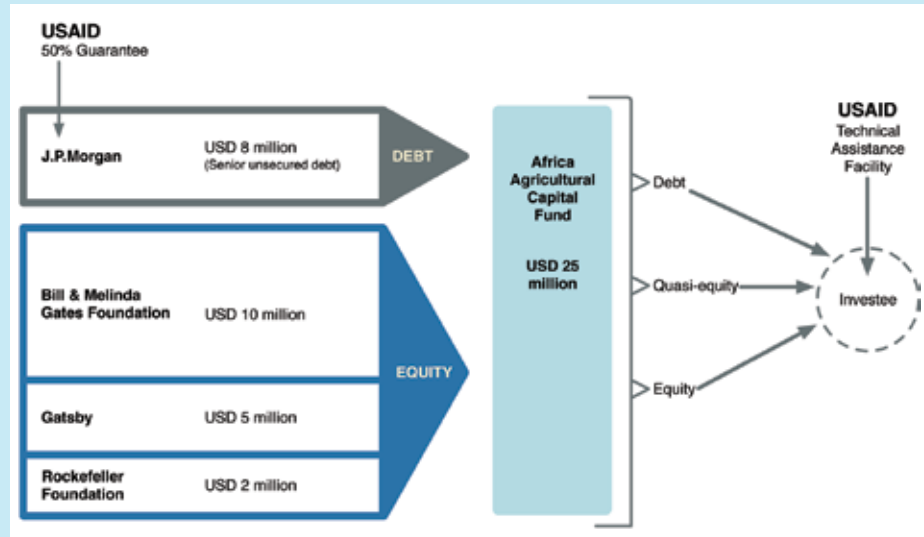


Figure 8: Formulating a business concept and getting established



## 4 Ingredients for success

Successful investment in locally controlled forestry needs certain key ingredients, or pre-conditions, to satisfy the needs of all participants. To some extent, these ingredients are directly related to investors’ needs, as described above. Unless these needs are met, the chances of building a financially viable business are slim. A business is a group of people working together to achieve shared goals, however, of which financial return, though important, is just one.

This section outlines how to form the necessary alliances that create essential **external conditions** for ILCF; the types of **partnerships** that can strengthen an enterprise’s internal capacity; and the **internal conditions** that will determine the most appropriate structure for the business to succeed.

The table below sets out how these ‘favorable conditions’ arise from certain steps taken by the enterprise at each stage.

Table 6: Tactical approaches to improving the conditions for ILCF

Task	Constraints and challenges	Recommended action	Favourable conditions
Influence the external conditions	<ul style="list-style-type: none"><li>• Governance</li><li>• Tenure</li><li>• Isolation</li></ul>	<b>Organise</b> through cooperatives, associations and federations	i. Clarity of tenure ii. ‘Good enough’ governance
Improve the internal conditions	<ul style="list-style-type: none"><li>• Organisational structure</li><li>• Sufficient capability to execute the plan</li></ul>	Seek and manage <b>partnerships</b>	iii. Organisational structure with clear roles and mandate iv. Transparency and accountability v. Mutual learning and flexibility in order to improve performance vi. Agreed goals, expectations, benefit sharing and exit strategy vii. Checks and balances on decision-making to overcome disagreements viii. Respect different values and embrace change

### 4.1 Influencing the external conditions

Even a very well set up locally controlled forestry business will struggle to attract any kind of investment if its legal rights over land or resources are uncertain, or if the governance context of the country is unsound. In such circumstances, the enterprise will be viewed as too risky for investment (particularly bank lending), or else will be compelled to form an investment partnership that is designed to distribute the bulk of the profits to the investor, in order to compensate them for the additional risk. These external conditions are explained in more detail below.

#### 4.1.1 Clarity of tenure, rights and obligations

Where there is no clear legal tenure, it could be said that the forest is not ‘locally controlled’, and therefore investment in locally controlled forestry is not yet possible. Therefore, tenure is the fundamental necessary condition for ILCF. Yet rights-holders have argued that one of the key reasons for getting involved with an investor is that it may lead to clarification of tenure, indeed this could be seen as an outcome that is actually more important than direct financial rewards.

As part of the process of securing long-term tenure security, rights-holders may need to be prepared to work with governments to **encapsulate** their rights into an existing legal framework (for instance a concession or lease) that permits fair use of the resource, even if this does not in the short-term advance their ultimate goal of freehold tenure.<sup>64</sup> This implies some compromise may be required by the local rights-holders in order to allow investment to proceed, but with the stated long term goal of obtaining more permanent formal tenure in future.

Clarity of tenure is of interest to all parties in the deal, but there are subtle differences in approach:

- ▶ **Rights-holders** usually have a quite sophisticated understanding of the multiple overlapping layers of state-defined and customary-practice ownership, management and use rights. They may hold various interpretations of how ‘tenure’ maps onto these layers. Tenure may be tied up with issues of self determination or intra-community politics, and can often have a complicated legacy.
- ▶ For **investors**, tenure is generally understood as a legal right that creates an asset that can be assigned, for instance to become an asset on the balance sheet, or as collateral for a loan. The investor needs to identify how rights to land and standing timber are held by the company.
- ▶ **Governments** in most cases understand tenure as a strategic tool to confer the benefits of land use on different interest groups while retaining the freehold and receiving rent in return.

These formulations are not necessarily incompatible, but they do need clarification. There is some tension: government may ignore rights claimed by communities, and whilst such rights may have local informal recognition, this may not be sufficiently robust for investors. On the other hand, leases granted by government without local consent are not consistent with FPIC principles and thus do not constitute sustainable investment (and carry significant risks for the investor).

Clarity of tenure for investment purposes can only come about by bringing together rights-holders, government and investors. This in turn requires a government that has the willingness and capacity to engage in such an exercise, and this condition is examined below.

#### 4.1.2 Good enough governance

For investment in sustainable locally controlled forestry to succeed, local and national governance needs to be ‘good enough’ to improve the investment climate in forestry and landscapes. The process of improving governance creates the circumstances for good institutions, which in turn improves the enabling environment for business. So this is

primarily a government responsibility, but is a process of change that unfolds over time and involves many different actors. For instance, the Extractive Industries Transparency Initiative<sup>65</sup> shows how foreign investors have acknowledged their role in supporting efforts to improve governance and in not undermining institutions.<sup>66</sup>

Good enough governance, institutional quality, democracy, accountability and transparency all contribute to a more enabling environment for business. For instance, good quality social institutions and legal frameworks start with rights as something to be protected and nurtured. The better the institutions, the lower the transaction costs, the more attractive for investors. Commercially oriented parties will make better deals where there are decent institutions than where governments are left alone with investors to strike deals out of the public eye, as in many of the so-called ‘land grab’ deals.<sup>67</sup>

Many of the pre-conditions for successful investment in trees and landscape restoration, such as clear tenure and property rights, flow from an improved institutional context. It is not realistic to expect governments to reform tenure in isolation, without considering the broader institutional issues, such as the role of forests as a strategic asset in the political economy of the country.

It is probably undesirable for governments to allow their enthusiasm for community-led reforestation schemes to lead them to ‘supervise’ deals between investors and communities. This is likely to lead to inflexible negotiation positions or interference in the objectives and modalities of the deal. It is unlikely that good market-based deals would emerge from such a process. Alternatively, there may be lessons from Guatemala’s National Forest Finance Strategy, or how Mozambique is increasing the capacity of communities to negotiate deals with the private sector. Rather than supervising, governments should empower the rights-holders, be on hand with back-up if needed, but let the deals happen (and then monitor them so lessons can be learned).

A ‘good enough’ government makes ‘enabling’ investments in public goods, by creating the institutional conditions for investment as well as committing funds to tenure reform and spatial planning, which can be significant items of expenditure. For instance, donors have helped Papua Province in Indonesia to formulate the provincial spatial plan for the next twenty years, covering thirty million hectares of forest, with special attention given to ‘putting people back in the plan’.<sup>68</sup> Donors that give sectoral support direct to government budgets may need to ensure that resources are focused on improving the institutions rather than attempting to intervene directly in local forestry.

Good governance can improve institutional conditions and create a more enabling environment for business by ensuring:

- ▶ Clear tenure and usage rights for defined periods, reflecting local customary rights.
- ▶ A legal system that allows for enforceable contracts and terms of payment.
- ▶ Foreign Direct Investment rules that do not place forestry on the prohibited ‘negative list’, that is, rules that allow foreign investors to own equity stakes in local companies.
- ▶ A level playing field (for example, forest governance excludes illegal logging, and state-owned enterprises do not have monopolies or control licensing).
- ▶ Many players, open markets and competition.

- ▶ Fiscal rules that encourage investment in Sustainable Forest Management.
- ▶ Systems for promoting transparency and monitoring corruption.

### Box 13: What is 'good enough governance'?

Helping states achieve 'good governance' has been the ultimate goal of international development projects ever since donors realised that outsiders, armed either with good will or gunboats, really cannot change the fundamental conditions and problems in another country, however much money they spend. Instead, the aim has been to try and change the 'software' that determines how effectively a nation is governed.

This perspective tends to assume that governance reforms should ensure institutions in less developed countries closely resemble those of an OECD state. However, in reality, some 'advanced nations' have patchy governance. The role of history, culture and politics in shaping institutions is also overlooked. The deterministic approach fails to prioritise what needs to change first, and how complex dependencies dictate the sequence of change.

A better goal, therefore, is 'good enough' governance.<sup>69</sup> This requires a more nuanced understanding of how institutions and government capabilities evolve. It accepts that not everything can change at once, and that trade-offs will be needed that defer utopian dreams in favour of practical action that examines the incentives and norms of institutional actions, devising ways to adjust these for different outcomes. The system of governance may not change for a long time, and 'good governance' goals will be missed. But in the meantime some important progress in poverty alleviation and improved environmental management is achieved.

#### 4.1.3 Organise to thrive

Most forest rights-holders wanting to set up businesses cannot improve the **external conditions** outlined above. They lack political and economic power, often because they are isolated. Alliances that support SMEs, such as Forest Connect, have shown that SMEs and their associations are often isolated in four main areas:

- ▶ Isolation from each other – whose support could help develop scale efficiencies and bargaining power.
- ▶ Isolation from consumers / markets – whose inputs could help product development and sales.
- ▶ Isolation from financial and business development service providers – whose services could strengthen business and technological capacity.
- ▶ Isolation from policymakers – whose decisions could improve their operating environment.

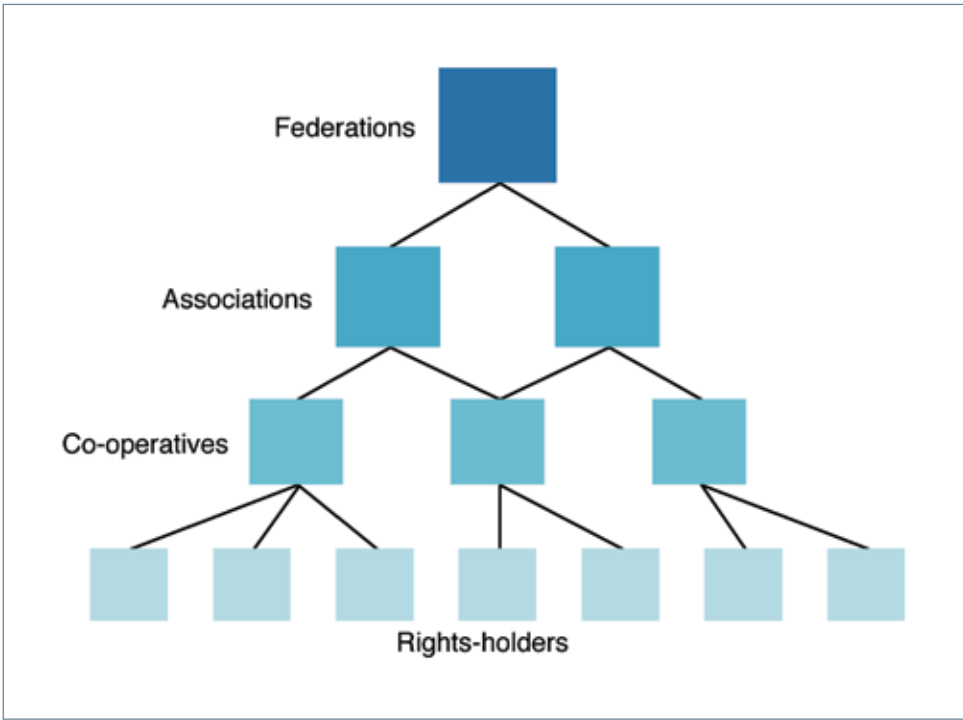
Understandably, there has been a focus on collective action. The rationale is that overcoming social structural difficulties – creating the trust and organisational structures necessary for collective action – can help reduce transaction costs and so help to foster investment. To date, much of this focus has been at the level of the firm (the 'first tier' of social organisation). For example, considerable emphasis has been placed on formalising share-based or stakeholder-based associations and cooperatives<sup>70</sup> or else developing new partnerships, debt, grant and equity based relationships with private sector investors of different types.<sup>71</sup>

Social organisation is often a secondary consideration to economic and environmental goals when dealing with community forest enterprises.<sup>72</sup> Yet social organisation is required to define and staff appropriate business roles, and undertake basic business registration, management and record-keeping in order to manage income and costs effectively (and inspire investor confidence, should expansion be desired). At the regional or national level,

social organisation is crucial for better-linking forest enterprises to each other (in business groups or federations), to markets, to financial and business service providers and to policy- and decision-makers.<sup>73</sup>

Locally controlled forestry in Scandinavia has shown that the most sustainable forest owners' organisations form through bottom-up processes. The local forest people took the initiative to form local organisations that later merged into larger and often regional organisations and cooperatives. It was the local initiative, often spurred by outside economic forces trying to take away local control, which formed such organisations. Personal interest, land tenure, economic forces and market access were key elements in developing solid organisations with a locally controlled foundation. Figure nine shows how rights-holders form cooperatives, that in turn join associations, that then organise collective action in federations.

Figure 9: The hierarchy of organisations



4.1.4 The role of associations<sup>74</sup>

There are different forms and functions of associations in community and family forestry. Three typical functions of associations include:

- ▶ **Service provision:** for example, associations can help with forest management; supply high quality seedlings at relatively low costs; or offer legal support for land tenure conflicts. They can also provide marketing services, improved access to markets and negotiation of better prices.
- ▶ **Lobbying:** associations will represent their members and put pressure on government as a unified voice to support policies beneficial to their members and LCF.

- ▶ Processing of timber and other forest products can also be through associations, directly, or through specialised structures.

Associations can also be formed at different levels: local, provincial, national and international. Local associations usually have a simpler structure and have more direct links with their members. Provincial and national associations may be more effective in lobbying government for favourable policies; and international and national associations serve as platforms to share learning and jointly improve practices among different groups.

Three types of funding streams for associations are:

- ▶ government grants
- ▶ government cost shares (indirect funding)
- ▶ percentage of sales revenue from members.

To maintain their autonomy, the best funding structure for associations may be from members' sales revenues, as a service fee. Government cost shares can be reasonable, too, as associations provide public benefits.

Associations can directly and indirectly help create a favourable environment for investments: associations can help communities to reach economies of scale by aggregating product volumes, and they can provide technical support, business skills training and market access. From an investor's viewpoint, associations can help members develop their business plans, help evaluate local market opportunities and manage member production processes. Governments may look suspiciously on associations, but it is important they see associations as allies instead of threats in pursuing better forestry management for the public good. Associations can actually deliver services to the communities and investors at lower costs than governments can, providing a direct platform for governments to interact with members of the associations.

There is no 'cookbook' of functions an association should carry out, nor at what levels associations should form. It all depends on local economic, social and environment contexts, which evolve through time. But there may be some universal principles. Associations should:

- ▶ *Respect and uphold the rights of members* and provide them with as much control as possible. The key that holds an association together is shared interests. Members of the associations need to think through what they need most from associations as a group and how the associations can work best for them. It should be the members themselves who decide the form and function of the associations, based on their own local context. And it is important for an association to be transparent in its conduct, especially financially, to maintain trust among its members.
- ▶ *Root operations in their members*, carrying out functions as close to members as possible. Each time a new tier is added to an association, such as creating a federation of local associations, costs rise and effectiveness may decline. Added layers are expensive, take time and energy to maintain, and are harder for members to control. As distance from individual families and villages grows, sense of ownership and trust in the accountability of elected representatives and staff may decline. While higher tier associations have important contributions to make, the core functions of an association should be carried out as close to its members as possible.

- *Learn and evolve in different local conditions.* Members always need to think through what functions are most essential to an association and at what level those functions can be carried out most effectively. It is always a learning process in which members need to regularly reevaluate their association's operations, learn from experiences and improve practices accordingly.
- *Inclusion of women and youth is vital.* Given women's strong involvement in forestry management and youth's central role in the future of LCF, it is necessary to strategically involve them by understanding their incentives for participating.

#### Box 14: How measurement associations in Sweden act as intermediaries to maintain trust between cooperatives and smallholders<sup>75</sup>

The first measurement association was established more than 100 years ago and by 1950 there were 12 such associations covering the whole of Sweden. Today, these have merged into three. A company known as **SDC** was created in 1961 to process the data from all measurement associations. The three measurement associations and SDC now work very closely together, having the same owners (sellers and buyers together), and the measurement is standardised across the whole country.

The measurement association acts as an intermediary between buyers and sellers of pulpwood and sawlogs (and more recently biomass fuel pulp). Every shipment of raw timber arriving at a processing plant is appraised, and a price is struck, based on up-to-date market information and the quality of the log or chips. SDC manages the data for 800 such reception points, appraising logs supplied by 125,000 smallholders.

This service is designed to provide an independent third party oversight of the price being offered at the gate of the pulp mill or sawmill. This results in a price seen as fair by both buyer and seller that is not manipulated. The reason for this system is that even in a country with a high degree of social capital and transparency, an asymmetry of power and information is inevitable between forest smallholders and the large companies that buy from them. Without the confidence in prices, the relationship between buyer and seller will become disfigured by disagreements, mutual suspicion and distrust. Indeed, this is a common state of affairs in many commodity value chains throughout the world. The aim is for buyers to compete via price lists, not via timber measuring methods.

The lesson for other countries is that having very efficient cooperatives that buy from smallholders does not mean that trust can be taken for granted. Although an independent monitoring system adds to transaction costs (approximately 7 cents per cubic meter in Sweden, but arguably this is less than it would cost for firms to run their own reception centres), it is an essential link in the value chain as it helps the whole system run smoothly.

## 4.2 Forming partnerships

Even in advanced economies, it is very difficult for a small organisation to upgrade itself up to the standard required for investment without some sort of outside assistance. In the context of locally controlled forestry, different kinds of partnerships may be required at different stages of development. The goal is to set the necessary internal conditions, and some of these in turn are essential for forming and managing successful partnerships, not only with intermediaries (such as Business Development Service Providers and NGOs), but also with companies and investors.

Objective	Type of partner
Improve capacity	BDSP or NGO
Access markets	Intermediary or broker
Long term buyer	Processing company

#### 4.2.1 Business Development Service Providers

Investors expect an enterprise to have the organisational and individual capacity to execute its business plan. However, in the case of locally controlled forestry enterprises, significant capacity building will usually be required, which the investor may not allow for or consider part of its responsibility. This is especially the case with banks that are wary of lending to organisations that may not possess requisite financial management skills. Even if communities have made an effort to enhance their own capacity they may face negative perceptions from financial institutions.

Capacity building may be delivered by NGOs, but in most cases such organisations will not themselves have the skills to bring community enterprises up to the required standard of commercial professionalism. Specialised Business Development Service Providers (BDSPs) are more likely to be able to deliver the sort of training and support that SMEs need. Also, agencies that provide organisational development (such as BDSPs) may themselves be investment opportunities.

All enterprises need to purchase various technical services in order to help them become more effective. For instance it is common for forestry businesses to use the services of silvicultural specialists. Locally-controlled ventures also need assistance with core aspects of setting up and running a business, such as:

- ▶ Help applying for necessary permits.
- ▶ Training and business planning (organisational development and business planning).
- ▶ Linking up mentoring for senior managers.
- ▶ Facilitating the formation of clusters and associations.
- ▶ Introductions to investors or lenders and assistance with negotiations for finance.
- ▶ Designing benefit sharing and arbitration processes.
- ▶ Helping implement the business plan.
- ▶ Monitoring performance and advising on improvements.
- ▶ Auditing financial accounts and identifying weaknesses in systems.

Businesses need to buy in technical and business development services, but smaller companies tend to undervalue these services.

There is a need to differentiate between those services that will always be bought in (or for a long time in any case) and separate training and capacity building, and also intermediary services. BDSPs may do all these things.

In general, **enabling investment** should cover the cost of bringing locally-controlled forest enterprises up to a required standard. Ongoing technical support should be funded from the enterprise itself, however, and be fully accounted for in the business plan.

The desired outcome<sup>76</sup> of a BDSP programme is that SMEs will:

- ▶ Increase their competitive capacity, while adopting more professional management and increasing business opportunities.
- ▶ Increase their productivity and their ability to offer improved services.
- ▶ Start to use business management tools.
- ▶ Optimise planning in the short, medium and long term.

- ▶ Modify their vision in terms of consulting and training needs.
- ▶ Develop a more strategic vision of the business, which would eventually be reflected in increased profitability, among other things.

Once SMEs are in this position, they will be more likely to ‘graduate’ from grant-funded **enabling** investments and start to make successful deals to secure longer term **asset** investment.

#### 4.2.2 Intermediaries and brokers

In most – if not all – cases where outside investment in rural enterprises has been successful, an intermediary of some sort has been involved. This may be an NGO, a local businessman, a church group or a company specialising in sourcing specific products. These intermediaries can help to overcome the isolation problem outlined in the previous section. They can also help shepherd small enterprises through the difficult early stages of establishment, incubating them until they are fit to take on formal credit or equity investment.

Yet intermediaries may not always be competent to supply these services, or they may run out of funds. Some intermediaries are themselves donors or philanthropists, but by focusing on purely social or conservation objectives may be pursuing a goal that is at odds with broader aims the local communities wish to achieve. Clusters and associations can assist rights-holders in vetting appropriate intermediaries. Enabling investment, particularly from donors interested in stimulating rural enterprises, should ensure service providers have secure funding to enable them to extend services to SMEs over the medium term.

Although intermediaries can play a positive role, the nature of the relationship is often unclear and can reduce the sense of communities’ ownership and empowerment. This may be caused by the complexity of donor’s procedures and policies, meaning that communities do not have the capacity to receive direct financial flows, which instead are channelled via intermediaries, with dangers of co-dependency. For instance, a survey of community forest enterprises in Cameroon revealed that “some community forests claim to be held ‘hostage’ by local NGOs in a bitter-sweet relationship of mutual need”.<sup>77</sup> Perhaps the community is fulfilling social goals at the expense of long-term business sustainability, to either comply with the wishes of the NGO, or to perpetuate the symbiosis.

Indeed, some rights-holder groups have called for “*performance indicators which focus not only on economic efficiency but also on results to achieve indigenous rights...and other indicators identified as significant by the community*”,<sup>78</sup> yet this seems to presuppose that forest enterprises can aim for and achieve a broad spectrum of goals simultaneously. Experience seems to show that some of these goals may be conflicting, or should more properly be tackled in sequence, rather than all at once.

One should bear in mind that investors may also need to work through intermediaries to seek and engage with local rights-holders. However, investments should usually be made directly into a viable enterprise rather than via an NGO. In some cases this may mean that intermediate enterprises, or brokers, exist at various points in the value chain. Financing could be directed to better-capitalised downstream companies, which then form partnership contracts and joint ventures with rights-holders upstream. The relationship between all these companies must, however, be equitable and commercial in nature.

4.2.3 Processing company

Where rights-holders are not yet in a position to form their own enterprises and attract investment, they have often found themselves able to make some form of partnership deal with a company that wishes to act as ‘off-taker’ for their product, (for instance timber from natural forests, or non-timber forest products); or set up a scheme whereby the community is contracted as an outgrower for the company, for instance in the case of plantation timber. These arrangements are called ‘company-community partnerships’.<sup>79</sup>

This is not quite the same as investing in locally controlled forestry as advocated in this guide. In some ways it is more akin to the ‘resource-led’ system of investment, whereby a company is seeking access to natural resources and labour, but is not interested in helping the rights-holder in building up a business or asset base. For many communities, however, these kinds of partnerships may be the first step towards market involvement, and one distinct advantage they offer is that they are more tolerant of low capacity and lack of formal enterprises.

One way to think of how these arrangements work is to consider how the parties are in command of the five components of organising production: land, labour, capital, extension/technology, and market access.<sup>80</sup> For instance, in a timber concession model the split is 5-0, as the investor controls the land (by lease from the state), supplies the labour, capital and technology, and is often the sole gateway to the market through vertical integration with downstream processing. Local communities have no control over any of these factors, and limited opportunities for benefiting from the arrangement.

Table 7: How commercial arrangements allocate the factors of production

Concession		Company-community partnership	
Company	Community	Company	Community
Land	X	X	Land
Labour	X	X	Labour
Capital	X	Capital	→ ?
Skills and technology	X	Skills and technology	→ ?
Market access	X	Market access	X
5	0	3	2

With a company-community partnership, the split is usually 3-2, but with the better deals there is usually a commitment on the part of the company to increase the skills of the community and give them access to technology. In some cases the community is also expected to share the risk of the venture, so they also have capital at stake. However, market access is generally reserved for the company; indeed it may be a condition of the deal that the community is forbidden from selling to other companies. This can be a significant weakness if the company exerts its greater power in order to depress prices.

4.3 Favorable conditions for successful partnerships and enterprises

Whilst the partnerships described above are needed to improve the capacity of locally-controlled enterprises, and enhance their ability to attract investment, the partnerships themselves have a number of conditions for success. These conditions, described in detail below, are essential for a successful business, and need to be developed in parallel to the ongoing process of improving the enterprise’s capacity and business performance.

Table 8: Summary of favorable conditions and key features

Condition	Features
(iii) Organisational structure with clear roles and mandate	<ul style="list-style-type: none"> <li>• Business is a formal legal entity</li> <li>• Standard operating procedures, roles and responsibilities</li> <li>• Structure that balances needs of participation with requirement for positive decision making</li> <li>• Oversight by trustees or non-executive directors</li> <li>• The needs of the business are separate from the needs of the stakeholders</li> </ul>
(iv) Transparency and accountability	<ul style="list-style-type: none"> <li>• Standard operating procedures in local language(s)</li> <li>• Independent auditors</li> <li>• Independent third-party certificate of sustainable forest practices</li> <li>• Appoint non-executive directors or trustees</li> <li>• Agree upon practical and accessible channels of communication</li> <li>• Identify party representatives, set out their authority, and create an obligation for them to communicate with the people they represent</li> <li>• Investors sign up to international standards of transparency and responsibility</li> </ul>
(v) Mutual learning and flexibility in order to improve performance	<ul style="list-style-type: none"> <li>• Improved understanding and empathy for other parties</li> <li>• Courteous communications and avoidance of small, unintended insults</li> <li>• An agreed process of deal development and performance management</li> </ul>
(vi) Agreed goals, expectations, benefit sharing and exit strategy	<ul style="list-style-type: none"> <li>• Joint statement of vision for the business, allowing for compatible, yet different, objectives</li> <li>• Rules of engagement specify how benefits will be distributed in certain circumstances</li> <li>• All benefits are defined in cash terms, for ease of comparison</li> </ul>
(vii) Checks and balances on decision-making to overcome disagreements	<ul style="list-style-type: none"> <li>• An agreed arbitration process mediated by a third party</li> <li>• Regular and free flow of information among the parties</li> <li>• Frank discussion of problems</li> </ul>
(viii) Respect different values and embrace change	<ul style="list-style-type: none"> <li>• Agreed terms of engagement with wider community</li> <li>• A local development plan that outlines how social and economic change will be managed, with any negative effects ameliorated</li> </ul>

#### 4.3.1 Condition (iii): Organisational structure with clear roles and mandate

##### Key Features

- ▶ Business is a formal legal entity.
- ▶ Standard operating procedures, roles and responsibilities.
- ▶ Structure that balances needs of participation with requirement for positive decision-making.
- ▶ Oversight by trustees or non-executive directors.
- ▶ The needs of the business are separate from the needs of the stakeholders.

As a minimum, rights-holders need to have constructed some kind of organisational entity that is able to enter into trading relationships. This will need a clear leadership structure and decision-making process that is understandable to both members and partners.

The ownership of the new entity, and the terms under which shareholders can withdraw their investment, will need to be discussed. For instance, a separate limited company may have shares owned by a cooperative or directly by community members, in each case suggesting a different form of relationship between the company and local people. The different types of business, and the kinds of investment they can attract, are set out in the table below.

Table 9: Types of business entity

Business Type	Example	Application	Notable Aspects
Sole trader	Outgrower	Individual dealing with buyers.	By default, a smalholder is a sole trader and can borrow money in own name.
Partnership	Producer group	Aggregation of produce to achieve higher prices.	Informal farmer groups meet this description. Unlikely to obtain a loan as a group.
Cooperative	–	As above, with clear constitution and legal basis to operate.	Hard to borrow money (except for credit union), and not possible for outsiders to own shares.
Company limited by guarantee	Association	Not-for-profit ventures, e.g for advocacy.	Although anyone can own a share, it is not usually suitable for receiving investment as assets are not distributed, but it can get bank loans.
Limited company	Trading company	Commercial trading company that intends to make a profit and accrue assets over long term.	Shares can be bought by outsiders and traded between them. All shareholders entitled to a dividend based on number of shares held.

There needs to be clear delineation between managers and local owners, where such roles may often overlap in practice. Local rights-holders may have representation as investors (either as direct shareholders or via their membership of a cooperative), but this does not confer the right to influence the day-to-day running of the business. Whilst the cooperative may encourage democracy, the business itself may not be particularly democratic. A regular small business would have one or more leaders, who would be identified as the entrepreneurs. This person gives comfort to the investor by demonstrating permanence (unlike other staff, the entrepreneur is tied to the business and will not / cannot leave) and commitment (they will work as hard as possible to ensure success). Such an individual may not be present in a more collective community business, however, so the constitution needs to make clear who is in charge, who is accountable, and how can they be replaced. It is possible to have an entrepreneurial culture without having just one entrepreneurial leader, but it needs to be designed into the organisation from the start.

### The business is a separate entity

For certain types of asset investment, such as equity or loans, investors will require that the proposed enterprise is already, or on the road to becoming, a formal legal entity that can trade and enter into commercial relationships. In most countries it is unlikely that a community group or cooperative would satisfy this criteria.

This requires all parties to consider the business to be a separate entity that stands apart from its directors and shareholders, and as such is almost another party in negotiations. In some jurisdictions a company is in fact a discrete legal entity and the embodiment of

the agreed rights and obligations of all parties. The company's interests cannot be made subordinate to any one group of stakeholders and the benefits should be distributed according to the agreed formula.

This is the fallback position when negotiating benefit sharing: any act that compromises the sustainability of the business cannot be permitted, even if all parties agree to it. This is where a 'golden share' can be useful, to ensure that such a set of circumstances is unlikely to arise (see box for description of a golden share).

#### 4.3.2 Condition (iv): transparency and accountability

##### **Key Features**

- ▶ Standard operating procedures in local language(s).
- ▶ Independent auditors.
- ▶ Independent third-party certificate of sustainable forest practices.
- ▶ Appoint non-executive directors or trustees.
- ▶ Agree upon practical and accessible channels of communication.
- ▶ Identify party representatives, set out their authority, and create an obligation for them to communicate with the people they represent.
- ▶ Investors sign up to international standards of transparency and responsibility.

Transparency can relate to the process of negotiating a deal, and also to the way the business is managed, managers appointed, salaries agreed and benefits distributed. Many community enterprises fail because lack of transparency leads to loss of trust between the leaders and the members. Investors are actually more likely to be accustomed to a high degree of transparency, and the role of published accounts and auditing in fostering accountability. Banks expect to receive some scrutiny of the deals they sign.

Transparency should permeate every stage of the process, and efforts made by all sides to ensure that information can be readily accessed and understood (transparency is worthless if the information can be understood only by insiders). Whilst transparency deals with access to information, capacity building enables people to understand the information and act on it appropriately, and it reduces the possibility of exploitation. Thus the principle of transparency is that there will be open and honest sharing of information at all times. The practical steps involve training, translation and use of appropriate communication tools.

Equitable benefit sharing requires transparency (for instance through an open book policy and disclosure of related transactions and directors' other interests), particularly if transfer pricing is occurring between related businesses and joint ventures. In some cases, an investor may be relaxed about receiving no dividends from a business if they are benefiting from cheap raw materials but this would be to the disadvantage of co-investors.

However, transparency is just one element of the process of trust building. In modern investment relationships, the process of trust is embodied in institutions that require directors and stakeholders to be held accountable to each other. For instance, the sanctions for misconduct by directors are severe in many jurisdictions, usually ensuring some adherence to fiduciary responsibilities. This is buttressed by standardised systems that monitor performance, such as independent auditing of accounts. In forest investment, with

long time frames and remote locations, transparency and verification play an important role in satisfying investors that future returns can be realised. However, local institutions may be weak or non-existent, and judicial systems dysfunctional. In such circumstances a small forestry business can provide third party verification of trustworthiness, for instance by using forest certification schemes, setting up auditing systems and the long-term involvement of intermediaries. Investors can also indicate they are serious about transparency and accountability by complying with schemes such as the Equator Principles or engaging with ‘publish what you pay’ schemes (see box).

#### Box 15: International schemes to improve transparency

a) **The Equator Principles** is a voluntary financial industry benchmark for determining, assessing and managing social and environmental risk in project financing. It extends the application of the International Financial Corporation’s performance standards to other private projects even where IFC is not involved.<sup>81</sup>

b) **Publish What You Pay (PWYP)** is a campaign to encourage investors in the natural resource sector to reveal all payments they make to obtain licenses and concessions. Revenues from resource extraction are very often not disclosed by the governments or the companies involved; in some cases this information is a state secret. This lack of accountability facilitates embezzlement, corruption and revenue misappropriation. The scheme can work at a national level (revealing payments to governments), but also at the local level, by recording payments to police, army and local officials.<sup>82</sup>

Schemes such as these have benefits to all parties. They lower transaction costs, strengthen civic engagement and improve the business environment. Although mining companies have been slow to reform, respectable investors welcome such schemes. For instance a recent survey of investors managing \$1.2 trillion, mostly on behalf of pension funds, showed widespread backing for America’s proposed rules on PWYP.<sup>83</sup>

### 4.3.3 Condition (v): mutual learning and flexibility in order to improve performance

#### Key Features

- ▶ Improved understanding and empathy for other parties.
- ▶ Courteous communications and avoidance of small, unintended insults.
- ▶ An agreed process of deal development and performance management.

A successful business deal requires a process of negotiation. This runs more smoothly when each party examines their position through the eyes of the other party. The ability to empathise with the core beliefs and needs of others, even if they are quite foreign, is the foundation for building social capital and trust, which in turn is the glue that holds deals together.

This level of understanding is possible only if all parties are flexible, adaptable and sensitive to the needs of others. Donors and philanthropists making **enabling** investments, however, have more opportunity to be flexible than **asset** investors who have some clear lines that they cannot cross. But asset investors are aware that a deeper understanding of the context is a key step in minimising risk and uncertainty. They will likely, therefore, be keen to engage in the learning process.

Rights-holders also need to be flexible and take steps to learn more about the needs of investors. Enticing an investor to part with capital involves presenting the business case in a way that illustrates how it is of benefit to the investor first and foremost. Whilst presentations to donors will highlight the social and environmental benefits, asset investors will want to see persuasive data that show the enterprise will be financially viable and sustainable. For many

rights-holders, learning how to think in this way may be part of the process of transition towards engaging with the market economy. This is not just conceptual, it also reaches deep into the ways in which obligations are understood, and how rights may become contingent on certain responsibilities being taken seriously.

Governments need to understand that their planner's view of the economy and forest estate is probably flawed, outdated or incomplete. Becoming involved in the process of investing in locally controlled forestry allows them to learn the needs of the market, the constraints that diminish value, and the policy areas that need most urgent attention.

#### Box 16: Developing mutual understanding

Different actors (notably investors and forest rights-holders) have quite different cultural and professional outlooks that use key linguistic terms differently. Different meanings for common words held by rights-holder groups and investors, and unfamiliarity with the professional or cultural language of the 'other side', hinders understanding at times and challenges joint progress. For example, 'investment' is understood by investors as a primarily financial term involving capital transactions, whereas forest rights-holders understand 'investment' to mean something much broader, the active allocation of resources (including rights, organisation and capacity alongside capital) to enhance forestry assets – not only in the present but also for future benefits. Such differences in language are rooted in different perspectives about the objectives of investing in forested landscapes.

The fact that rights-holders often perceive their autonomy as immutable and their rights as inalienable introduces some challenges for investment as seen from the perspective of the investor, because a partial 'relinquishment' of both is perceived as critical to investors if contract-based investments are to take place.

#### 4.3.4 Condition (vi): agreed goals, expectations, benefit sharing and exit strategy

##### Key Features

- ▶ Joint statement of vision for the business, allowing for compatible, yet different, objectives.
- ▶ Rules of engagement specify how benefits will be distributed in certain circumstances.
- ▶ All benefits are defined in cash terms, for ease of comparison.

In conventional investing, it is not always essential that the investor and investee share a common vision, but it is important that the investee conveys a sense of having a singular vision, and that this is consistent with the investor's own world view, and sufficiently motivating to suggest to the investor that this company will achieve its business goals. Objectives indicate the direction of travel, while vision generates motivation and tenacity.

As discussed earlier, many investors may be seeking more than just a financial return. They may also want to see some impact in terms of a more secure natural resource and more capable business partners, either as a deliberate intervention, or as part of what they would expect to see emerge from a free enterprise model. For instance, some investors want to see a better local business environment and be able to draw on increasing pools of local professionals, which builds a middle class and reinforces democracy. Of course this may not be quite what the local people want, as it also implies unequal distribution of rewards, whereby skilled labour is more highly valued and returns to land rent are diminished. But that is the world as it is, so for practical purposes the framework stands: investors are not looking first and foremost to induce broad social change, but they do expect to see from their efforts improvements in local capacity to do business and enter into productive market relations, which may in turn cause some local change.

In reality, the power imbalance between investors and local people means that the investor's objectives often shape the conservation and commercial activities of communities. Therefore such partners have to be responsible and avoid imposing their values and goals on local rights-holders. But it seems inevitable that some values are going to be transmitted in the process of developing a successful business, and this may not be a wholly undesirable outcome. Perhaps what is needed is a means by which the values can be revealed and discussed openly, acknowledging that goals may change, and it is more important that visions are compatible than identical.

The 'rule of engagement' should be that all parties understand what they are putting into the deal, and what benefits they can expect to take out in any given set of circumstances. Such a deal can accommodate what to do with profits that exceed expectations, but can also formulate deals that allow for cash to be kept in the business if a dividend distribution is considered imprudent. Of course, the benefit being 'shared' is not always cash. It could be anything valued by the either party, but to evaluate if benefit sharing is fair, it probably needs a cash proxy value of some sort.

Timely and equitable benefit sharing is important for sustainability, and perceptions of inequality will lead to disputes requiring arbitration. This will be particularly the case if projects are either far below or far above profit target. It is important that equity investors have confidence that they will be allowed to participate in unusually high profits without having renegotiated terms thrust upon them in the name of fairness.

The exit strategy needs to reflect the investor's need to liquidate the holding at some point in the future, and the rights-holder's ability to change the financing structure over time, perhaps moving from an equity model to debt financing, as the business becomes more bankable.

#### 4.3.5 Condition (vii): checks and balances on decision-making to overcome disagreements

##### Key Features

- ▶ An agreed arbitration process mediated by a third party.
- ▶ Regular and free flow of information among the parties.
- ▶ Frank discussion of problems.

Where communication is difficult and social capital is low, deals need checks and balances as well as a degree of trust. The design of the business entity needs formal systems and rules, such as Articles of Association and SOPs. These will define rules and procedures that balance the rights of shareholders with the need for company officers to make effective business decisions in the long term interests of the company and all its shareholders, such as replacing a non-performing executive.

Such a structure should be careful not to discriminate between different classes of shareholders if that means diminishing the autonomy of the local rights-holders (for example voting and non-voting shares, preferred stock and so on).

Investment partnerships are built on trust, openness and the perceived fairness of how each party's contributions are rewarded. However, matters may still arise that require resolution,

and this may involve third parties. A pre-defined negotiation process can identify agreed routes for arbitration and conflict resolution. Such a mechanism is a standard clause in mainstream investment, but where there are disparities of power, resources and access to information, a more innovative approach is required.

In any business, if the shareholders are deadlocked (for instance where the investor and entrepreneurs each hold 50 per cent of the shares) then exercising a straight vote may not resolve anything. For this reason, it is sometimes appropriate for a third party to hold a 'golden share' which does not have much face value or right to dividends, but can be used as a casting vote (see Box below).

If arbitration cannot resolve differences, then eventually legal recourse is the only option. This would be the case if a bank or other creditor intended to recover assets. In many countries the legal system is not in a suitable condition, or sufficiently independent, to rule on this properly. It may be necessary to agree that disputes will be settled by an alternative jurisdiction (such as Singapore, USA, UK), with costs borne by the creditor.

#### Box 17: Using 'golden shares' to provide third party oversight

A 'golden share' is a nominal share that gives the holder the power to out-vote other shareholders in certain pre-defined circumstances. It does not usually have much face value or right to dividends but can be used to ensure a business stays loyal to a set of founding principles. NGOs and philanthropists could in some circumstance hold such a share if they are independent from asset investors and rights-holders.

A golden share may also be used as a casting vote if the shareholders are deadlocked (for instance where the investor and entrepreneurs each hold 50 per cent of the equity), where exercising a straight vote does not resolve the issue.

For instance, UK-based Fairtrade coffee company Cafédirect uses what it calls a 'guardian share', held by independent organisations to act as a casting vote in the case of a dispute where the company's founding mission may be compromised.<sup>84</sup> This differs from the ordinary shares in that it gives the owners (the guardians) certain additional rights. These are:

- ▶ They have the right to appoint a director to the Cafédirect Board.
- ▶ Their consent is required to make any changes to the key principles of Cafédirect's Gold Standard, or to the company's objects as set out in its Articles of Association.
- ▶ They have a right of consultation before any changes can be made to the wording of the full Gold Standard.

#### 4.3.6 Condition (viii): respect different values and embrace change

##### Key Features

- ▶ Agreed terms of engagement with wider community, illustrating the institutional, cultural and social linkages between the business and local traditional power structures.
- ▶ A local development plan that outlines how social and economic change will be managed, with any negative effects ameliorated.

As part of ensuring meaningful local control, communities should be involved in defining the priorities for investments, as 'a local sense of ownership of the process and sharing of benefits increases security of control'.<sup>85</sup> However, it is not clear how this control will be exercised and to what extent it is applicable only to common land rather than smallholdings. Where do the boundaries of the 'community' start and finish? Who defines the insiders and outsiders? In most literature on the subject the various right-holders are lumped together as

one group. For instance, a UK government's report on forestry<sup>86</sup> uses the terms 'indigenous communities', 'local communities' and 'smallholders' interchangeably without attempting to define these groups.

There is a danger that investors embrace the terms used by the communities uncritically, developing a hierarchy of rights claimants.<sup>87</sup> This leads to characterisations of the 'deserving poor' such as hunter-gatherers in culturally interesting tribal groups who are deemed to be 'good' for forest resources. On the other hand there is the 'undeserving poor', for example landless peasants, shifting cultivators and migrants, who are seen as destructive. This oversimplifies the local context, leading to misidentification of stakeholders and misallocation of benefits, with potential for conflict.

Furthermore, where responsibility for managing forests is devolved to local right-holders, how is this managed in practice? For instance, the forest user group concept (FUG) in Nepal has a separate legal basis from the village leadership. This can be a strength as it allowed the FUG to include actual forest users, who tend to be the poorest, rather than village elites, who may have a different agenda.<sup>88</sup>

Village institutions could be said to have a symbolic role, however, that may offer some stability in times of uncertainty. Radical changes to institutions, or the introduction of parallel institutions such as forest enterprises, may lead to instability and resistance.<sup>89</sup> On the other hand, it has been suggested that: "Communities are less prone to 'paralysis by committee' or infighting than is generally perceived".<sup>90</sup> The rights-holders' groups may need to consider how they present evidence that communities are inherently inclined to consensus on social and environmental issues, as it may be the case that this consensus conceals power relations at work. No doubt the answer is complicated, because of the diversity of groups from around the world.

Regardless of how the groups define their approach to autonomy and decision-making, they will need to prepare themselves for change, as exposure to market relations (such as by moving from a subsistence to market economy) may force them to reconsider some of their existing institutional arrangements. Some major social, environmental and economic transformation is likely to be the eventual outcome of the deal. Indeed, if a locally-controlled enterprise is successful, it is hard to see how it could not be transformative in some way. Rights-holders need to prepare for this transformation, taking measures to ameliorate the 'disordered effects of progress' such as inequality, maladaptation and loss of cultural homogeneity.<sup>91</sup> If the theories regarding the links between autonomy and improved livelihoods are correct, then the positive changes should outweigh the negative, but in some fragile communities any change may be traumatic.

This requires a realistic sense of the unintended and unknowable consequences of progress. This is relevant to investors as they may in some cases be reluctant to be part of an intervention that induces rapid social change. However, this reluctance in turn may lead investors to adopt a patronising stance to rights-holders, especially Indigenous Peoples, while failing to appreciate their rights to determine their own development model.

## 5 Roadmap to success (the process)

Building an investment partnership with rural enterprises, in either forests or agribusiness, is in some ways no different from mainstream investment in urban areas. The process of discovery, relationship building, negotiation and implementation will be familiar to investors and bankers from any sector. As previous sections of this paper have argued, however, there are some specific challenges to investing in forestry and related activities. At each stage the local counterparts will need advice, mentoring and capacity building, supplied by an intermediary with the cost covered by a separate ‘enabling’ investment pool.

This guide describes the ‘process’ as a series of stepping stones to completing an investment deal. Each enterprise should navigate these steps at their own speed, and there may be times when they feel stuck and can make no further progress. This is the point at which (if they have not done so already) they should be building partnerships, or reviewing the value of the partners they already have.

This section gives a brief overview of the steps towards making an investment deal. It is written with the assumption that it is in the long term interest of locally controlled forest enterprises to seek asset investment, even though they will, in most cases, require some enabling investment in the short and medium term to help them navigate this process.

### 5.1 How the process works

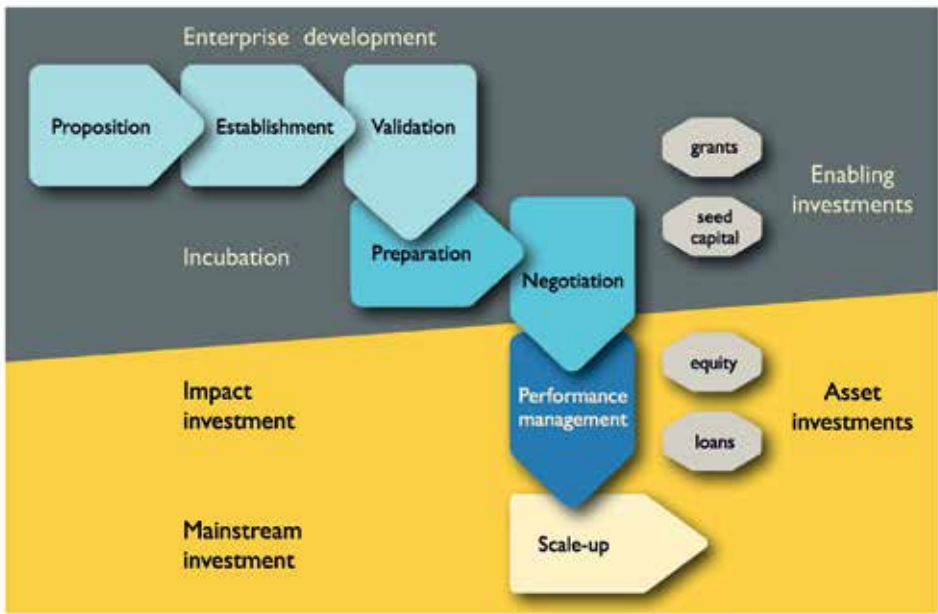
Describing the procedure to set up and build a locally controlled business as a series of steps masks the fact that few such processes are linear. Different steps may be carried out at different times, and projects may not start at the beginning. In reality many projects have already been implemented to varying degrees for varying periods of time.

The process may require returning to certain issues more than once. For instance, a validation stage should test the business concept and the community’s capacity to deliver it, before an investor is involved. Gaps identified at this stage need to be addressed, either by improving the value proposition or by upgrading capacity and organisational strength. Later in the process, the investor will follow a due diligence process, which could also identify further gaps requiring attention. At this point, roles can be assigned to third parties such as NGOs and other intermediaries, and budgets allocated.

Throughout the process, and particularly once the business is operating, there needs to be a commitment to continuous learning and improvement. This will enhance capacity building as well as the value of the investment. This commitment should distinguish between ‘single loop learning’ (which asks: are we doing things right?) and the more rigorous double-loop learning, which examines the context and boundaries of the project (asking: are we doing the right things?).<sup>92</sup>

The main steps in the process are: proposition, establishment, validation, preparation, negotiation and performance management. The process, and the different types of investment that support it, is shown in figure ten below:

Figure 10: How different investment types match the stages in the process



## 5.2 Proposition

Proposition →	Establishment →	Validation →	Preparation →	Negotiation →	Performance
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The essence of building a new business is for an individual or a group of people to have an idea and then commit to it. Imagination is required to envision and develop the basic business concept, which in the early stages is built around the resources that are available, such as forest commodities or environmental services. However, the business idea should not focus only on realising the extractive value of commodities but also consider the skills and potential of the local people who will work for the business. At this stage, the rights-holders will need to summarise the value proposition, considering its financial potential, social and environmental impact and suitability to the local context. Although the motivation to set up the business may be to satisfy local economic and social goals, this is an outcome of running a successful business rather than a satisfactory proposition for setting it up. There should first and foremost be an understanding of the market demand that the proposition answers (for example, ‘supplying sustainable timber for local market’, or ‘processing precious woods for export’).

At this stage of the business development, all that exists is the core idea. In order to turn this idea into something tangible by following the steps outlined in this chapter, the founders of the business will need to exhibit some core attributes, none of which require advanced education or special skills:

**Passion** for the vision and mission of the business is a motivator for the core team and other stakeholders, but **flexibility** is important if the plan needs to change when it meets the sharp corners of reality. Good **communication** means making room for uncomfortable truths by cultivating an atmosphere for honest and healthy debate that invites curiosity and scrutiny.

Lastly, most start-ups fail because they run out of time or money, and **stamina** will be required to see the task through.

The aim should be to build a sustainable business, not just access short term rents or income from labour. Sustainability is meant not only in the environmental sense – although of course that is crucial for a locally controlled forestry business to thrive in the long term – but also in the financial sense. To survive, a business must get many things right, but the most fundamental insight is to keep a market focus. As management guru Robert Kaplan summed it up:

**“Satisfying customers is the source of sustainable value creation.”<sup>93</sup>**

**Box 18: Formulating a vision and mission**

The difference between ‘vision’ and ‘mission’ is often misunderstood.

The **vision** describes the desired future state that will be brought about by the business, for example, ‘a sustainably managed production forest that protects ecosystem services whilst providing prosperity to local people’.

The **mission** tells us how the business intends to achieve its vision, for example, ‘Joint forest management with local communities, combining modern technical techniques with traditional wisdom and know-how, to produce a range of quality manufactured timber products for domestic and export markets.’

**5.3 Establishment**

Proposition →	Establishment →	Validation →	Preparation →	Negotiation →	Performance
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Most LCF organisations that are seeking investment are already established. It may however be necessary to revisit this phase, in order to ensure there is a really strong foundation on which to build a sustainable enterprise. Although this step is the first part of the process, in reality it continues throughout the process. A well-run community forest enterprise pays attention to creating the right conditions for continual development, learning and improvement.

The aim the establishment phase is to build the capabilities of the organisation so it may be connected to finance, technology and resources, in order to bring about the vision outlined in step one.

**5.3.1 Institutional development**

The organisation needs to establish the most favorable institutional conditions in which to do business and thrive. Many of these aspects may be hard to engage with in the early stages, or will require partnerships with NGOs and other civil society organisations. These include aspects such as:

- ▶ Identifying and formalising tenure rights.
- ▶ Clarifying legal access to land or natural resources.
- ▶ Building working relationship with local and national government and identifying which programmes and policies are available to assist the business.
- ▶ Appraising the organisation’s position within the wider community, in terms of participation and legitimacy. To what extent can this business be said to be ‘locally controlled’? What community conflict resolution mechanisms are in place?

- Identifying potential risks and weaknesses that arise from the institutional context, such as: lack of government support, weak tenure rights, local conflicts, cultural issues, and considering how these can be mitigated or how the business itself will be a vehicle for resolving some of these issues (for example, tenure rights may be strengthened when the business is more successful).

#### Box 19: An illustration of the changing role of NGO partners as the business develops

Koperasi Hutan Jaya Lestari (KHJL), a community-owned teak cooperative in Indonesia, arose out of work done by a local NGO, Jaringan Untuk Hutan (JAUH). Both partners had to work with different levels of government in order to obtain the permit to market timber, and subsequently to take over management of some degraded state forest land for new planting. The process of obtaining this permit took over eight years, and required tenacious lobbying by JAUH. In addition, both partners were supported by The Forest Trust (TFT), a global non-profit that helps companies and communities deliver responsible products, by helping locally controlled forest enterprises to achieve forest certification. In 2005, KHJL successfully obtained an FSC Group Certificate, the first FSC certified cooperative in Southeast Asia. See the case study for more details.

The relationship between JAUH and KHJL started as an open-ended long-term arrangement, but as KHJL has developed into a more sophisticated business, it has come to require different types of support. In applying for business development grants, it is now more likely that these are paid direct to KHJL; in the past, all grants went to JAUH to cover their work with the cooperative. KHJL has a strong bond with JAUH, and attributes its current success to that relationship, but it is conceivable that in the future it may start to diversify where it obtains organisational and technical support.

In response to this changing situation, JAUH is now re-casting itself as a Business Development Service Provider, requiring a more professional and clearly specified contract with its 'clients'. Thus the process of guiding KHJL through the institutional and organisational development stages has been as instructive and transformational for the NGO as it has been for the forest community.

### 5.3.2 Organisational development

The organisation may be a cooperative or informal group of individuals or families in the first instance. Most businesses start this way. The process of organisational development will make this unit more robust, flexible and effective. It will include activities such as:

- Formulating the vision and mission of the organisation.
- Appointing the core leadership team and assigning roles.
- Fulfilling the legal requirements to register the organisation (for example as a cooperative).
- Analysing the strengths and weaknesses of the organisation (such as with SWOT analysis).

### 5.3.3 Team development

The core of the organisation is the team that takes on the key roles of leadership, management, finance, and so on. In the early years, these positions are often unpaid and may be taken by people who do not yet have the skills to carry them out most effectively. Therefore the business needs to consider how this core team will be made cohesive and mutually self-supporting (teamwork) as well as ensuring that each individual has the opportunity for personal development. The team must:

- Assess knowledge, attitude and skills.
- Work with NGO partners to identify training opportunities.
- Identify mentors in well-established organisations nearby.

### 5.3.4 Build partnerships

Partnership building is covered in some detail in the previous chapter. The organisation needs to overcome its isolation by building links with other cooperatives and similar organisations, in order to share best practice and learn from each other's mistakes. In order to open up to learning from a wider range of experiences, however, the organisation should also form linkages with local entrepreneurs and perhaps also larger businesses.

These partnerships may be merely associative (for instance, as a learning network) but they may also develop into horizontal and vertical trade linkages that will benefit the business in future.

#### Box 20: Leadership

Locally-controlled forest enterprises can often overcome various disadvantages if they have good leadership. How these leaders are appointed, and how they may be dislodged, varies according to the local culture and type of organisation. Communities have raised the issue of how hard it can be to appoint 'credible' leaders. 'Credible' implies more than a level of competency, it also refers to high ethical standards and what would be locally recognised as 'uprightness'. Whilst a good leader need not require brilliant technical skills nor long experience, he or she does need to have 'passion and responsibility', as described below:

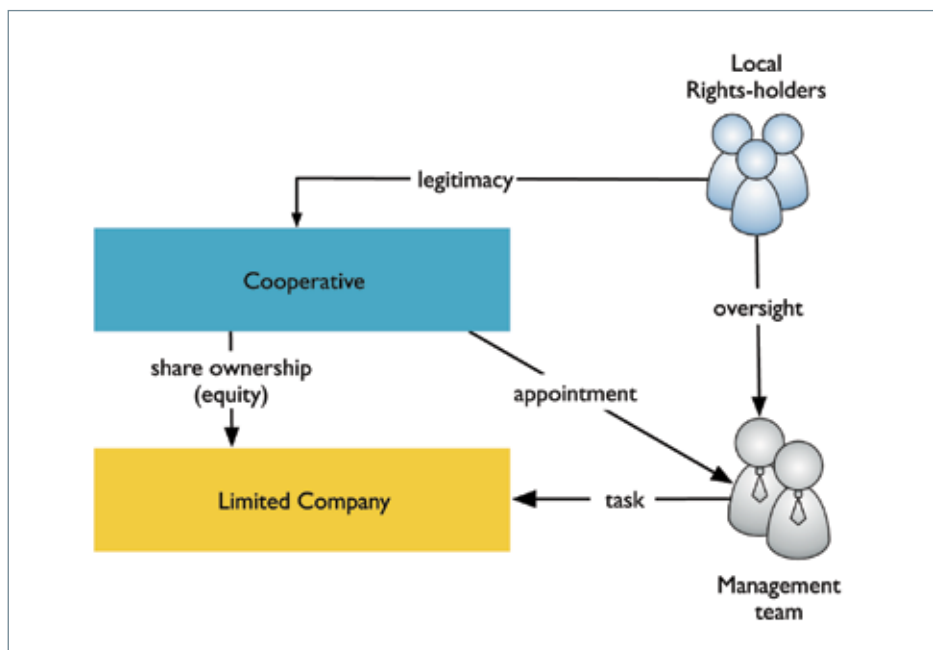
Passion	Responsibility
<ul style="list-style-type: none"><li>▶ Helps the organisation keep a sense of its identity, vision and purpose.</li><li>▶ Focuses on ensuring all staff are oriented towards delivering the company's 'promise' to the market (such as lowest price, highest quality, or best service).</li><li>▶ Continually questions and stimulates learning ("are we doing things right?", and, more importantly, "are we doing the right things?")</li><li>▶ Inspires and motivates staff.</li><li>▶ Embodies the belief that goals can be met through honesty and fair dealing.</li></ul>	<ul style="list-style-type: none"><li>▶ Accountable to the owners and investors (where the owners are the local people, perhaps via a cooperative, and the investors may be outsiders).</li><li>▶ Makes decisions. (<i>"it wasn't the new machine that made us successful, it was the <b>decision to buy the machine</b>"</i>).<sup>94</sup></li><li>▶ Invests in future leaders, acting as coach and mentor to the next generation.</li><li>▶ Always puts the company's needs before their own self-interest.</li></ul>

### 5.3.5 Setting up a legitimate business

Investment cannot easily proceed without viable business entities in which to invest. One of the key constraints facing investment in trees and landscape restoration is that much of the commercial activity involves informal, unregistered enterprises. Informality – not necessarily illegality – is pervasive in most developing country forested landscapes.<sup>95</sup>

If the business is seeking an equity investment then it will probably need to be a limited company. Cooperatives may be able to receive bank loans in certain circumstances, but usually on terms that are too narrow for use as capital investment or working capital. Forming a limited company does not mean that a community or farmer's group needs to lose touch with its values, such as solidarity. The shares in the company can be owned by a local legitimate body, such as a cooperative, and the profits shared through the existing benefit sharing process. As shown in figure 11, as the main shareholder, the cooperative appoints the management team, and ensures the business has local legitimacy as well as legal legitimacy.

Figure 11: Making businesses legitimate and accountable



The cooperative gets its legitimacy from participation by the local community. This requires a careful process, however: only the community itself can define the composition and structure of the business entity (usually with help from a third party – funded by ‘enabling’ investment). To be prepared for cash investment, this organisation should be fully formed and present itself as a coherent entity that in some way the investor can recognise. It is not reasonable (or desirable) to expect the investor to be making judgements about inclusion, gender or opaque local politics.

The process of setting up such an entity should follow community norms and general principles of community development (such as those from the FPIC guidelines). If investors are satisfied such a process was followed, it is unlikely they will require the details.

The issue of sequencing and **and layering** of ‘enabling’ and ‘asset’ investment is perhaps most clearly seen here. Preparing the community (‘enabling’ investment) means helping them articulate what they wish to achieve, how they are going to organise themselves into an investible business organisation, who can speak on their behalf, who has veto, are women excluded, and so on. These issues should ideally all be dealt with in the preparation phase before the investor is on the scene. Once the asset investor arrives, the community needs to confirm that an appropriate process was followed and that this entity is one that can make enforceable deals. Otherwise, the investor would face a future risk of disagreements over the terms of an agreed deal and ‘submarine’ claims over land and resources.

### Box 21: The process of securing tenure to land and assets

Securing tenure rights requires governance actions based on a number of legal ingredients (below). The sum of these give a forest or landscape enterprise the security it needs:

**Duration** – must be enough to provide an incentive for communities to invest both in the forest, and in businesses that might sustainably use it.

**Assurance** – tenure must be clearly prescribed, avoiding any ambiguity or distinction between ‘subsistence’ and ‘commercial’ use or between ‘land’ and ‘forest’ rights – guaranteeing returns from any investment.

**Robustness** – tenure must be easily defensible in a court of law. Rights must be prescribed and disseminated so that forest officers, transport police, customs and the judiciary, and so on, can use them in day to day practice.

**Exclusivity** – there must be no overlap between the commercial forest rights of communities and those of external investors or government agencies.

**Simplicity** – rights should be free of excessive bureaucratic steps, lengthy documents, costly registration procedures in far-distant offices, and so on.

## 5.4 Validation

Proposition →	Establishment →	Validation →	Preparation →	Negotiation →	Performance
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Once the organisation has been set up on a sound footing, the next step is to validate the business proposition. This ensures the concept is feasible and that the organisation could become a business capable of raising investment capital. This may take place some time after the establishment phase (in some cases years after), and the process of validation may also take some time. There will be many times when the organisation will need to go back to the drawing board and start again. This is why it is essential that the organisation is already reasonably robust and resilient before attempting this process.

### 5.4.1 Situational analysis

It is tempting for community businesses (and the NGOs that support them) to grasp the most obvious business opportunity without comparing its potential value and risks with other potential options. In some cases, the most obvious course of action may not be the most appropriate to the community’s strengths, or may be poorly matched with market demand. A situational analysis ensures that the business concept is rooted in the local reality as well as aiming for a genuine value proposition. To undertake this analysis, the organisation should do the some or all of the following:

- ▶ Re-visit SWOT analysis and identify how each strength is related to the opportunities, and how each weakness is related to the threats (see Box for guidance).
- ▶ Quantify the natural resources available to the business (for example, annual allowable cut in natural forest, hectares of land for plantation development).
- ▶ Identify the human resources available to the business (leadership team, local labour, bought-in expertise, NGO or local government technical advisors).
- ▶ Carry out market research: what do buyers value most (such as quality, price, or service)? Who is the competition, what do they offer?
- ▶ Consider local conditions – review local infrastructure, transport cost, climate, physical constraints (for example when are roads impassable, rivers not navigable).

Box 22: SWOT analysis

SWOT stands for Strengths, Weaknesses, Opportunities, and Threats.<sup>97</sup> This is a simple technique that analyses a business so that future strategy can be focused on building on strengths and mitigating weaknesses. The SWOT process is a highly effective planning tool that can be easily understood by people with no business skills or advanced education.

		Positive	Negative
Analysis of capabilities	Internal	Strengths	Weaknesses
Analysis of market, environment etc.	External	Opportunities	Threats

The process measures both the internal capacity (strengths and weaknesses of the business) and the external conditions (opportunities and threats facing the business). The first step is to grade the organisation's capability in the core competencies required for business, for instance: sourcing of raw materials, production, marketing, distribution and customer service. Aspects of the various competencies can be assigned as either strengths or weaknesses.

Next, the organisation considers the opportunities and threats. Opportunities could relate to new technology, raw material supply, new markets (such as for lesser-known species), new rules and regulations / permits, economic trends. Threats may include: raw material shortage, new regulations, economic trends, political instability, unfair competition, changing customer trends (for example, consumers buy plastic instead of wood, or iPads instead of paper).

The aim of the SWOT analysis is to find the optimum match of a enterprise's internal resources with the external environment by:

- ▶ building on the organisation's strengths; reducing weaknesses or adopting a strategy that avoids weaknesses;
- ▶ exploiting opportunities, particularly using the strengths;
- ▶ reducing exposure to, or countering, threats.

For instance, the SWOT may illustrate that a new locally controlled business should initially concentrate on the things it does well, such as growing and felling trees, as it does not yet have the competency to deal with production issues. Conversely, it may show that there is a market opportunity in a certain kind of processing, and that the business has a particular competency to take advantage of it. Over time it is a good idea to re-visit the SWOT analysis and update the table to reflect changes in the organisation and the external environment.

5.4.2 Concept development

Eventually a business plan will be required, but before going to that trouble (and expense), it is easier to generate a short concept note. This will be enough to test the idea, gauge interest among buyers and investors, and evaluate feasibility. The concept note converts the information gathered in the situational analysis into a summary of the 'value proposition', which is the promise that the business will unlock value in two places: delivering something that the customer values whilst also creating value within the enterprise by ensuring revenue exceeds costs.

There is an example framework for a business proposition given as an Appendix to this report (section 8.1 Framework for the Business Concept Document). In summary, this short document will:

- ▶ Set out the goals of the business (vision and mission) and define business (financial) goals separately from the 'impact' goals such as social or environmental outcomes. This is important, as at a later stage in the funding plan these goals may be funded by separate investors.
- ▶ Describe the business opportunity.
- ▶ Define how the organisation's strengths will be deployed in a strategy to exploit the business opportunity.
- ▶ Describe the features of the product and how it meets market demand (for example, certified timber is in short supply, buyers will pay a premium of n%).

### 5.4.3 Feasibility study

The business concept will need to be tested for feasibility and market acceptance. The way feasibility is assessed will depend upon the type of business but it may include some research and development, for instance using demonstration plots or pilot projects. It may also include:

- ▶ Environmental impact analysis.
- ▶ Social / community impact assessment (for example, is consent required from other community members, or other local groups?).
- ▶ Double-checks of the legal position (permits, export licenses, and so on).
- ▶ Discussions on the concept with partners, experts from outside the area and other intermediaries.
- ▶ Presentation of the concept to buyers and obtaining letters of intent or constructive feedback. It is important to get a sense of the real demand and price sensitivity.

The goal of the feasibility study is to make a decision, which will probably break down into:

- ▶ **Not feasible** – return to concept development (and perhaps also re-visit situational analysis with the new information gleaned in the feasibility process).
- ▶ **Possibly feasible** – the concept has merit but some gaps may need to be overcome before it can be fully realised.

### 5.4.4 Gap analysis

The process outlined above will have revealed some interesting and important issues. Some of these may be uncomfortable to hear, or will be demotivating as an exciting business idea begins to disintegrate when analysed and discussed with people from outside the group. This is the inflection point that separates real enterprises from income-seekers, however. An enterprising business, with an enthusiastic and resilient leadership team, will see how these 'home truths' can be turned into business advantages. The gap analysis will set out the distance between the ideal concept and the organisation's current capacity to deliver it.

This will cover issues such as:

- ▶ Meeting the demands of the market (quality, price, service).
- ▶ Improving social and environmental performance.
- ▶ Overcoming internal constraints (management weaknesses, low capacity, organisational problems).

- ▶ Overcoming external constraints (infrastructure, government policy, permits and legality).
- ▶ How can the business scale-up. The concept may not be feasible for a small business on its own but may be improved through collaboration or partnership with other local businesses.

The outcome of this process is a clear plan of action and a timescale. In some cases, the transition from the concept and R&D phase of the business until it becomes a start-up can take some time. Locally controlled businesses should be willing to invest as much time as it takes to get off to a proper start, and may need to persuade donors and philanthropists of the need for a methodical approach in making enabling investments.

### Box 23: Analysis of market constraints (part of 'situational analysis')

#### **Policies and rules**

Not all markets are free. For different reasons, governments might restrict investment options relating to forest landscapes. In Mozambique, for example, only Mozambican nationals can take advantage of the annual Simple License arrangement to exploit timber, whereas both national and international investors can pursue longer term concessions. In other countries such as Ghana, strict requirements for legality linked to the Voluntary Partnership Agreement (VPA) with the EU Forest Law Enforcement Governance and Trade (FLEGT) action plan restricts what timber species can be harvested and exported and how. Alternatively, many governments restrict investments in particular landscape contexts for environmental reasons, for example agriculture on sloping lands due to watershed and erosion concerns, or plantations on peatlands in Indonesia due to carbon emission fears.

#### **Market inefficiency**

Even where markets are relatively unconstrained by policies and rules, they may operate inefficiently because of a number of factors. Poor market information systems can constrain the ability to meet demand with supply. For many agriculture and forest products, lack of market information may be compounded by inadequate grading or product quality control. For example, in Honduras when Greenwood<sup>98</sup> was attempting to supply Taylor guitars with Mahogany guitar necks, a major effort went into building capacity for quality control before the first orders were delivered. Attempting to invest in community forestry timber operations has frequently collapsed through the inability to meet quality expectations on time.<sup>99</sup>

#### **Competition**

Where informality is rife, companies that chose to invest in sustainable management or even certification may face unfair competition from those who operate unsustainably or informally. In some cases, such competition may even be legal. In Brazil, for example, the large volume of legally felled timber arising from resettlement projects during the 1990s depressed the value of timber such that certified operations found it difficult to compete in the domestic market. Investment in biomass energy in many countries is hampered by the widespread availability of charcoal and fuelwood from unsustainable harvesting where no management costs are involved.

#### **Seasonality**

For investment in non-timber forest products (NTFPs), seasonality of supply may mean there is a glut during the harvesting period that depresses prices. In such circumstances, finding alternative markets or ways of storing products so as to be able to sell off-season are possible solutions.

### 5.4.5 Completing the validation stage

Once rights-holders have organised themselves to improve the external conditions and then formed partnerships in order to set up the best possible internal conditions, they may still struggle to raise investment finance. Even with clear tenure, in the context of good governance, with a good level of capacity in the management and leadership of the enterprise, designing a successful investment deal is a challenge. To some extent, this can be ameliorated if the new business moves through certain stages, accompanied by the most appropriate layers of enabling investment and asset investment.

The table below is a repeat of the table three, and shows the criteria still to be satisfied, even if the enterprise has – together with partners – been able to set up all the favourable conditions outlined so far. These outstanding issues that need to be satisfied are explained briefly below.

Table 10: Investment readiness scorecard, revisited

Type	Category	Criteria for investment	Satisfied?
<b>Enabling investment</b>		Compatible goals	Yes, see condition (vi)
		Potential for improvement	Yes, see condition (v)
		Flexibility	Ditto
		Likely to have positive social and environmental impact and has a plan to mitigate any negative social and environmental impact	Inherent in LCF proposition, and explained in business plan
<b>Asset investment</b>	Value	Viability of business proposition	Perhaps, see condition (viii)
		Measurable risks and returns	?
		Status of forest tenure and usage rights	Yes, see condition (i)
		Enterprise has sufficient scale	?
		Track record of managers	?
		External factors (country risk, governance and market constraints)	Perhaps, see condition (ii)
		Formal enterprise with permits	Yes, see condition (iii)
		Organisational capacity to deliver the plan	?
	Impact	All the above, plus: likely to have positive social and environmental impact and has a plan to mitigate any negative social and environmental impact	Inherent in LCF proposition, and explained in business plan
	Product	Potential to produce product to required specifications	?
	Banks	Liquidity of assets and collateral	?
		Sufficient cash flow	?
		Formal enterprise with permits	Yes, see condition (iii)
		Track record of managers	?
		Organisational capacity	?
		External factors (country risk, governance and market constraints)	Perhaps, see condition (ii)
		Sufficient owner's equity contribution	?

## 5.5 Preparation

Proposition →	Establishment →	Validation →	Preparation →	Negotiation →	Performance
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When the gaps identified in the previous step have been addressed (or when a plan is in progress to address them), the organisation will need to flesh out the concept document into a more complete business proposal and offer it to investors. In some cases, there may be gaps (for instance in technical capacity) that cannot be properly tackled until the business is fully funded. These can be identified in the business proposal as a line item for the training budget. The aim of this phase is to make the business ready to receive investment and commence operations.

### 5.5.1 Business plan

The business plan is the means by which an organisation can demonstrate that it has a full understanding of the business opportunity and how it may be realised. It is also a key tool in identifying and minimising risks, which is crucial not only to the investor's willingness to participate in the project, but also for ensuring that the community itself is not engaging in something with unacceptable risks. There are many resources available that describe in detail how to prepare a business plan, so this guide will not cover this aspect in great detail.

In brief, a business plan will show understanding of the customer needs, value proposition and value chain, with proof of expertise in the local market. The business plan cannot be judged purely on its own internal logic and the presentation of satisfactory numbers. The business plan is not a promise that certain outcomes will be achieved, but explains how the enterprise intends to take steps towards a clearly defined destination, while anticipating the risks that will be encountered. In evaluating a business plan's viability, an investor needs to take a number of factors into account, some of which are internal to the enterprise (staff, resources and so on) and others are external (such as risks, market forces, economic trends and cycles).

The plan needs to be a sober and impartial assessment of the steps needed to enable the business to reach its goal. It needs to include assumptions and calculations (such as yields, growth rates and price projections) that can be benchmarked against similar businesses. It will include a clear statement of the business mission and vision, and a description of the business model, which sets out the 'maths story' – how it plans to make money.

The business plan should be reviewed by a third party to check that is sound; NGOs, however, very rarely have the expertise to evaluate business plans. This is where a professional intermediary, such as a Business Development Service Provider, could be invaluable. In some cases there may also be an opportunity to have the business case rated by an agency (for example see SCOPEInsight case study). This will greatly enhance its credibility and the likelihood that it will find willing investors.

### 5.5.2 Funding model design

At its most basic, a business plan will specify the amount of funding required in order to execute the business plan. In most cases, a new business venture will need cash investment to cover the cost of purchasing assets and equipment (known as capital expenditure or 'capex'). It may also need to cash to cover set-up costs and overheads until the sufficient cash flow is generated by sales (this is sometimes known as operational expenditure or 'opex').

The funding model may also propose a funding mechanism, such as debt, equity or a blend of the two. It may demonstrate how the cash flow can be supplied by ‘funding strips’ that ensure the business is drawing down on debt or equity only when it needs the cash, and is not carrying a large cash balance on its account.

The most suitable funding model will depend to some extent on the appetite of investors and the nature of the asset offered as security. In some cases, the asset may not yet be available (in the case of growing trees), or perhaps is reliant on receiving sales income, in which case discounting invoices (or factoring) may be the answer. This is a method whereby the company uses purchase orders received from buyers as security for a loan, giving the investor or lender control over the income and reducing risk substantially.

Table 11: Comparison of financing instruments<sup>100</sup>

Financing instrument	Terms	Implications for locally-controlled enterprise
Grants	Duration: short-term Annual payments: none Repayment: none	<ul style="list-style-type: none"> <li>• Usually restricted use for predefined projects</li> <li>• High fundraising costs</li> <li>• Low entrepreneurial flexibility</li> <li>• Unreliable source of finance: follow-on grants may not be available</li> </ul>
Debt capital	Duration: long-term (3–7 years) Annual payments: interest payments (variable) Repayment: yes	<ul style="list-style-type: none"> <li>• Annual interest payments require low-risk business model</li> <li>• No dilution of ownership</li> <li>• Far-reaching rights of capital providers in case of default</li> <li>• High entrepreneurial flexibility in the use of capital</li> </ul>
Leasing	Duration: long-term (3–7 years) Annual payments: interest payments (fixed) Repayment: yes	<ul style="list-style-type: none"> <li>• Financing tied to specific capital expenditure item (e.g. truck or sawmill)</li> <li>• No dilution of ownership of enterprise</li> <li>• Capital provider has right to recover capital asset in case of default</li> </ul>
Equity capital	Duration: unlimited Annual payments: dividend payments (variable) Repayment: no	<ul style="list-style-type: none"> <li>• Dilution of ownership</li> <li>• Investor receives control and voting rights</li> <li>• Profit participation for investor</li> <li>• Potential impact on corporate culture</li> </ul>
Zero coupon bonds	Duration: long-term (5-15 years) Annual payments: none Repayment: yes, including accrued interest	<ul style="list-style-type: none"> <li>• Repayment matched to future revenue (e.g. timber harvest)</li> <li>• Investor has first call on asset in case of default</li> <li>• High transaction cost to design and issue the bond</li> <li>• Efficient way for enterprise to deal with delayed cash flow</li> </ul>

### Box 24: Matching the finance type to the business

As LCF enterprises may lack securable assets (land, personal assets, buildings, physical equipment, and so on) that can act as collateral, there is less opportunity for debt financing – for instance by taking a loan from the bank. This means the deal has to be built on equity,<sup>101</sup> whereby the investor takes a share in the business and has a claim to a share of future profits.

In the case of a timber plantation, the LCF enterprise may lack cash flow to repay loans or make dividend payments for some years. In such cases, a ‘zero coupon bond’ may be the answer, as it allows the repayment of both principal and interest to be made at the end of the term, which could be up to 15 years. This means the bond can be designed to match the likely harvest schedule of the plantation, ensuring that investors are paid out of available cash flow. This bond structure will not be possible until the business has some standing stock (and thus a track record in maintaining a plantation), however, so in the early years, equity investors may be required to finance the initial planting.

### 5.5.3 Offer to investors

In order to attract the most appropriate investors, the business must first be clear about what kind of finance it is looking for. This should be clear from the business plan and funding model. The most important distinction is between product and income investors. There may also be a hybrid model whereby product investors supply a purchase order directly to a finance company, which in turn makes an advance to the producer.

In order to be successful in finding investors, the enterprise needs to consider ways in which it can reduce the cost and uncertainty of doing business with them. Investors really need to get to know the company in order to evaluate risks and returns accurately. How can this process be made easier?

Raising finance is a key bottleneck for small businesses everywhere but this is particularly the case with locally controlled forestry. By following the steps outlined in this process model, businesses should at least be in a good position to attract capital.

#### Box 25: What is an 'attractive risk-adjusted rate of return'?

The investor is either lending money, in which case the business plan will need to demonstrate how interest payments will be made, or will be investing for equity. If investing for equity, the investor is making a claim on a share of future profits, so needs to be convinced that the rate of return will be enough to compensate for the risk that such profits will not materialise. This target internal rate of return (known as IRR) will vary according to the status of the investment criteria outlined in the Investment Readiness Scorecard in table three above. More secure tenure, in stable business environments, requires a lower rate of return.

### 5.5.4 Building capacity to deliver the plan

Forest rights-holders need competitive business skills to break into or create new markets, ensure profitability and attract investment for managing the forest resource sustainably. These skills are rare across forest landscapes in developing countries. Indeed, ad hoc alliances such as Forest Connect<sup>102</sup> have been established to help support small forest enterprises precisely because developing business capacity is so unsupported across forested landscapes.<sup>103</sup>

Entrepreneurial forest rights-holders need help understanding a number of areas:<sup>104</sup>

- ▶ **Markets and marketing** – finding out what customers want and developing promotional materials to convince customers to buy their product or services.
- ▶ **Competition** – assessing competitive advantages, such as providing the same value as their competitors but at lower cost, or offering more value at the same cost, or diversifying into new products or markets.
- ▶ **Value chains** – assessing what part of a value chain they can realistically occupy and what business form is likely to best serve their interests.
- ▶ **Business roles** – allocating different business tasks to the right people: business managers, supply, production and marketing coordinators and accountants.
- ▶ **Record keeping** – doing the basic accounting involved in balance sheets, profit and loss accounts and cash flow analyses.

One of the key areas that requires support is in helping forest rights-holder groups prepare for or negotiate adequate investment proposals. This involves both preparing the proposal – developing the initial concept or business idea, conducting an impact study, formalising an

organisational and institutional structure, preparing a feasibility study, getting agreement internally, and writing the concept note or business proposal; and negotiating the deal with an investor – such as disclosure of objectives, matching the investor to the concept, designing the deal with debt/equity financing, revenue sharing, time scale, involvement of third parties, conducting due diligence to identify gaps, making improvements, re-negotiating and signing a heads of terms agreement.<sup>105</sup>

**Box 26: The FAST Graduation Model**

Finance Alliance for Sustainable Trade (FAST) is a collaborative association between financial service providers and a broad range of stakeholders. It aims to increase access to finance for sustainable forestry producer organisations and SMEs in developing countries, so as to combat poverty. FAST’s uses a ‘graduation model’ whereby some of their partners and technical assistance bodies provide **enabling** investments in the form of financial training and help for SMEs to build investment and business plans. Once their financial proficiency is enhanced – along with their confidence to present a business case and discuss numbers with investor – the SME is able to ‘graduate’ to the next stage, where FAST will help the businesses find potential **asset** investors to whom they can present their business plan.<sup>106</sup>

**5.5.5 Benchmarking rates of return**

The rates of return predicted in the business plan have to be reasonable, given the risks involved. If too low, they are not attractive; if too high, they raise suspicion of being too optimistic or very risky. The underlying assumptions that inform the predictions (such as growth rates, market prices, taxes, establishment costs) need to be explained in detail. Risk factors need to be clearly identified in the business case, along with strategies to manage and mitigate them. Investors may also ask how sensitive these results are to various parameters such as price changes, biological growth, and other sources of uncertainty. Business developers should understand and be able to present the risk profile of their projects.

Any projections (such as yields, growth rates, price projections) in the plan need to be comparable with benchmarks of similar businesses, products, climate and so on. If they are very different from what may be commonly achieved elsewhere, then this will require detailed explanation.

**5.6 Negotiation**

Proposition →	Establishment →	Validation →	Preparation →	Negotiation →	Performance
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The negotiation phase is only possible if the previous phases have achieved certain outcomes, such as clear tenure rights, social licence to operate, draft business plan, identified a local organisation with legitimate representation and legal standing, awareness of capacities and needs, communication and transparency mechanisms and lastly, capacity to negotiate.

Negotiation starts by asking the right questions of the other party. Implicitly, the rights-holders asks the investor “How can we help you achieve return on capital?” while the investor asks the rights-holders “How can we help you overcome barriers to our mutual advantage, for example, tenure, market access?” This recognises that sometimes groups want something more from an investment relationship than just access to cash. For instance, they may be looking for security of tenure, or some form of empowerment. Of course the investor may also share these objectives (tenure is likely to strengthen the business case and balance sheet so will benefit all parties). Getting to shared objectives does not mean that all objectives are

the same, but that there is a substantive overlap that ensures all parties are committed to the success and longevity of the venture.

### 5.6.1 Due diligence

The investor will wish to conduct a due diligence process that will review many of the aspects discussed at length in Section Three of this guide ('Understanding investment').

To re-cap, the investors will be looking to evaluate the criteria in the table below, which also indicates what evidence may be required.

Table 11: Evidence required to fulfil the investment criteria

Type	Category	Criteria for investment	Evidence
<b>Enabling investment</b>		Compatible goals	Discussion
		Potential for improvement	Gap analysis
		Flexibility	Discussion and organisational assesemnt
		Likely to have positive social and environmental impact and has a plan to mitigate any negative social and environmental impact	Business plan and maybe also ESIA <sup>107</sup>
<b>Asset investment</b>	Value	Viability of business proposition	Business plan, market analysis, benchmarking
		Measurable risks and returns	Risk analysis (see below)
		Status of forest tenure and usage rights	Legal
		Enterprise has sufficient scale	Business plan and financial model
		Track record of managers	Interviews
		External factors (country risk, governance and market constraints)	Risk analysis (see below)
		Formal enterprise with permits	Legal
		Organisational capacity to deliver the plan	Organisational assesemnt and gap analysis
	Impact	All the above, plus: likely to have positive social and environmental impact and has a plan to mitigate any negative social and environmental impact	Business plan and maybe also ESIA
	Product	Potential to produce product to required specifications	Demonstrations and samples
	Banks	Liquidity of assets and collateral	Desk analysis and benchmarking
		Sufficient cash flow	Business plan and financial model
		Formal enterprise with permits	Legal
		Track record of managers	Interviews
		Organisational capacity	Organisational assesemnt
		External factors (country risk, governance and market constraints)	Risk analysis (see below)
		Sufficient owner's equity contribution	Business plan and financial model

## 5.6.2 Agree terms

A good negotiation process should reveal what each party has to offer and what they expect out of the deal. The favorable conditions discussed in the previous chapter are in some respects the building blocks of negotiating and keeping a good business arrangement. The box below outlines some guidelines for good negotiation.

The output from this process is an agreement to the ‘heads of terms’ – basically the skeleton of a contract.

### Box 27: Negotiating and keeping good arrangements

From *‘Rethinking Forest Partnerships and Benefit Sharing’* (World Bank, 2009)

Collaborative arrangements between partners take many forms, from informal agreements, to agreements with provisions that permit one partner to leave the arrangement, to fully enforceable legal contracts. Some agreements are not documented. Some have elements that are set forth in or based on legislation, forest management plans, organisational bylaws, or property records.

Effective and lasting collaborative arrangements tend to be characterised by a number of features analysed in academic literature on law, negotiation and conflict resolution. The study examined the importance of twelve of these factors, including:

**Common expectations** – about the undertaking and what it will deliver.

**Communication** – both formal or informal, which satisfies both sides and promotes transparency.

**Fully bargained** – parties in a negotiation feel they understand the other’s motives to their own satisfaction.

**Incentives** – the collaboration must be worthwhile not just to the community as a whole, but also to the particular people who have the power to help or hinder the project.

**Legally recognised** – where details are optimally set down in writing.

**Mutual respect** – neither side comes to the table from a position of superiority or inferiority and neither leaves the table feeling that the will of their counterparts was imposed or that some larger advantage and disadvantage provided unfair leverage.

**Mutual understanding** – of their own and each other’s responsibilities, and of specific details that are important or unimportant, such as deadlines and certain record-keeping requirements.

**Past history of conflict is thoroughly addressed** – the arrangement addresses past conflicts – particularly if the conflict regarded use of the resource being negotiated.

**Practical** – both sides view the terms of the arrangements as practical and each has the technical knowledge, capital, equipment, infrastructure, or simply labour and time necessary to fulfill their obligations.

**Self-determination** – neither party felt compelled to negotiate or sign the agreement – they acted on their own free will. If either party was persuaded to attend, they agreed to see what was being offered, and what was being offered was not viewed as an ultimatum.

**Trust** – the partners in effective arrangements trust one another.

**Verifiable obligations** – it is easy to determine if partners are fulfilling their obligations.

These features apply both to making agreements and to maintaining them. In keeping a long-term agreement, the sides frequently must come together, renegotiate bits and pieces, and revise their relationship to account for new information or changing conditions.

While different combinations of these features proved important in different types of collaboration, four emerged as nearly universally important: mutual respect, trust, practicality, and communication. Furthermore, strong and lasting partnerships are characterised by processes and practices that go beyond what is captured in an agreement itself.

### 5.6.3 Risk analysis and mitigation plan

Business plans need to anticipate risks and consider how they will be managed. Impact of certain risks may be more serious to community than investors, so need a different scoring mechanism than may be found in a regular business plan. If the business plan is sound and the enterprise has the potential to deliver it, then most investors will proceed even if there are still some areas of weakness that need to be addressed. They will be looking to determine if these weaknesses or constraints are internal or external.

- ▶ **Internal weaknesses** require a time-bound project for improvement (for example, capacity building of management).
- ▶ **External constraints** may require lobbying of government to improve the enabling environment for business.

This may require letters of intent from third parties confirming their role in the deal, agreed actions and commitments of funding. (such as: NGOs agree to cover costs of capacity building, government agrees to supply infrastructure and issue permits).

The risk mitigation process should be designed into the deal, for example, the business manages adverse price movements if a product investor has agreed to fixed prices. The business may manage market risk by planning for product diversification.

The contract can improve resilience and lower risk by introducing trusted third parties, for instance:

- ▶ Escrow accounts for capital drawdown and revenue collection.
- ▶ Arbitration services and foreign jurisdictions.
- ▶ Crop verification and asset protection.
- ▶ Performance certification (such as PEFC, FSC or RSPO).
- ▶ Financial auditing by professional accountants.
- ▶ Insurance to cover political, economic or physical risks.
- ▶ Third party product verification (see SDC case study).

#### Box 28: Risk mitigation reduces the ‘cost’ of capital, increasing the returns to rights-holders

Changing the risk profile has two important effects on financing. Firstly, it allows investments to be made that otherwise would have been deterred by the risk (often, forest SMEs cannot get loans at any price). Additionally, it reduces the cost of finance, alleviating the costs of servicing capital and thus making businesses more viable. For debt finance this relationship is obvious: less risky loans attract a lower interest rate. For equity finance the relationship is more complicated. A component of the investor's target rate return is the risk factor, so if this risk is diminished, the target return can reduce. In practical terms, this means the business can distribute less in dividends, retaining more capital in the business for investment and thus reducing the need for working capital finance.

5.6.4 Developing a shared vision

Investment in trees and landscape restoration requires a closer partnership than conventional passive investment, and so some overlap of vision and goals seems to be appropriate and desirable. The process calls for each party to reveal their vision and then agree goals that are consistent with each party’s vision. For instance, the local enterprise’s goal may be to develop a plantation and harvest trees for sustainable profits, while restoring the local eco-system and maintaining social cohesion. Their vision is a healthy and prosperous community living in a rich natural environment. Meanwhile, the investor’s goal is to make a positive return on capital while using that capital to promote environmental goals without social conflict. The common ground is:

- ▶ Make a profit and a growing balance sheet.
- ▶ Enhance the forest landscape.
- ▶ Build social capital.

There are the issues that should be explored further to reveal potential differences in values and vision, such as:

- ▶ Does an enhanced forest landscape require a diverse forest – so monoculture crops are not appropriate?
- ▶ What is the endgame of afforestation in terms of utility and amenity value – will the future forest provide more than just timber?
- ▶ Do the requirements for financial discipline that underpin profitability preclude early dividends to a social fund?

This is a process of mutual learning and is the first step in determining if this partnership is viable and sustainable. It does not mean that either side needs to compromise their values, but rather that goals need to be clarified to avoid later misunderstanding.

5.7 Performance management

Proposition →	Establishment →	Validation →	Preparation →	Negotiation →	Performance
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5.7.1 Monitoring and feedback

The business will need to agree with the investors how best to monitor performance, using agreed criteria, and audit financial statements to ensure transparency and accountability. The results from the monitoring can be used as constructive feedback to improve performance (‘are we doing things right?’). If necessary, the organisation can revisit its business plan and change its approach to the value proposition (‘are we doing the right things?’). Changes may be required to strategy, or to staff. Managers may need to be replaced and teams reorganised. This is common to all businesses, especially start-ups, and rights-holders should be wary of resisting such changes. The business needs to be able to make these changes without interference by either local communities or government.

5.7.2 Dealing with disputes

Re-negotiation of terms is as likely to arise from unexpected success as it is from failure. In the event of failure the investor or creditor is left with most of the liability, but in the event of great success there may be a feeling that the investor is taking out too much, even if their share is in line with the original agreement. Dispute resolution will not be necessary if all parties have discussed such eventualities in advance.

### 5.7.3 Measuring impact

The business needs to be evaluated first and foremost on its own terms with reference to the business plan goals agreed with the investor. This will help ensure the business becomes a self-sufficient entity, which can increasingly expect more constructive and equitable dealings with investors, banks, customers and the state. The essence of locally controlled forestry is that through obtaining some autonomous economic power, local people can strengthen their claims to land, natural resources and government services.

As observed earlier in this guide, however, many investors will also be interested in the non-financial impact of the deal. This could be social, economic or environmental. There are increasingly sophisticated methods available to measure these impacts.



## 6 Case studies

### 6.1 Planting Empowerment, Panama

Planting Empowerment was founded in 2006 to improve on the monoculture teak plantation model expanding into the Darien region of Panama. The founders, all former development workers in the region, developed a sustainable forestry model in partnership with local landowners and have been expanding it through private equity investments.

#### Approach

Rather than purchase land, Planting Empowerment leases land from private landowners and indigenous communities to cultivate mixed tropical hardwoods, along with shorter-term cash crops such as plantains to maximise production of the land. The lease agreements are 25 years, allowing trees to develop a significant amount of valuable heartwood. The business encourages the formation of local industry based on the timber production but expects to sell the majority of the timber harvested into international markets. Planting Empowerment sells cash crops domestically to offset maintenance costs for the trees and provide more work opportunities.

#### Financing

Planting Empowerment is a for-profit enterprise that maximises the social and environmental benefits from its operations. The business has raised over \$180,000 in equity financing through its forestry investments, which expect to produce a base case 10% IRR. The business's 100+ investors tend to be interested in social or economic empowerment and environmental conservation. The first round of funding was intended to provide proof-of-concept for the new investment model, and came largely from friends and family investors. Having closed that round of financing, Planting Empowerment followed with another fund, bringing the total number of trees planted to over 22,000, or approximately 20 hectares. The company is now merging those funds into one holding company that will begin to vertically integrate itself and operate more like a traditional timber management firm.

#### Local involvement

The business began at the grassroots level and thus local involvement figures heavily in its success. Private landowners receive a monthly lease payment of \$14-\$18 with a 2-4 per cent share of net revenues from their respective plots. The contracts are negotiated individually based on the opportunity cost to the partner, but each contract scales payments to the partner to keep pace with land appreciation. Indigenous communities receive a \$2000/ha upfront lease payment and 10 per cent share of all net revenues from their lands.

The private landowners are mostly subsistence farmers, so some kind of steady income is of interest to them. The strategy is to remind them monthly of the benefits they're receiving from the project and reduce the potential for them to mispend a large upfront payment or have the capital to purchase more forested land and then deforest. With the indigenous community, such a small monthly payment split between all of the community members would not be substantial enough for them to notice. Also, the aim is to let communities invest in larger projects that could benefit everyone, such as infrastructure projects.

All land leases are only for a portion of the partners' land, allowing them to continue their current practices. The payments represent a short-term economic incentive to maintain land tenure and reduce the partner's need to wait until the trees are sold to realise income.

### Partnerships

Planting Empowerment has partnered with the Smithsonian Tropical Research Institute to provide saplings and the UNDP office in Panama on community projects. Interaction with local government is minimal, except for the registration of the plantations.

### Challenges and opportunities

The biggest challenge for Planting Empowerment is raising capital because the company is young and takes a non-traditional approach to forestry. However, with inputs such as land and labour becoming scarcer, the focus on local engagement may provide Planting Empowerment with an advantage over traditional forestry companies.



## 6.2 Wildlife Works – Kenya

Wildlife Works has been in business for 14 years and pioneered a new business model that brings innovative market-based solutions to communities and wildlife conservation in the developing world. They formed a new entity, Wildlife Works Carbon LLC (WWC), which was established to help local landowners monetise forest resources and biodiversity assets.

In 2011, they announced an agreement with BNP Paribas Corporate & Investment Banking and its commodity derivatives business, in which BNP Paribas will provide up to U\$50 million in finance to combat deforestation and climate change. The bank's carbon finance business and Wildlife Works will develop a portfolio of large scale REDD carbon projects in Africa, with an aim to protect five million hectares of native forest and capture 25m tonnes of carbon dioxide annually. BNP Paribas will have the option to purchase avoided emission credits created from the portfolio, with the right to purchase 1.25 million tonnes worth of credits over the next five years. In addition, the insurance giant Allianz SE, headquartered in Munich Germany, has made a 10 per cent equity investment in WWC.

Wildlife Works' pioneering Kasigau Corridor REDD project was the first ever to be issued with Voluntary Carbon Units (VCUs) for REDD under the Voluntary Carbon Standard (VCS). This is now the most widely used carbon accounting standard issuing credits in the voluntary market. It is validated and verified under the Climate, Community and Biodiversity Standard. Allianz has also agreed to a multi-year option to purchase carbon credits from WWC's Kasigau Project.

This flagship project protects over 500,000 acres of forest and brings benefits from direct carbon financing to local communities whilst securing a corridor between the Tsavo National Parks.

The project is designed to bring substantial benefits to local communities, while protecting forests and biodiversity. This work has created thousands of sustainable jobs for rural Kenyans and secured enduring markets for their products. The benefit-sharing model is very simple and transparent: with the sale of REDD carbon credits generated through the voluntary market, carbon dividends are divided into three pools. These three pools are: 1) landowner dividend, 2) community development projects as administered by a trust; and 3) operational costs/ROI for Wildlife Works and its shareholders. Wildlife Works also works closely with both the Kenya Forest Service and the Kenya Wildlife Service. This close working relationship extends the resources of government organisations, whilst adding legitimacy and support to Wildlife Works' operating ethic.

Obvious external threats include increased poaching, and global demand for illegal ivory and other animal products. Additionally, charcoal production, illegal harvesting of timber and so on also constitute challenges. Significant opportunities exist for enhancing good community relations, community investments and so on, through community development projects in the project area.

### 6.3 PhytoTrade Africa – Southern Africa

PhytoTrade Africa was established in 2002 as the trade association of the ‘natural products’ industry (including foods, drinks, oils and ingredients used by the food and cosmetics industries) in Southern Africa. It’s a non-profit, membership-based organisation, representing private sector businesses, development agencies, individuals and other interested parties in eight countries. Its purpose is to alleviate poverty and protect biodiversity in the region by developing an industry that is not only economically successful but also ethical and sustainable.

PhytoTrade is currently working on selling powder from baobab trees, used as a food additive and health supplement. Producing around 150 tonnes of baobab powder annually would involve around 1,000 people. This would entail an initial investment of between US\$150-200,000, covering factory and machinery costs together with investment in harvesting groups, training, certification, transport to factory, and so on, but excluding working capital investment.

PhytoTrade Africa has gained approval for its members to sell baobab powder into the EU under the Novel Foods regulation. The next step is to raise baobab powder’s profile, since as a new ingredient it is unfamiliar to the buying public. PhytoTrade’s marketing emphasises baobab’s many beneficial health and cosmetic qualities but also conveys its role in improving livelihoods and sustaining biodiversity.

Regulatory barriers remain in much of the world, however, including the US (under the Generally Regarded as Safe (GRAS) regulations) and Canada. Other major markets remain untapped (such as the Far East and South America).

To date, the development of the baobab sector has been relatively fast and shows strong potential for further growth – especially given the significant resource base within Africa. As the sector continues to grow, there will be a need to ensure that other countries where baobab grows in appropriate quantities can join the commercialisation. At the individual enterprise level, domestic and regional markets are key to establishing viable businesses whilst the export markets are developing. Opportunities clearly exist within the countries where PhytoTrade is working for investment in baobab processing.

[www.phytotradeafrica.com](http://www.phytotradeafrica.com)

## 6.4 Centro Terra Viva – Mozambique

As part of the Forest Connect alliance, Centro Terra Viva (CTV) has been working with communities to develop investible entities in bamboo (Bambu association – Barué) and in integrated coconut fibre use (Community Development Association – Coconut Group).

The support process is still in its early stages, and has been limited to enabling investments covering the space and logistical costs to bring local communities working with bamboo and integrated coconut fibre together; exchange visits between groups; training costs in plantation management, harvesting, handling, product development and design; the costs of establishing a demonstration centre; and the cost of formal registration of new commercial associations.

The objectives are to promote more efficient and profitable production of bamboo and coconut fibre furniture and home furnishings (such as tables, vases) for the local and regional markets of Manica and Sofala Provinces (the Beira Corridor) – notably in cities such as Chimoio and Beira.

Leaders of newly established commercial associations, together with member producers, have been involved in day-to-day production of bamboo and coconut fibre furniture and home furnishing products, and have taken part in training and exchange visits.

For both product lines, CTV helped communities to constitute and legally register commercial associations. They then identified experts to provide training on using of bamboo and coconut fibre (from planting, management and harvesting to product processing, design and commercialisation).

In order to scale-up commercial activities CTV negotiated with a ‘soft’ donor, the Government of Mozambique small enterprise authority IPEME, to establish a demonstration centre on bamboo.

CTV also financed farmer association exchange visits and participation in trade fairs, where farmers could build their experience both in product design and marketing.

As farmer associations have become more formal, it has been possible to explore options for investment and retail with local companies. The impact of the interventions so far has been formalised producer groups producing more products for the market (vases, tables and so on), which have been sold at higher values to increase family income. The total amount invested to date has been approximately US\$ 20,000 and no external ‘asset’ investors have yet been approached.

## 6.5 Novella Partnership

In 2002, the Novella Partnership was founded to help scale up the production of Allanblackia oil in Ghana, Tanzania and Nigeria and at the same time to reduce poverty, promote sustainable enterprise and biodiversity conservation in Africa. The partnership's vision is to build a sustainable (environmental, economic and social) supply chain that will contribute to the development of Allanblackia businesses in Africa.

Novella is an international public-private partnership with a wide range of actors. Unilever has carried the largest investment and buys the harvest in pre-processed crude oil for refining in Rotterdam and has received a food clearance for Allanblackia oil in spreads from the European Food Safety Authority. This is the entry ticket into the food market.

The objectives are to obtain a high value product from Allanblackia oil in order to export it to western and internal markets, at the same time providing income for local communities and the national economy.

Local people have an important role at different levels of the supply chain. Allanblackia seedlings will be sold in local nurseries, giving them an additional income source. Local farmers are the next step of the supply chain. They are in charge of growing Allanblackia, with the opportunity of choosing between different production models (for example, different scale, different possibilities of intercropping such as cocoa). In parallel, local people can also harvest wild Allanblackia seeds and sell them to the local companies.

The World Agroforestry Center (ICRAF) is leading the scientific work on domesticating Allanblackia to boost harvest levels into commercial viability. Novel International is the African partnership member and consists of the companies developing the supply chain in the main three countries of focus at present; Ghana, Nigeria and Tanzania. Technoserve, an NGO specialising in private sector development, provides business advice and access to both markets and capital for the venture. IUCN is also involved, working to integrate forest landscape restoration principles into the different models for increased production of Allanblackia. IUCN is also supporting the development of a market differentiation system for the Allanblackia oil, in collaboration with the Union for Ethical Biobased Trade.

In 2008, Unilever took a step back from managing the national level supply chain and handed it to three local companies in Africa (Novel Ghana, Novel Tanzania and Novel Nigeria). The reasoning behind this decision was to strengthen decision-making, ownership and implementation at a national level and support the vision of Allanblackia as a product from Africa for the benefit of Africans.

Even though local people do not directly own a stake in the business, they benefit directly from selling their production/collection to Novel companies. Farmers are seeing additional income of around US\$ 100 from seeds harvested from around 15 trees. A scaling-up of production will generate increased income for more farmers, whilst stabilising the supply of oil. Fair price-setting for purchasing from the farmers and the Novel companies is a commitment that all Novella Partners are striving to achieve.

The Swiss government has invested CHF 3 million, and around € 2.5 million to date through its SECO agency. Unilever has invested € 1 million Euro since 2004. In the past ten years, an estimated US\$ 10 million has been invested in the supply chain. If 8.25 million Allanblackia trees are planted – the project's objective – the total economic impact of Allanblackia agricultural production could increase to € 18.6 million in annual GDP, spread across the three countries involved.

Challenges include keeping a sustainable supply chain and ensuring that all stakeholders commit to the sustainability standard. Allanblackia oil has similar properties to palm oil, so preventing the same environmental issues is a further challenge.

## 6.6 Association des Organisations Professionnelles Paysannes – Mali

Within Mali, farmer organisations have invested considerable time and energy in strengthening local producer associations. The Association des Organisations Professionnelles Paysannes (AOPP), part of the Forest Connect alliance, has worked with one of its members, the Association Siguidiya des femmes de Nampasso to help women generate income from néré fruit. The Association worked with local experts to develop training on picking and gathering fruit, monitoring fruit gathering activities, developing processing techniques for néré fruit, and also researching market information and pursuing both local and national markets.

Revenue is always managed in cash and goes to help the cooperative's members meet their financial needs in the form of loans with an interest rate of 10 per cent.

Women now take an active part in managing the family farm, taking responsibility for specific management activities for the néré fruit. AOPP has substantially improved the information flow between local farmers and other actors along the néré fruit value chain. It has also developed links between enterprise groups and formal development initiatives, as part of a carefully planned exit strategy.

The group continues to face significant challenges, such as: organising aggregated sales and access to the market; supporting the value chain for Soumbala and shea butter through Market Analysis and Development (a participatory training approach designed to help local people develop income-generating enterprises while conserving tree and forest resources); reaching basic literacy levels; developing marketing skills; and learning new processing techniques for néré.

There are also important opportunities. A 2006 law that recognises the enhancement and protection of non-timber forest products (NTFPs) as a valuable and important resource is an important step forward. Increased experience and training for women in néré nut processing has led to an officially recognised cooperative that receives support from the PACR ( the Project for the Support of Rural Cooperatives). Other NTFPs (karité, liane goïne) and their markets are also developing in the area.

Since 2011, the total amount invested into the cooperative through private partners and equity capital has reached approximately US\$ 28,600 (CFA 15,000,000). For every CFA 500,000 invested, the cooperative generates, after sales, a CFA 50,000 profit. Annual income can reach approximately CFA 300,000

## 6.7 PINFOR – Guatemala

The Government of Guatemala has sought to address the challenge of financing sustainable forestry activities by providing incentives for sustainable forest management through an incentive programme, known as PINFOR. The objectives of the programme include: aiding the natural regeneration of forests, improving forest management and promoting forest protection and reforestation. Local communities, municipalities, private landowners and interested organisations are all eligible to apply for funding from this programme. PINFOR is financed using one per cent of state operating expenses. As of 2009, it has provided about US\$134 million to the forest sector and helped establish roughly 100,000 ha of plantations.

In April 2011, the NFP Facility and the Growing Forest Partnerships (GFP) in Guatemala, taking advantage of the PINFOR, began providing support to a group of 189 ‘reforestadores’ (“re-foresters”) in San Francisco Petén, Guatemala, to help them enhance their leverage in the marketplace and boost community incomes. As a result of this support, a wood products enterprise, called Red Forestando Chachaklum, S.A, was created. It was formed by six forest communities from San Francisco Petén, which collectively own and manage about 1.084 ha of planted forest.

Petén is a region of Guatemala where almost 87 per cent of the population experiences some level of food insecurity and 34 per cent of school children exhibit delayed physical development due to chronic malnutrition. Considering the abundant natural resources available in the region (50 per cent of Petén is covered by rich tropical forests) the high level of poverty represents something of a paradox. The continued isolation of communities from marketplaces as well as their limited business capacities in accessing forest investments partly explains why local populations have so far been unable to reap significant social, economic and environmental benefits. Challenges include how to identify suitable local and external markets for wood products that derive from forest plantations, and how to effectively strengthen the business capacities of local actors to overcome their isolation from markets. In the municipalities of San Francisco, San Benito and La Libertad in Petén, the challenges faced by re-foresters were no different to any other tree planter in Guatemala who has received forest incentives. All the individuals in this group could be defined as poor, isolated and lacking a voice and a coordinated network. They were particularly isolated in four key areas: (i) from each other; (ii) from consumers/markets; (iii) from financial and business development service providers; and (iv) from policymakers. They neither had contact with the formal market nor with the forest industry. As a result of these efforts, however, tree planters are now able to interact directly with larger companies as a collective, including notably those in Guatemala City, which produce particle board, and are interested in establishing fair and longstanding business relations. Within a year, the enterprise had already entered into its first business negotiations.

Another forest incentive programme, known as PINPEP, was also created to cater to the financial needs of small forest holders, specifically those with forestlands of less than 15 ha. It is expected that over 400,000 people will directly benefit from this publicly supported incentive scheme. The establishment of this programme was a direct result of the successful policy advocacy of the National Alliance of Community Forest Organisations, a forum established for 11 umbrella organisations and 400 grassroots organisations with the specific objective of identifying the challenges facing forest communities and smallholders and advocating for their rights and empowerment.

## 6.8 GreenWood – Honduras and Peru

GreenWood promotes sustainable development for the real world. It works with local partners and alongside residents of remote forest communities to help them earn more by managing their forests to create valuable wood products than they would otherwise derive from conventional slash-and-burn agriculture or illegal logging. It employs appropriate woodworking technologies, creative niche marketing and state-of-the art chain-of-custody verification to support good forest management and sustainable development.

A U.S.-based nonprofit, GreenWood has been active in Honduras for nearly twenty years and has worked in the Peruvian Amazon since 2008.

GreenWood ‘investors’ are typically manufacturers, wholesalers or retailers seeking access to wood products that meet their criteria for excellent forest management, quality control, legal and transparent chain of custody and participation of community partners. GreenWood builds long-term business relationships with all partners in the value chain, from the resource rights-holders and intermediate service providers, to private sector clients.

One of the enterprises that GreenWood launched in 1999 and 2000 in northeastern Honduras is an innovative guitar-part production business. Most of the forest areas assigned to communities here are in the buffer zone of the Río Plátano Biosphere Reserve, a UNESCO World Heritage Site (1982).

The GreenWood enterprise now supports three agroforestry cooperatives representing nine communities, who currently export at least five different grades of kiln-dried dimensioned bigleaf mahogany parts to the Taylor Guitar Company of California and several smaller U.S. clients. GreenWood is cultivating new markets for additional product lines, utilising a broader range of mahogany and other species.

Members of the local cooperatives execute virtually every aspect of the on-the-ground forest management, protection, silviculture, timber harvesting, production, chain-of-custody verification and shipping, with the active support of GreenWood’s local collaborating nonprofit NGO, Fundación Madera Verde (FMV).

GreenWood plays the role of honest broker in the guitar-part transaction, and of technical production advisor. Its investment in local forest enterprise also includes procuring grants, contracts or loans for related management and research activities. These include such innovations as the GPS-based Helveta timber-tracking system, DNA collection and analysis, new species identification, tree planting and mahogany regeneration. GreenWood and FMV collaborate in planning and executing the entire process, and they coordinate implementation with cooperative members.

GreenWood and FMV collaborate with local government representatives to expedite harvest and export permits. Government representatives are included in all relevant production and training exercises.

The largest volume of sales and income for GreenWood producers has been generated through the export of mahogany guitar parts – approximately 10,000 board feet per

community group per year over the last five years. GreenWood subcontracts the fulfillment of all purchase orders to the community groups or through FMV. Net sales proceeds accrue directly to the co-ops, which have procured their own Wood-Mizer band sawmills, through a discounted purchase and a low-interest loan brokered by GreenWood. Approximately half of the sawmill loan principal has been paid off after only one year of production; loan balances are expected to be fully liquidated by the end of the current harvest schedule.

GreenWood aims for its community partners to take ownership of as much of the productive process as possible, capturing the greatest value from their own resource. It is important that they understand all steps in the process, even those they are not currently capable of managing, such as the brokerage function and direct client relationships. Every step has a value that is factored into the cost of doing business.

There are many untapped opportunities, in terms of potential new communities and expanding the current list of GreenWood clients, products and wood species. These are mitigated by a host of endemic threats and challenges, such as: illegal logging and land invasion; political turmoil and corruption; under-resourced bureaucracies; complex regulations; weather and vulnerable infrastructure; tree disease and natural defects; and market fluctuations.

In the five years between 2005 and 2010, US\$ 714,760 was invested in Honduras in the purchase of more than ten containers of custom-sawn and graded high-value guitar parts. Production of an anticipated three to five more containers of guitar parts from the 2011 harvest, which is currently being processed and shipped, is expected to raise investment in Honduras to at least US\$ 900,000.

This has resulted in the export of more than 111,000 board feet of mahogany, to date, an average of slightly more than 50 percent of the total authorised annual volume of mahogany from participating community forests. Export yield as a proportion of total harvest has risen steadily and dramatically, year on year, from 39 percent of total authorised volume in 2005 to more than 65 percent in 2010, due to improved production quality and the expanded market for a wider variety of timber grades and dimensions.

Proceeds are equitably and transparently distributed between cooperative members, and they support a wide variety of community needs, such as workman's compensation insurance, solar energy and micro-hydroelectric projects, road maintenance and school repair.

In 2010, our original agroforestry cooperative partner, Copén, was recognised by the FAO as one of 18 model forest communities in Latin America.

[www.greenwoodglobal.org](http://www.greenwoodglobal.org)

## 6.9 Cochabamba Project – Bolivia

The Cochabamba Project Ltd (Society) was established in March 2009 as an 'Industrial and Provident Society for the Benefit of the Community', specifically to complete a reforestation project by approximately 2,000 smallholders in the tropical regions of the Cochabamba, Santa Cruz and Beni provinces in Bolivia.

The project attracts private investors and CSR foundations by presenting itself as primarily a social rather than a financial investment.

The Cochabamba Project is a fully trading Industrial Provident Society, working in equal partnership with poor smallholders on the fringes of the Bolivian Amazon to establish and maintain a profitable and sustainable community-based forestry enterprise, as part of a wider project known as ArBolivia. Its members provide the finance needed for local smallholders to plant native species of tropical hardwoods as an alternative to unsustainable farming practices. The project has been designed to cover an area of 7,200 hectares and involve 2,000 smallholders who belong to cooperatives within the departments of Cochabamba and Santa Cruz.

In addition to the forestry enterprise funded by the society, the wider project incorporates a comprehensive land use programme including conservation, agro-forestry and silviculture.

ArBolivia is an alternative business initiative promoting reforestation and fair trade. The initiative seeks practical solutions to increasing worldwide deforestation, climate change and poverty in developing countries. ArBolivia will reforest 6,000 hectares in the subtropical lowlands of the Amazon Basin in Bolivia, through small-scale forestry plantations with local farm families, using almost entirely native tree species. It includes the on-farm establishment of ecological corridors, protective plantations, as well as sustainable agricultural land use. The following organisations are involved: Sicirec (Project Managers), Ethical Investments (UK promoter), Plan Vivo, Forest Finance and U&W – a sustainability consultancy.

The participating smallholders in Bolivia provide the land and labour, whilst income from the sale of carbon credits to a European government helps to finance operational costs. The project aims to triple the income of local families. Any surplus will be used benefit local communities in the district of Cochabamba by promoting environmental sustainability and by tree planting in conservation areas.

Smallholders receive practical advice and support on all aspects of farm management, including land use, crop and stock selection, and marketing support. The project has now been certified by Plan Vivo, the only international standard for community based forestry projects which protect and promote native species.

Shareholders are also members of the society and are entitled to one vote, no matter how many shares they hold. Shares cannot be sold or transferred to another person or organisation but they can be redeemed to the society at their face value or less. Because it uses the Industrial and Provident Society model, by law the project cannot offer a generous interest rate to its UK investors. The IPS structure effectively acts as an unregulated bank, with depositors coming and going over the years but the same capital being tied up in the project.

Some of the challenges facing this scheme are:

- ▶ The inability to wrap the project up in an authorised investment vehicle that can be marketed in the UK.
- ▶ The long wait until revenues accrue.
- ▶ A misconceived perception of political risk.
- ▶ Poor understanding of forestry within the financial services industry.
- ▶ Liquidity issues, or more specifically the lack of a defined exit route within an acceptable timeframe.
- ▶ Failure of COP 15-Copenhagen and uncertainties over carbon markets has made it impossible to sell long-term credits.

However, teaming up with an accredited CDM project makes it much easier to convince retail investors that this is a legitimate scheme.

The Cochabamba Project Ltd raised over £620,000 (US\$ 880,000) in an initial public share offer in 2009. These funds paid for planting 241 hectares within the project area, covering the purchase and germination of seedlings, the ground preparation and the planting of trees within the project areas managed by ArBolivia. Since then, investors in the UK have invested over £3.1 million. The project is less than three years from receiving the first significant timber revenues. These revenues will exceed £1 million in 2015 alone, with much more thereafter. After October 2014, the project should move firmly into profitability. Assuming that everything goes to plan, over the period from 2015 to 2020, the business will be able to repay debts, pay interest on shares and meet requests to redeem shares.

In return for its investment in trees the society will receive 50 per cent of the future timber revenues, whilst the participating smallholders in Bolivia will receive the other 50 per cent. The Society hopes to be able to pay interest on shares of up to 7.5 per cent, which it proposes to accrue and pay when shares are withdrawn (as no interest can be paid for some years until the trees mature).

[www.3dinvesting.com/ms/cochabamba.coop](http://www.3dinvesting.com/ms/cochabamba.coop)

## 6.10 Lake Taupo Forest Trust – New Zealand

LTFT is an indigenous owned and operated forestry enterprise. In this enterprise, individual landholdings have been aggregated into a large estate with integrated management overall. The business is run as a leasehold partnership with the state for 28 years, sufficient for a single rotation of trees. The Lake Taupo Forest Trust (LTFT) was established in December 1968 to represent the interests of the owners of 66 separate Maori land titles. LTFT is a statutory Maori authority that administers the land interests of over 11,000 owners and covers 33,000 hectares of land including 22,000 hectares in productive world class plantation forestry. It is located in the central North Island of New Zealand.

Both LTFT and the state are equity investors in the forest, and no debt is held.

### Objectives

- ▶ To protect the integrity and ownership of Nga Taonga tuku iho (core asset of land and resources) administered by the Trust on behalf of the beneficial owners.
- ▶ To strive for optimal and sustainable asset growth and financial returns through development of the Trust assets to assist the long-term social, cultural and economic development of the beneficial owners.
- ▶ To apply the principles of professionalism, honesty and due diligence in attending to Trust business.

Approximately 40 per cent of the 150 workers involved in Lake Taupo Forest are either owners or descendents of owners of the lands. The Trustees of LTFT tend to be the elders of the tribe, and they undertake a governance role to ensure all the cultural, economic and social goals are being met. Local people, including owners, are involved at all levels of the workforce from high management to labouring.

While LTFT often communicates with a range of NGOs and other intermediaries, none are directly involved in the forest governance, management and operations.

The state invested in the enterprise to start with (from 1969) but its stake is gradually being eliminated, such that at the end of 2021 they will have relinquished their ownership in all assets and control.

The profits (“stumpage”) are shared on a ratio relative to each party’s contribution. The lease is now finishing, and as the first rotation trees are harvested, the land comes out of the state lease and is replanted by the Trust using its share of the first rotation profits. In this way the Trust increases its fully-owned area by around 900 ha per year. It is scheduled that by 2021 all of Lake Taupo Forest will be Trust-owned, and harvesting of the second rotation will commence. The Lake Taupo Charitable Trust (LTCT) administers parent Trust funds for Maori community charitable purposes that benefit Lake Taupo Forest Trust, landowners and the descendants of these owners. These purposes include: promoting health, social, cultural, and economic welfare and providing grants for education.

In 2002 Lake Taupo Forest achieved Forest Stewardship Council (FSC) Certification. FSC-certified wood produced by the company is sold in both the domestic and export markets. LTFT is investigating opportunities to invest further up the value chain, so that rather than simply selling logs, it can add value to these logs in the region and get involved in the marketing and distribution of these processed products.

The 33,000 ha of LTFT land is committed to this venture. In addition, the Trust has to date invested around US\$ 30 million in establishing and managing the second rotation of trees on the land.

The forestry investment is forecast to produce a real rate of return of between six and seven per cent. To date, the Trust has distributed around US\$ 30 million to its owners, but this will increase substantially once it starts to harvest the second rotation crop of trees in 2021.

## 6.11 Södra – Sweden

### History

The founding insight of Södra in the 1930s was that extension work and improving skills would not be enough to substantially improve livelihoods of forest farmers. In forestry, especially northern long rotation forestry, you need income today in order to afford better practices that will yield benefits in 60-100 years time. This requires better prices from the mills. There was a feeling that mills were exercising monopsony power (or maybe cartel effects) to drive down prices at the farm gate. Thus in the early years, Södra was involved in aggregation in order to obtain better prices from the mill, in addition to giving technical advice to farmers.

Until World War Two, Södra was a lean operation, taking a small margin on sales to finance the low overheads. However, higher demand for timber drove rapid expansion during the war. This was financed partly by the marginal return but also by asking members to invest.

In the post war period, Sweden imposed an export ban on round wood, in order to stimulate the domestic processing industry. There was no domestic pulp industry, so Södra did not have a market for the small dimension wood produced from thinning. Without thinning the stand development is sub-optimal, but thinning is expensive. If thinning could be made commercially viable, then future stands would be in better shape. So Södra invested in obtaining its own pulp mill and over time expanded until it owned five mills, producing 1.9 million tonnes of pulp per year.

The first mill was developed in alliance with other associations. It needed political support in order to gain bank participation. To begin with, the mill was owned directly by the association but later a separate limited company was set up to own and operate the mill. This model is still used today. Södra owns a number of limited companies that operate as separate trading units. The Södra pulp mills are said to be 'firm but fair' with the farmers, driving a tough bargain and expecting quality product. This keeps the mill profitable, and the farmers gain through the benefit sharing process.

It was not all plain sailing for Södra. The 1970s recession hit the business hard (many associations went bankrupt in this period). The government saw the strategic value of Södra however, and bought a 40 per cent stake in the business – the only time when part of the business has not been owned by the members through the cooperative. No one else could have stepped in to save the business. Södra was not listed on the stock market, so could not raise capital in the conventional manner. Södra did not want to float shares because that would mean loss of control. There is still a strong sense of independence to this day.

The Södra bailout was controversial. Why was it selected for saving when many other forestry businesses failed? Södra had built up a non-market value that was important, however. It had political and social capital founded on its ability to organise and motivate farmers. In the end, the state did well out of the deal, making a 50 per cent return in five years – in picking a winner it has been vindicated.

Post-crisis, Södra became more professional. It realised that it could not rely on members to bail out a crisis; solidarity only goes so far. Members cannot put their own money and assets

at risk if the business looks shaky. So the business needed to get more robust and resilient. Södra repaired the balance sheet and introduced some liquidity safeguards. For instance, after giving notice to resign, members must now wait five years before they can get cash from their capital account, unless they are selling their forest, in which case cash is paid out after next AGM.

Södra still helps out members. For instance, Storm Gudron in 2005 caused uneven destruction, flattening some farms but leaving others untouched; Södra released some reserves to be able to pay wood prices at double the market rate (as the market rate had collapsed because of the glut of timber).

### Objectives

- ▶ Trading and processing forest and forest products, primarily from association members.
- ▶ Achieving a secure and appropriate market for members' forest products at market prices.
- ▶ Supporting and developing (the members) forestry.
- ▶ Monitoring and promoting the business policy interests of our members (primarily ownership rights and so on).

### Role of forest owners

In Södra's system, landowners sell their raw material to the cooperative, which processes it into high-value products. Many cooperatives nowadays provide owners with a full range of forest management services, including planting, cleaning, harvesting, and planning, as well as an internal system of finance to support landowners' investment needs.

The products are aggregated to achieve economies of scale and the land itself remains under individual family ownership. There are no intermediaries involved.

### Role of investors

The members and owners of the cooperative are local forest owners and they receive a dividend from their shares. Members do not pay a fee to be part of Södra but they participate with risk capital in the form of capital contributions. Capital contributions are drawn from payments for wood deliveries and are repaid when membership expires. The contribution is SEK 600 (US\$8.50) for each hectare of productive forest land. Contributions are not required for land exceeding 200 hectares but members may pay more if they wish. A growing number of members elect to do this as capital contributed is the basis for profit dividends.

The capital belongs to members, but Södra uses the money during the membership period and pays dividends on contributed capital. At 2010 year-end, total member capital contributed in Södra was SEK 2,211 million (US\$315 million). Through bonus issues, SEK 1,402 million (US\$ 200 million) has been transferred to members' individual capital accounts.

### The future

Södra is now a successful well-capitalised business, owned by its members. Some argue that its task is now completed and it should de-mutualise in order to give a cash windfall to each member. Many members feel that this would be to betray the principles upon which the cooperative was founded, however. They would be cashing-in on the accrued savings of

their grandparents, who deferred consumption in order to manage their forests better and build up Södra. Furthermore, members fear they would 'lose control', and their position as small-scale timber sellers would revert to the bad old days, when they would be at the mercy of monopsonistic markets.

### Lessons learned

- ▶ Public action played a role in stimulating domestic processing industry (for example, the log export ban). The pulp industry, by encouraging thinning and essentially using a waste product, actually stimulates better forest management.
- ▶ A cooperative needs to take a long term business view. There is no point in conceding to farmers' short term price demands now if that is out of step with the market and eventually weakens the business.
- ▶ Sometimes state intervention is justified. The state was able to perceive collateral that the market could not value, namely the hidden assets of the members that would eventually be brought to bear to buy out the state's holding when the economy improved. So during the 1970s economic crisis, the state recognised that Södra had a liquidity problem rather than a solvency problem, and thus made the decision to bail it out.



## 6.12 ForestFinance – Panama

The ForestFinance Group develops agroforestry products, such as investments in both fine tropical timber and cacao forests (which are characterised by faster cash flow due to the sale of agricultural products), as well as carbon sink forests. The company has 17 years of experience in developing and operating sustainable reforestation projects and currently manages projects in Colombia, Costa Rica, Germany, Panama, Peru and Vietnam. Its goal is to convert the value of certified and sustainably managed forests into economic and ecological investment products. A ForestFinance forest consists of up to seven different tree species for wood production and a selection from 50 additional native tree species to enhance biodiversity. Due to the high biodiversity of the mixed forests, they are much less affected by pests and diseases than monocultures. They provide living space for numerous bird species and mammals and are managed according to the highest standards of certified sustainable forestry, under the FSC standards.

The reforestation project of ForestFinance was the second to receiving “Gold Rating” from the Climate, Community and Biodiversity Alliance (CCBA). In May 2009, the ForestFinance project “CO2OL Tropical Mix” was tested according to strict social and ecological criteria of the Carbon Fix Standards and was successfully pre-validated by the Technical Board of the Carbon Fix Standards.

The local population benefits from the creation of socially secure long-term jobs in rural areas, micro-credits and other benefits such as life insurance. ForestFinance also runs social development projects in the communities, such as introducing environmental education in local schools and creating a public nature trail. About 250 people are permanently employed in ForestFinance reforestation projects in Panama alone. The type of employment it offers includes professional training in addressing sustainable forestry techniques for the forest workers.

Local people also get involved in collaborative projects between ForestFinance and other NGOs. In Vietnam, ForestFinance cooperates with SEQUA, a German Initiative, in education programmes for forest workers and engineers. In Panama it has an ongoing co-operation with Earth Train to restore nature reserves. There are other initiatives in other countries where it operates.

ForestFinance also collaborates with universities such as TU München, University of Panama and the Smithsonian Tropical Research Institute (PRORENA). In addition, ForestFinance is a founding member of the Biodiversity Partnership Mesoamerica (an organisation that promotes Public-Private Partnerships in the region), a member of the Deutsche Umweltstiftung, Senat der Wirtschaft (German Section of Global Economic Network), the FSC and Biodiversity in Good Company.

ForestFinance works with local governments. In Panama the environmental authority, ANAM, regulates forest activities by conducting regular inspections of the projects. In Vietnam, it is the regional government that grants the land use rights to ForestFinance.

The investors profit from the thinning, harvest and commercialisation activities of the forest and its products within the framework of a harvest cooperative. In Vietnam small

forest owners and farmers also receive parts of the profit. ForestFinance finds that the most significant challenges it faces are the availability of objective data, access to land, political and security risks, and recruiting the workforce. To date ForestFinance has invested US\$ 80 million and the estimated returns of the different investment products are 5-10 per cent depending on the investment type.



## 6.13 Green Gold Forestry – Peru

Green Gold Forestry Limited (GGF) is a UK sustainable forest products company with operations in Peru. Founded in 2007, GGF produces a wide variety of premium quality hardwood timber for international markets. Its operations are vertically integrated and GGF owns forest concessions, transport, and a new sawmill plant based at Iquitos, a city of 370,000 people on the River Amazon. GGF is certified by the Forest Stewardship Council for Chain of Custody and Forest Management.

GGF owns its forest concessions in the Loreto region of north-east Peru; all extraction plans are approved according to Peru's Forestry Law, which is administered by the regional government (PRMRFFS). These are managed using very low-impact sustainable harvesting. The company is committed to the highest standards of environmental and social responsibility and works with NGOs, including the World Wildlife Fund, Amazon Alternative and the Rainforest Alliance, to ensure that operations meet international best practice criteria. GGF produces top quality hardwood timber, principally for export to North America and Europe.

GGF maps each tree for extraction and records species, measurements and GPS coordinates. GGF's system provides full chain-of-custody tracking demonstrating legality and provenance in compliance with international laws such as those defined under the Lacey Act (USA) and Forest Law Enforcement, Governance and Trade (FLEGT – EU).

GGF intends to extend its operations and increase forest under management by the end of 2013. In addition, it will invest in further value-adding processing at its Iquitos-based plant – for example, kiln drying and finished product manufacturing.

Nearly all of GGF's management and workforce are local to the Loreto region of Peru. GGF is working with the World Wildlife Fund and Amazon Alternative to develop community forestry partnerships and for certification. Additionally, the Rainforest Alliance provided technical expertise to optimise sawmill operations. Under its proposed community forestry programme (scheduled for 2012/13) GGF will partner with NGOs and communities and provide technical expertise and assistance for responsible harvesting of community forests to FSC standards. Communities will benefit through training and investment in equipment and through fair and transparent access to the market. GGF is committed to being an employer of choice and provides superior benefits to its employees, including training, pension and health plans.

GGF has been funded through its growth stage by private individuals who have provided equity and debt. Some equipment has been bought using lease finance. The company is currently targeting institutional investors, including development institutions, for expansion capital. GGF's expected returns are in line with risk-adjusted private equity returns in manufacturing businesses.

[www.greengoldforestry.com](http://www.greengoldforestry.com)

## 6.14 The Amazon Alternative

The Amazon Alternative (TAA) is a public-private partnership of forest and timber companies, NGOs, financial institutions, certifying bodies and governmental institutions. Embedded in the Dutch Sustainable Trade Initiative framework, TAA focuses on development and strengthening of the FSC certified timber production and value chain in Brazil, Bolivia and Peru. TAA's objective is to certify 2.5 million ha of tropical forest in the Amazon region of Brazil, Peru and Bolivia and to increase the volume of Amazon FSC timber on domestic, Dutch and European timber markets. Furthermore, TAA works on a number of additional supporting strategies, such as efficiency increase and improving value chain finance. The core objective, however, is to significantly increase the amount of Amazon forest that is sustainably managed. The programme provides information about the FSC certification standard, its purpose, and requirements. TAA co-finances training on technical, ecological and social criteria of the certification system. TAA supports business improvement and facilitates market links and connections to the financial sector. Together TAA works with specialised institutions, on innovation regarding forest business performance assessment, preparing and presenting investment plans, promotion of lesser known species, and promoting FSC timber on local markets.

TAA works with SCOPEinsight, the first rating organisation in Agriculture, Aquaculture, Dairy/livestock and Forestry, to assess the creditworthiness of producer organisations by profiling their organisational performance. The profiling is based on the SCOPE (SCoring of Organisational PErformance) rating methodology. TAA also works with FAST to help companies prepare their investment plans and present these to financial institutions, which have received detailed and specific training on the concepts (financial and social) and dynamics of sustainable, certified forest management. TAA works with a consortium of Dutch timber importers who want to invest in promoting lesser known timber species on the Dutch and European market.

Each forest and timber company (private and/or community owned) has its own responsibility in preparing and achieving certification, improving efficiency, and linking to markets. TAA has a facilitating and linking role, involving local service providers, NGOs and governmental institutions according to their specific role. There is a TAA national coordinator in Bolivia, Peru and Brazil.

TAA does not implement programme activities by itself. For all operational issues, TAA works with networks of companies (such as chamber of forest companies, chamber of exporting companies), national FSC offices, private sector service providers, local governmental institutions, and national and international NGOs. The link between exporters and importers is realised by agents, brokers and traders. For promotion of FSC in the Netherlands and Europe, TAA works closely together with FSC Netherlands and the IDH programme Linking Europe. It also works closely with the local governments whose roles are multiple: illegal logging monitoring and law enforcement; issuance of forest concessions; facilitating bureaucratic procedures and other actions to promote FSC.

There is no benefit sharing within TAA as such. But each forest company (private or community) has its own arrangements with the local people on benefit sharing. FSC requires Free Prior Informed Consent (FPIC) of local communities and indigenous peoples.

In general, forest companies pay the local forest communities to harvest in the community forests. But communities living in or near a private concession also have certain benefits, since the company has various social responsibilities that are an inherent part of the certification requirements.

Some of the challenges faced by TAA are that the international demand for FSC timber has a limited influence on timber production in Amazon countries. Local markets' demand for timber is increasing and these markets do not value sustainable sourcing enough.

TAA helps facilitate access to financial institutions, leading to loans by local and international financial institutions and investment capital by investment funds. The total amount invested until December 2011 has been € 2,227,000 (from Dutch government resources, NGO contributions and private sector contributions).

[www.theamazonalternative.org](http://www.theamazonalternative.org)



## 6.15 FAST International

With 109 members in 29 countries, the Finance Alliance for Sustainable Trade (FAST) is a collaborative association between financial service providers and a broad range of stakeholders. It aims to increase access to finance for sustainable forestry producer organisations and SMEs in developing countries, in order to combat poverty. FAST is uniquely situated to lead this sustainable forest finance strategy, based on its successful experience in other sectors.

As a result of the disconnect between financing and producer organisations and SMEs, there are a growing number of non-traditional, socially-oriented sustainable financial institutions (FIs) entering the field to fill this credit gap. These focus specifically on providing credit to sustainable SMEs in developing countries. Their credits are typically provided as short-term value chain finance, as part of trade contracts with buyers, and have an extremely high rate of credit repayment, and additional financial, social and environmental returns.

In 2011, within the framework of the International Year of Forests, and building upon its previous work in the forestry sector, FAST launched the first phase of its three-year strategy: Financing the Sustainable Forestry Sector. Work under this strategy began in May, in Lima, Peru in partnership with The Amazon Alternative (TAA), in collaboration with WWF and FSC, and with the support of ICCO, HIVOS and the Citi Foundation. The activities of this phase were based on the FAST Financial Fair© model and concentrated on:

- ▶ **Supply:** A two-day workshop was held to train both local mainstream and socially-oriented FIs in the basic concepts of sustainable forestry and how to understand the challenges and opportunities, risks and needs of financing in the forestry sector in Peru. The workshop included technical, legal, financial, and environmental information, including information about sustainable forestry certifications, markets and other key aspects that are important for financial institutions to take investment decisions. A key element of this workshop was to bring together FIs and forestry technical experts in order to support their evaluations of the technical viability of forestry projects.
- ▶ **Demand:** From a pool of SMEs working with FAST and TAA partners, seven sustainable forestry SMEs were selected to participate in the first FAST Financial Forestry Fair, based on the requirements of the FIs and their readiness. These SMEs received support and training in how to present their business and how to apply for credit alongside other technical assistance being provided.
- ▶ **Linking supply and demand:** The FAST Financial Fairs consist of a series of one to one meetings between sustainable SMEs and interested FIs organised for a one or two day period. The first FAST Forestry Financial Fair (FFFF) took place in Lima, Peru. Six FI members and partners of FAST participated, including: Root Capital, Rabo Rural Fund, responsAbility, IFC, Asesorandes, and Fovida. Twenty-five meetings between the FIs and the seven pre-selected sustainable forestry SMEs took place according to the profile and needs of both the FIs and the SMEs. Through the Fair, the SMEs sought a total of US\$ 22,259,162, in requests ranging from US\$ 50,000 to US\$ 13,123,987.
- ▶ **As of April 2012,** FAST and TAA have been able to confirm approximately US\$ 813,000 in financing provided through connections made at the FFFF, fulfilling the requests of three of the SMEs. For the other SMEs, a continuous improvement system will be implemented



to work on concrete and specific aspects identified through their experience and feedback from FIs, so they will have greater possibilities of accessing credit in future.

- **Advocacy:** A networking event took place immediately after the workshop and the FFFF to promote the importance of investing in Peru's sustainable forestry sector. Presentations from the workshop were made available to participants and the results were widely communicated ([www.fastinternational.org/en/node/1390](http://www.fastinternational.org/en/node/1390)).

The model, as described above, consists of working with the supply and demand sides as well as linking them together. This is a continuous improvement model that allows direct follow up with both supply and demand. It improves access to finance through identifying specific requirements and conditions that need to be in place for SMEs and FIs to do business together.

The second phase of the project aims to continue follow up and carry out another FAST Financial Fair in Peru and to implement the model in Bolivia. As well, FAST plans to develop tools that will further enhance access to finance in the sector, including: market information and risk management tools for financial institutions; financial literacy training materials for sustainable forestry SMEs; and tools and resources to measure the social, environmental and financial impact of investing in sustainable forestry.

[www.fastinternational.org](http://www.fastinternational.org).

## 6.16 SCOPEinsight

SCOPEinsight is a rating organisation in Agriculture, Aquaculture, Dairy/livestock and Forestry that assesses the creditworthiness of producer organisations by profiling their organisational performance. The profiling is based on the rating methodology SCOPE (SCoring of Organisational PErformance). It gives a complete and unprecedented insight into: internal management maturity on key topics like governance, operations and financial management; financial performance; risk management; sustainability issues; and the management of supply and markets, which indicates the embeddedness of the organisation in the value chain. Most of all, its framework provides a platform, aimed at transparency, with profiles that give valuable information to producer organisations for their own business development efforts; to government agencies, business development service providers and NGOs in their assessment methodologies and services for developing producer organisations.

SCOPEinsight has set up original and reliable tools for stakeholders that can be used on a locally controlled forest project, as well as in other sectors. The SCOPEinsight profile helps right-holders and investors through multiple means:

- ▶ It provides valuable information for financiers regarding client identification and credit appraisal processes; for traders and exporters wanting to identify suppliers and their procurement policy; and for input suppliers, in order to identify customers and their credit policies.
- ▶ It leads an assessment project, provided only to the producer organisations and their partners. In a detailed way it shows the strengths and weaknesses of the producers, including insight into how to maintain the strengths and to improve the weaknesses. It can be used in capacity building projects and it enables objective Monitoring and Evaluation (M&E). It assesses internal management, management strategies for exogenous risks, and management of supply, of markets, and of service providers.

[www.scopeinsight.com](http://www.scopeinsight.com)

## 6.17 TFT (The Forest Trust)

TFT (The Forest Trust) is a global non-profit organisation that helps companies and communities deliver responsible products. TFT acts on the ground in forests, farms and factories to help create products that respect the environment and improve people's lives.

Since inception in 1999, its main focus has been to empower forest-dependent communities and provide solutions to the issue of deforestation. It is a membership organisation, including over 80 leading international retail and manufacturing companies who are committed to sourcing responsible products. TFT also works collaboratively with institutional donors and individuals looking to build capacity on the ground for responsible environmental and social management. In doing so, it gives communities and local companies the tools to provide responsible wood products to world markets. With offices in 14 countries and over 90 staff, TFT has made ground-breaking achievements in forest conservation and supply chain sustainability. To date, TFT's projects have covered 8.5 million hectares of land.

Since 2003, TFT has been working in partnership with community-led forestry initiatives in Southeast Asia. TFT staff provide technical training, empowerment and support to local forest managers; teaching them best management practices in a variety of forest management systems including natural forests, plantation forests and smallholder agroforests. TFT helps smallholder forest managers to become FSC certified and to sell their wood to international companies seeking wood from responsibly managed forests.

The first partnership with community smallholder forests was in Indonesia, in which TFT began assisting the local cooperative Koperasi Hutan Jaya Lestari (KHJL) to manage their teak agroforests and help smallholder forest managers to sell their responsibly-sourced wood. TFT provided training in FSC group certification and helped form a group forest management plan. A network of environmental and social NGOs working throughout Southeast Sulawesi Province, called Jaringan Untuk Hutan (JAUH, Network for Forests), helped establish organisational structures to enable regular and transparent communication within the group.

In 2005, KHJL successfully obtained an FSC Group Certificate, the first FSC certified cooperative in Southeast Asia. With continued support from TFT staff, KHJL maintained their FSC certification and has grown from 196 individual smallholders with 153 ha of land, to over 760 members covering 750 ha. In addition, KHJL received a state licence to manage 4,640 ha of state teak plantation area under the Community Plantation legislation in December 2008.

Since this initial project, TFT has developed a series of smallholder agroforest group certification programmes including:

- ▶ KOSTAJASA, located in Central Java, which started in 2006 and received FSC certification in 2009.
- ▶ Luang Prabang Teak Program, located in Northern Lao PDR, started in 2008 and received FSC certification in 2011.
- ▶ Dipantara, located in Central Java, started in 2009. Its FSC certification is pending.
- ▶ Punjab and Haryana Shisham, located in Northern India, started in 2010.
- ▶ Klinik Tani, located in Central Java, started in 2012.

Since 2003, TFT has invested approximately US\$ 1 million in support of community / smallholder forestry with funds secured from government resources, NGOs contributions, and TFT member companies.



## 7 Appendices

### 7.1 Framework for the business concept document

A business concept document is similar to the executive summary of a full business plan. It outlines the business opportunity, describes how the firm will address this opportunity and explains how this will be a viable financial proposition. A good concept note will convey the innovative features of the business idea, with a focus on the value proposition and marketing of the product or service. It will have limited financial information, probably confined to estimates of capital required and target payback period (although the more financial data, the better).

Table 13: Example framework from the Papua Province Entrepreneur's Group, Indonesia

	Title	Notes
1	Vision and mission	The <b>vision</b> describes the desired future state that will be brought about by the business, for example, 'a sustainably managed production forest in Sarimi that protects ecosystem services whilst providing prosperity to local people'. The <b>mission</b> tells us how the business intends to achieve its vision, such as, 'joint forest management with communities in Sarimi, combining modern technical techniques with traditional wisdom and know-how, to produce a range of quality manufactured timber products for domestic and export markets.'
2	The business opportunity	This section describes the current situation (briefly), and pitches the business opportunity. Note that this is a <b>business</b> opportunity; there may be many other opportunities for intervention, but it is only those that are potentially profitable that interest us here. For instance: '...timber extraction in Sarimi is confined to one species (merbau) for export, is inefficient and fails to plan for future regeneration. Furthermore the exported products have little added value and reach undiscerning markets, which are less concerned over legality and sustainability. Buyers in Europe and USA have expressed an interest in purchasing higher value products if sustainability, legality and FPIC criteria can be met, and where it can be shown that the trade contributes to social and economic development and environmental sustainability. These buyers are prepared to pay a premium for certified products and offer technical assistance in developing higher added value manufactures, such as components, veneers and mouldings.'
3	Market strategy	In summary, this section could list the three or four most important features of the product or service, for example: <ul style="list-style-type: none"> <li>▶ Using latest cutting technology to improve recovery rates from hardwood logs by 30% (thus improving resource use and sustainability).</li> <li>▶ Working with award-winning designers in London and Bali to develop a range of certified furniture components.</li> <li>▶ Using R&amp;D and market research to develop a range of wooden products using lesser-known species.</li> <li>▶ Agreeing long term raw material supply contracts with consortia of furniture SMEs (ASMINDO) in Central Java on favourable payment terms.</li> </ul> <p>Based on the expertise of the partner, this section could also include further detail regarding the following:</p> <ul style="list-style-type: none"> <li>▶ Product development.</li> <li>▶ Marketing (design, pricing, demand) and sales (distribution channels).</li> <li>▶ Customers (examples).</li> <li>▶ Competitors and examples of similar businesses in Indonesia or abroad.</li> </ul>

	Title	Notes
4	Business strategy	<p>This section describes how the business will actually deploy resources and make money. It starts with the value proposition, which can be summarised as: 'This business makes (or does) X with K for C', where X = the product or service, K= the factors of production, e.g. capital, labour, raw materials, and C= the target customer. For example, <i>'Jaringan Kayu Perkasa produces high quality PEFC or FSC certified certified wooden components in our modern factory in Jayapura, using hardwoods from forests managed sustainably by Indigenous People that are also shareholders in the business, for distribution through selected importers in Europe, USA and Japan.'</i></p> <p>X and K are to some extent covered in the previous section (market strategy), but this section articulates how it will organise the factors of production effectively. This will raise questions such as:</p> <ul style="list-style-type: none"> <li>▶ Where will the factory be located?</li> <li>▶ How will the timber concession be obtained, and how much will it cost?</li> <li>▶ Where will staff be found, and how can they be trained?</li> <li>▶ How will key stakeholders, such as local communities, be included in order to ensure the success of the business?</li> <li>▶ How will local land rights be negotiated and compensated?</li> </ul> <p>And not forgetting:</p> <ul style="list-style-type: none"> <li>▶ How will the business make money?</li> </ul> <p>It would be useful to have some financial estimates if possible, but the detailed business modelling will follow at a later stage. At the least, this proposal should indicate:</p> <ul style="list-style-type: none"> <li>▶ Likely capital requirement, and how much of this will be financed by co-investors.</li> <li>▶ Key price point information (such as difference between certified and non-certified wood, purchase price of raw materials).</li> <li>▶ Major capital expenditure (capital goods, permits, land and so on).</li> <li>▶ Target turnover (both physical and financial) and profit, with estimated payback period.</li> </ul>
5	Sustainability	<p>This section describes how the business will accord with the 'triple bottom line' principles of 'people, planet, profit'. Some of these will already have been listed in previous sections (such as community involvement, sustainable forest management) and can be reiterated here.</p> <p>An important reality check for the investor will be to use this section to test if the proposed business is in line with the values and objectives of the 'socially and environmentally responsible' investment sector.</p>
6	Organisation and management	<p>A key success factor of the proposed venture will be the quality and experience of the people and organisation implementing it. The partner / co-investor should outline why they have the necessary credentials. Who will be the key management team, and how will key staff be found, rewarded and retained?</p> <p>This section should also include a very brief stakeholder analysis and discussion of proposed ownership structures, for instance how communities may be included in the equity over time, for example, <i>'local clans have agreed to discount the royalty (hak ulayat) due on stumpage in return for deferred options on shares which will be activated in year 7 via the cooperative'</i>.</p>

	<b>Title</b>	<b>Notes</b>
7	Challenges, risks and assumptions	<p>This is the first stage of testing the viability of the proposal. By honestly disclosing all assumptions and potential risks, they are made available for further analysis.</p> <p>For instance:</p> <ul style="list-style-type: none"> <li>▶ A key challenge is purchasing a non-active timber concession area at reasonable cost and having the transfer approved by Ministry of Forestry.</li> <li>▶ Risks include: illegal logging, police demanding unofficial fees, communities selling timber to other buyers, international boycott of Papua or Indonesia, civil unrest...</li> <li>▶ Assumptions: timber sale prices derive from data from ITTO, TFT...</li> </ul>
8	Further information needed	<p>List the additional research that needs to be done to turn this proposal into a complete business plan, for example:</p> <ul style="list-style-type: none"> <li>▶ Compile historic prices on merbau 1990-2010.</li> <li>▶ Research examples of other businesses (e.g. in South America) that have processed timber in remote areas.</li> <li>▶ Get prices for capital goods, such as Lucas Mill, bandsaw, Kilns with captive power / co-generation from biomass, Skidders approved for RIL.</li> <li>▶ Find out the local government plan for cancelling and re-distributing non-active concession permits.</li> </ul>

## 7.2 Key points in a written contract

From *'Rethinking Forest Partnerships and Benefit Sharing'* (World Bank, 2011)

### **I(A). If the partners want to be able to enforce the contract in court, the contract should be legally valid.**

To achieve that, the partners should consider the following:

- ▶ Local law: contracts must be consistent with local law and public policies, or courts will refuse to enforce them. Projects that involve transfers of property ownership or rights need to be analysed from the perspective of property law.
- ▶ Intent to be bound: contracts need to show, directly or by implication, that the parties intend to be legally bound by their agreement. Often, just the formality of the contract and the use of phrases like “the two sides agree” or “side A promises that” imply the necessary intent.

### **I(B). The partners should create a contract that is clear and understandable, and reasonably complete in capturing the agreement.**

Making an understandable and complete written contract is one way to bring the sides to have similar expectations about the project. To do that, the partners should pay attention to the following:

- ▶ Accuracy: the contract must actually capture the agreement that the parties have in mind. In general, a court will assume that a written contract is accurate and will be reluctant to look much beyond the document to understand the agreement.
- ▶ Precision and lack of ambiguity: the contract must be specific in its meaning. It must not be subject to multiple, inconsistent interpretations. This is often difficult to achieve.
- ▶ Plain language: sometimes legal language gives contracts a formality that impresses on the parties the seriousness of their commitment. Some legal concepts can only be clearly expressed through legal terms. On the whole, though, plain language is preferable. If a contract's language is too complex for one of the parties to understand, a judge might question whether it truly reflects the intent of that party.
- ▶ Depth and detail: the depth and detail will depend to some degree on the complexity of the agreement, the sophistication of the parties, and the cultural setting. There is no universal level of detail that is appropriate, it is a matter of balance. If writing the details requires the parties to consider risks and contingencies, and if the details give the parties good direction, that is good. If producing the detail is time-consuming and costly, or if the detail does not reflect the true agreement of the parties, that can be bad.
- ▶ Completeness: ideally, the parties should place their entire agreement in writing, in a single contract or a set of related contracts. If there are side agreements, the contract should make that clear; otherwise, a court might presume that the written agreement reflects the complete understanding of the parties.

### **II(A). In the contract, the parties should address some of the key factors of agreement-keeping.**

To do that, the partners should consider the following topics:

- ▶ Expectations of what it means to make an agreement: the contract can discuss what will happen if the sides do not live up to their obligations.
- ▶ Outcomes of enforcement (remedies): courts apply a limited set of remedies to contract disputes. Contracts are not legislation and cannot require parties that breach the contract

to pay fines or go to jail. However, a contract can give the court some guidance on what remedies to apply, such as rescission or award of damages. In some cases, the most practical remedy for the sides may be to just dissolve the partnership and walk away from the project, as if the agreement never existed (rescission). In some cases, the parties may want to assign monetary values to certain possible failures to honour the contract that would otherwise be difficult to price (liquidated damages).

- ▶ **Practicality:** implementation should be within the capacity of the parties, or the contract should include means of strengthening capacities. Consider the following factors:
  - The government or business's capacity to oversee the work of the community or individuals.
  - The community or individuals' capacity to manage the forest and the organisational aspects of the project.
  - The availability of necessary capital and the means to manage it.
  - The availability of technical skills.
  - The availability of infrastructure and equipment.
  - The timetable of the project.
- ▶ **Verification:** if compliance is not inherently obvious, or if compliance needs to be documented or recorded, the contract should provide for that.
  - The contract can include intermediate milestones that will indicate that the sides are making good progress.
  - The contract can specify or have one side provide technical means to measure progress.
  - The contract can specify record keeping requirements, such as for financial accounts and receipts. It may need to provide for audits.
  - The contract can require the project to be transparent to outside observers.
- ▶ **Communication:** the contract should encourage or require ongoing communication between the sides.
  - The contract can identify means for routine and emergency communication between the sides.
  - The contract can identify who may speak for each side, and who should receive important communications. By naming the proper persons or by establishing institutions and procedures, a contract can make it more likely that the representatives for both sides will actually function effectively as the ears and voice of their sides.
  - The contract can address communication infrastructure, and ensure that the communication requirements of the project fit the capacity of the infrastructure.
  - The contract can call for regular project meetings.
- ▶ **Incentives:** the project should include the right parties and create the right incentives.
  - The people who can ensure success should be part of the project.
  - Those people should have sufficient reasons to work for the project's success.
  - The rights and benefits that the project grants should be reliable.

## **II(B). The parties should consider ways to handle disputes besides going to court.**

To do that, the contract can deal with points like the following:

- ▶ The contract can include agreed-upon ways for the parties to bring up problems with each other.
- ▶ The contract can identify what would be a “material breach” – a problem so significant that it could lead to terminating the partnership or seeking payment of damages.
- ▶ The contract can explain what happens if overwhelming circumstances (force majeure) make compliance with the agreement impossible.
- ▶ The contract can include ways to seek outside help to resolve disputes short of going to court, such as mediation or arbitration.
- ▶ The contract can call for traditional dispute resolution practices short of going to court.

## **III. The parties should pay attention to details that have been known to lead to disagreements and court suits.**

For example, the partners might consider the following topics:

- ▶ How the parties are named: the contract must clearly identify who are the parties entering the agreement. If any of the parties are legal “persons” (for example, a government, a corporation, or an NGO), the party must have a recognised existence under local law and the individual signing the agreement must have authority to enter the contract on behalf of the party. In a case where the participant is in effect a family, the contract may want to name the family members or indicate that upon the death of the participant, a spouse or child may elect to take on the participant’s obligations and receive the benefits.
- ▶ How the land is described: the contract must precisely identify the land involved. This may be done through words or through maps, although words that refer to established land surveys are often more precise. In some cases, contracts use both words and maps. In those cases, or in any case where the contract refers to two or more descriptions of the land, the contract should say which one to follow if the two turn out to conflict.
- ▶ How the contract affects outsiders: contracts normally only set requirements for the people who make the contracts and the people closely connected with them, for example, as employees. Except in limited ways, contracts cannot create obligations for strangers to the project. Any partnership that needs support or cooperation from an outsider may need to make the outsider a party to the main agreement or a side agreement. If the contract creates named benefits or rights for outsiders, the partners may want to consider whether the contract and local law empower the outsiders to go to court to demand those benefits, and whether that is appropriate. If the partnership involves a piece of land that might change ownership during the partnership term, the partners may want to structure the contract so that the obligations “run with the land” and bind the new owner.
- ▶ Project activities and compliance with law: the parties may want to include promises to comply with local law in their use of the land. For example, a forest products company may want to have its outgrowers promise to comply with environmental, labour and safety laws.
- ▶ Return of land: if the contract gives one side possession of land for a limited term, the parties may want to consider what condition the land must be in when the term ends, who own fixed improvements on the land, and other issues involved in handing the land back.
- ▶ Liability: contracts should be reviewed for their effect on the parties’ liability for each others’ actions. A contract could implicitly make the parties responsible for each other’s actions, or could require one party to indemnify another.

### 7.3 Assessing organisational capacity

A common method of assessing an organisation's capacity is through a SWOT analysis, which considers internal aspects such as the strengths and weaknesses of the business, and the opportunities and threats facing it. Although this is useful for getting a sense of the general state of the business, it does not tackle the underlying characteristics that will determine how successful it will be in grasping opportunities and managing threats. Therefore an exercise such as an Organisational Self-Assessment (OSA) may be required.

An OSA process will reveal the elements of organisational capacity that need to change for the business to get stronger. For instance:

**Common values** – not just sharing the vision and mission, but fully understanding what it will take to achieve it.

**Altruism** – the extent to which all stakeholders recognise that the interests of the business supersede their own individual needs. The ability to defer benefits and not allow short term self-interest to prevail at the expense of the business.

**Transparency and accountability** – good managers and leaders have the confidence to bear scrutiny and face the consequences of their actions.

**Optimism** – willingness, motivation, enthusiasm, self-reliance and belief that the business can achieve its aims.

**Leadership** – leaders have power, influence and the ability to motivate an organisation. Other dimensions (such as optimism and altruism) will be dependent on the quality of leadership.

**Context** – extent to which the political and economic environment enables small businesses to thrive. When politicians and civil servants take a patronising approach (reflected in laws and regulations), the organisation is weak, while if they take an enabling approach to the organisation acting on a self-managed basis, the business will be stronger.

**Networking** – small forest enterprises are often isolated from each other and from markets. Successful businesses form linkages throughout the value chain as well as horizontally amongst similar businesses, in order to access innovation, technical solutions, management ideas and market intelligence.

**Political power** – the degree to which the organisation can participate in national and district decision making. Formal businesses, as tax payers, have more political leverage than fragmented, informal micro enterprises.

## 7.4 Attendees at the Dialogues

Abdulla Diku	Björn Merckell	Eko Waskito
Adama Doukom	Bo Ohlsson	Elizabeth R. Sandler
Adama Nana	Bojan Rantasa	Elvis Tangem
Adrian Kahemela	Boris Quezada	Emily Matche
Agung Wiyono	Boukary Zieba	Endah Suwarni
Agus Wibowo	Branko Skenderski	Ephraim Muchiri
Aisyah Sileuw	Buddha Lama	Ernesto Herrera-Guerra
Alan Purbawiyatna	Carl Henrik Palmér	Estebancio Castro Diaz
Alberto Chinchilla	Carlos Roxo	Fatmir Brazhda
Alda Salomao	Caroline Pradeau	Fausto Rodrigues de Camargo
Aleksandar Damjanovic	Cath Long	Fiona Napier
Aleksandar Radosavljevic	Catherine Thuo	Francis Kagema
Alex Georgianna	Celestino Abrego	François Ouedraogo
Alexander Dadzie	Charles Uwiragiye	Fred Kafeero
Ali Kaka	Chris Buss	Fredrick Njau
Alicia Calle	Chris Knight	Gabriel Thoumi
Anders grennborg	Christine Padoch	Ganesh Karki
Anders Roos	Christopher Webb	George Asher
Andrew Y. Dokurugu	Claire Ogali	Ghan Shyam Pandey
Anne Davis	Clarisse Kambou	Gilberto Arias
Annika Siwertz	Clark Binkley	Gilberto Solano
Annika Valentin	Clement K Kariuki	Gjore Poposki
Apsara Chapagain	Clive Suckling	Goran Bjorkdahl
Arafa Salim	Dàniel Désiré Ouedraogo	Govinda Kandel
Arati Pathak	Daniel Fatie	Grazia Piras
Arturo Santos	Daniel Ouedraogo	Hakan Sjöholm
Asafi Cynthia Wechabe	David Fichman	Haki Kola
Ashim Paun	David Finneren	Hapsoro
Athumani Mamu	David Goodwin	Harald Säll
Atilla Lengyel	David Vincent	Hassan Sachedina
Agus Djailani	Dev Bahadur Kunwar	Hasse Bengtsson
Augusta Molnar	Dewi Rizki	Helen Thorton-Mutiso
Aurelio Chavez	Diah Y. Raharjo	Hemant R. Ojha
Aziz Hamid	Diaharata Diasso	Hemed Mwafujo
B.B. Rai	Dian Novarina	Henri Koubizara
Baki Shahu	Diego Dávalos	Henrik Riby
Bal Ram Kandel	Diji Chandrasekharan Behr	Henry Heyneardhi
Bambang Adji	Dil Bahadur Khatri	Herbert Pircher
Ban Maya Parja	Dinesh Chandra Devkota	Hermudananto
Barthélémy SAM	Dominic Elson	Hortencia Hidalgo Caceres
Benjamin Hodgdon	Dominic Walubengo	Hubertus Samangun
Benjamin Singer	Duncan Macqueen	Inazio Martínez de Arano
Bernadus Winderatmo	Dusko Topic	Indrawati Muktan
Bharati Pathak	Edgar Ramiro Caal	Inganji Yakhama
Bhim Khadka	Edi Suprpto	Ingeborg Bromée
Bhimsen Poudyal	Edmund G. Barrow	Isidore Sorgho
Bhishma P. Subedi	Edna Kaptoyo	Israel Ruiz
Bishnu K.C	Edouard Bonkougou	Ivar Legallais-Korsbakken
Bishnu Lal Shah	Eduardo Junior Arenas Hernández	J.B. Susanto

James Griffiths	Marcus Colchester	Rostanto Suprpto
James Mayers	Margareta Renström	Rudolf Makhanu
Janne Narakka	Mari Albiñn	Ruth Martínez
Jasenka Milijic	Maria Garcia	Sabine Baer
Javier Mateo-Vega	Marie Henningsson	Saidou M. Soro
Jean Marie Kabore	Mario Rafael Rodriguez Palma	Samuel Carpintero
Jeannette Gurung	Markku Simula	Samuel Nketiah
Jerker Thunberg	Martin Bolte	Sandika Ariansyah
Jhony Zapata	Mary Nderitu	Sara Omi
Jim Degerman	Matthieu Yela Bonketo	Sarah Price
Jimbria Sakho	Max Ooft	Saso Petrovski
Jimmy Eggers	Mayra González Sagui	Scott Landis
Joachim Kagiri	Mike Kessler	Sean Watters
Joelle Brans	Miljenko Zupanic	Shanti Bidari
Johan Akerblom	Minnie Degawan	Shanti Chaudhary
John Curtis	Miriam Prochnow	Shiva Pandey
Johnson Cerda	Mohamad Kar Kha	Shoana Humphries
Jon Grayson	Mohammed Nasimul Islam	Silverius Onte Unggal
Joram Kagombe	Morten Thoroe	Simon Petley
José Antonio Asturias	Mourmouni Dialga	Skip Krasny
José Manuel Pérez	Muhammad Sidik	Somying Soontornwong
Joseph K. Cheruiyot	Mwajuma Abdi	Sophie Grouwels
Joseph Lawson	Mwangi James Kinyanjui	Staline Kibet
Joseph Nkinzo	Nania Yago	Steven Johnson
Joshua Irungu	Narayan Devkota	Stewart Maginnis
Juan Funes Alvarado	Natalie Hufnagl-Jovy	Sugeng Suyono
Julius Kamau Wambugu	Nikola Nedeski	Sunyoto
Kady Traore	Nisro	Svarte Swartling
Kanchan Lama	Nitu Kafle	Sylvestre Ouedraogo
Kantau Ole Nkuruna	Njari Jackson	Taufik
Kayanna Warren	Olli Haltia	Teresa Sarroca
Kerstin Jonsson Cissé	Omayra Casama	Terhi Koipijarvi
Kevin Whitfield	Orlando Lozada	Theodore Sorgho
Kipkemboi Kandie	Ouboli Jonas YOGO	Thiphaphone Phetmany
Klas Bengtsson	P. Pierre Guigma	Thomas Enters
Krishna Acharya	Parbat Gurung	Thorsten Celerander
Krishna Chandra Paudel	Patriady Indrajana	Tomonori Sudo
Krishna Prasad Lamichhane	Patrice Pa'ah	Tony Hill
Lars Borklund	Pekka Jamsen	Untung Karnanto
Leif Krasny	Per Björkman	Victor Lopez Illescas
Lennart Ackzell	Peter DeMarsh	Vila Chanthavong
Ljupcho Paruleski	Peter Dewees	Vladimir Stojanovski
Ludovic Pascal Conditamde	Peter Gardiner	Vojislav Milijic
M. Pramono	Peter Kampen	Vu Phuong Thao
Mads Asprem	Petra Kollmannsberger	Xiaoting Hou
Magnus Berg	Pierre Nikiema	Warwick Ragg
Magnus Petersson	R.M. Herismoyo	Wishnu Tirta
Mahamady Sawadogo	Raja Ram Shyangtan	Yani Septiani
Makedonka Stojanovska	Ram Prasad Neupane	Zainuri Hasyim
Mamby Fofana	Ritva Toivonen	Zheng Zhong
Manoj Nadkarni	Riziu Pandu Permana	Zoran Sekuloski
Marcial Arias Garcia	Rob Dodson	
Marco Cárdenas	Ronny Hansen	

## 7.5 Links to other resources and partners

### Impact investing networks

- ▶ Global Impact Investing Network: [www.globalimpactinvestingnetwork.org](http://www.globalimpactinvestingnetwork.org)
- ▶ Bridges Ventures: [www.bridgesventures.com](http://www.bridgesventures.com)
- ▶ Stanford Social Innovation Review: [www.ssireview.org](http://www.ssireview.org)
- ▶ TONIIC: [www.toniic.com](http://www.toniic.com) an international impact investor network promoting a sustainable global economy.

### Further reading on impact investing

- ▶ Impact Investing: transforming how we make money while making a difference. Antony Bugg-Levine, Jed Emerson (Jossey-Bass, 2011)
- ▶ Coordinating Impact Capital: A New Approach to Investing in Small and Growing Businesses. John Kohler, Thane Kreiner, Jessica Sawhney (Santa Clara University, 2011)
- ▶ Innovations, September 2011 – SOCAP11 Impact Investing Special Edition. Philip E. Auerswald, Iqbal Z. Quadir (Editors), (MIT Press, 2011)

### Guides and toolkits for supporting locally controlled forestry

- ▶ IIED series of publications in support of ILCF and support to small forest enterprises: [pubs.iied.org](http://pubs.iied.org) for instance:
  - Supporting small forest enterprises: A cross-sectoral review of best practice <http://pubs.iied.org/pdfs/13548IIED.pdf>
  - Supporting small forest enterprises – A facilitator's toolkit. Pocket guidance not rocket science! <http://pubs.iied.org/pdfs/13558IIED.pdf>
  - Investing in locally controlled forestry: natural protection for people and planet <http://pubs.iied.org/pdfs/17130IIED.pdf>
- ▶ Profor: [www.profor.info](http://www.profor.info) has various products focused on assisting communities to benefit from partnerships and private investment. These include:
  - Making Benefit Sharing Arrangements Work for Forest-Dependent Communities. Provides practical guidance on how to identify and work with beneficiaries when rights are unclear, set up agreements among parties and determine benefits, and design of benefit sharing arrangements that complement the local context.
  - Mobilizing Private Investment in Trees and Landscape Restoration in Africa. This helped identify immediate investment opportunities, main constraints to investment and policy and institutional reforms needed to overcome constraints and create an enabling climate for accelerated private sector investment. TFD Review: Investing in Locally Controlled Forestry (In press)
- ▶ The group enterprise resource book [http://www.ruralfinance.org/fileadmin/templates/rflc/documents/1128084661360\\_The\\_group\\_enterprise\\_resource\\_book.pdf](http://www.ruralfinance.org/fileadmin/templates/rflc/documents/1128084661360_The_group_enterprise_resource_book.pdf)
- ▶ Community based tree and forest product enterprises – Market Analysis and Development Manual <http://www.fao.org/docrep/014/i2394e/i2394e00.pdf>
- ▶ Mapping the market: a framework for rural enterprise development policy and practice [http://practicalaction.org/docs/ia2/mapping\\_the\\_market.pdf](http://practicalaction.org/docs/ia2/mapping_the_market.pdf)
- ▶ Value links manual [http://www.valuelinks.org/images/stories/pdf/manual/valuelinks\\_manual\\_en.pdf](http://www.valuelinks.org/images/stories/pdf/manual/valuelinks_manual_en.pdf)
- ▶ Making value chains work better for the poor – a toolbox for practitioners of value chain

analysis <http://www.valuechains4poor.org/file/V4P%20Toolbook%20v3%20Final.pdf>

- ▶ Producer organisations – a practical guide to developing collective rural enterprises <http://policy-practice.oxfam.org.uk/publications/producer-organisations-a-practical-guide-to-developing-collective-rural-enterpr-115532>
- ▶ TFT handbook: ‘Sustainable Community Forest Management: A Practical Guide to FSC Group Certification for Smallholder Agroforests’. Designed to provide simple practical solutions to the most common information challenges smallholders face when trying to achieve FSC group certification [www.tft-forests.org](http://www.tft-forests.org)

### **Networking and associations for locally controlled forestry**

- ▶ Forest Connect: [forestconnect.ning.com](http://forestconnect.ning.com) Forest Connect is an international alliance dedicated to tackling the isolation of small forest enterprises. Established in late 2007, its aims are to avoid deforestation and reduce poverty by better linking sustainable small forest enterprises to each other, to markets, to service providers and to policy processes such as National Forest Programmes.
- ▶ Growing Forest Partnerships: [www.growingforestpartnerships.org](http://www.growingforestpartnerships.org) GFP is about building up and supporting networks at local, national and international levels.
- ▶ The Forests Dialogue: [environment.yale.edu/tfd](http://environment.yale.edu/tfd) Investing in Locally Controlled Forestry Initiatives.

### **Forest Certification bodies**

- ▶ Forest Stewardship Council: [www.fsc.org](http://www.fsc.org)
- ▶ Programme for the Endorsement of Forest Certification: [www.pefc.org](http://www.pefc.org)

### **Other selected reading:**

- ▶ Arborvitae, issue 41 – “Forest Finance” <http://www.iucn.org/forest/av>
- ▶ *The value of investing in locally-controlled forestry: the economic impacts of scaling up LLS experiences in Africa, Asia & Latin America*, Markets and incentives for livelihoods and landscapes series n°4, IUCN, Gland, Switzerland
- ▶ Livelihoods and landscapes strategy: final report, landscape papers and thematic working papers: <http://www.iucn.org/forest/lls>

## 8 Endnotes and Bibliography

### Endnotes

- 1 Collectively called 'locally controlled forestry'.
- 2 Data from International Family Forest Alliance (IFFA).
- 3 Facts mainly derived from KSLA (2009) and Palmer (2012), with additional input by Svarta Swartling.
- 4 For example, see case studies in this guide, and also Kozak (2007), Dewees et al (2011).
- 5 Particularly by the investors and rights-holders, NGOs and governments that have attended the various TFD meetings.
- 6 For instance see Chhatre and Agrawal (2009), Macqueen (2008), Elson (2011), Power (1996) and evidence presented in the next chapter.
- 7 Dialogue and planning conference for The Three Rights Holders Groups (known as G3) in Rome, 2010.
- 8 FLEGT: Forest Law Enforcement, Governance and Trade, an EU programme to remove illegal timber from the supply chain.
- 9 Dialogues have been held in Brussels, Panama, Macedonia, Kenya, Nepal, Burkina Faso, London, Indonesia and Sweden.
- 10 But many of its suggestions and models will be applicable to investing in SMEs in almost any sector.
- 11 Mayers (2006)
- 12 Cernea & Schmidt-Soltau (2006)
- 13 Bateman *et al.*, (2011)
- 14 Chomitz (2007)
- 15 Definition agreed at inaugural meeting of 'G3' in Rome, 2010.
- 16 De Schutter (2010)
- 17 See The Forests Dialogue FPIC dialogue stream – <http://environment.yale.edu/tfd/dialogues/free-prior-and-informed-consent/>
- 18 Elson (2011b)
- 19 Elson (2010)
- 20 Programme for the Endorsement of Forest Certification (PEFC) [www.pefc.org](http://www.pefc.org) and Forest Stewardship Council ([www.fsc.org](http://www.fsc.org)).
- 21 Gregersen *et al.* (2011)
- 22 The Economist (2010)
- 23 Kuntoro Mangkusubroto, Government Minister, Indonesia, at the RRI Forest Tenure Conference, Lombok, (July 2011)
- 24 Rodrigues, et al. (2009)
- 25 Molnar (2007)
- 26 Macqueen (2008)
- 27 DFID LFP (2009)
- 28 Carter *et al.* (2007)
- 29 Scherr, *et al.* (2004)
- 30 Porter-Bolland *et al.*, (2011)
- 31 For examples, see Elson (2011c) and RRI (2012).
- 32 Notably Bauer (1954), later de Soto (1995) and most recently in Besley and Ghatak (2010).
- 33 Carter *et al.* (2007)

- 34 Macqueen and Cotula (2008); Parthiban *et al.* (2010)  
35 de Soto (2000), p.177  
36 Elson (2010)  
37 Mayers (2006)  
38 Dwyer (2007)  
39 Deininger (2003)  
40 For example, see Beck *et al.* (2005).  
41 Binswanger *et al.* (1995)  
42 This framework of ‘pragmatist / sceptic / advocate’ was first explained in Macqueen (2004).  
43 For example, Munden (2011).  
45 This assertion is based on evidence gathered by the author’s own field work in Indonesia and Cameroon.  
46 These features are explained in some detail in Elson (2010).  
47 For instance, Credit Suisse (2012, page 6) sees philanthropy in support of ventures or social entrepreneurship as charitable giving, not investment.  
48 *ibid*  
49 Koh *et al.* (2012)  
50 *ibid*, p.18  
51 Strictly speaking, a bank may regard making a loan as the provision of a financial service rather than an investment. Unlike an equity investor, the bank is not especially interested in the future growth of the company, but only focuses on the evidence that the loan can be serviced and repaid. However, the loan will appear on the bank’s balance sheet as an asset and therefore for the purposes of this guide it seems reasonable to regard banks as profit-oriented ‘asset investors’.  
51 For example, McKinsey (2008) and Campanale (2009).  
52 JP Morgan (2010)  
53 Thornley *et al.* (2011)  
54 JP Morgan (2010)  
55 Bugg-Levine *et al.* (2012)  
56 IRIS: Impact Reporting and Investment Standards (<http://iris.thegiin.org>) is a framework for measuring the social performance of impact investments. It provides a standardised approach, with the aim to lower transaction costs and improve investors’ ability to understand the impact of the investments they make.  
57 McKinsey (2008)  
58 GEF (2009)  
59 Mayers (2011)  
60 ‘Over trading’ is where a small company becomes a victim of its own success by purchasing inputs to satisfy larger orders for which payment will be delayed, creating a cashflow crisis  
61 Evidence of microcredit’s lack of impact on poverty can be found in the Randomised Control Trial conducted by the MIT Poverty Action Lab, among many other studies.  
62 For example, Bateman and Chang (2009).  
63 GIIN (2012)  
64 Elson (2010)  
65 <http://www.eiti.org>

66 For example, *EITI Principle No.9*: ‘We are committed to encouraging high standards of  
 67 transparency and accountability in public life, government operations and in business’.  
 68 von Braun and Meinzen-Dick (2009)  
 69 Wells (2011)  
 70 Grindle (2004)  
 71 Macqueen *et al.* (2006)  
 72 Elson (2010)  
 73 de Marsh (2011)  
 74 Macqueen (2007b)  
 75 This section on associations was written by Peter deMarsh of IFFA.  
 76 Based on information supplied by Lars Björklund, SDC.  
 77 Neuman and Kremenutzky (2007)  
 78 Mbile *et al.* (2008), p.7  
 79 TFD Panama dialogue co-chairs’ summary.  
 80 Mayers and Vermeulen (2002)  
 81 Dwyer (2007)  
 82 [www.equator-principles.com](http://www.equator-principles.com)  
 83 [www.publishwhatyoupay.org](http://www.publishwhatyoupay.org)  
 84 Economist (2012)  
 85 Cafédirect (2012)  
 86 TFD Nepal Dialogue  
 87 Eliasch (2008)  
 88 Wells *et al.* (2006)  
 89 Brown *et al.* (2002)  
 90 Engberg-Pedersen (1997)  
 91 Macqueen (2007) p.2  
 92 Cowen and Shenton (1996)  
 93 Argyris and Schon (1978)  
 94 Kaplan (2004)  
 95 Howe (2005)  
 96 Kozak (2007)  
 97 RRI (2009)  
 98 Books and resources explaining business planning tools are easy to find. This description  
 99 draws on The Economist Guide to Business Planning by Friend and Zehle (2004).  
 100 <http://www.greenwoodglobal.org/>  
 101 Kwisthout, undated  
 102 Adapted from Schwab (2011)  
 103 Petley, per cor, (April 2010)  
 104 Forest Connect: <http://forestconnect.ning.com/>  
 105 For example, Macqueen (2008).  
 106 Macqueen *et al.* (2009)  
 107 Elson (2011)  
 108 [www.fastinternational.org](http://www.fastinternational.org).  
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This Guide to Investing in Locally Controlled Forestry (ILCF) emerged out of 11 international dialogues that assembled more than 400 people to discuss how to make ILCF happen. It is a primarily a tool for practical action – providing guidance on how to structure *enabling investments* and prepare the ground for *asset investments* that yield acceptable returns and reduced risk, not only for investors, but also for local forest right-holders, national governments and society at large. After providing strong justification for this approach, the guide sets out a framework for structuring investments with tactical advice for building the partnerships necessary for successful ILCF. The core of the guide is a roadmap to successful ILCF that covers the business stages of proposition, establishment, validation, preparation, negotiation and performance management – with practical advice for both investors and forest right-holder groups. Case studies of successful ILCF and a range of useful templates and sources of further information are provided. The guide is produced by the Growing Forest Partnerships initiative, supported by the FAO, IIED, IUCN, TFD and the World Bank.



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