



Towards an enabling environment for small and medium forest enterprise development*

Rural communities and groups have long been managing forests and increasingly have gained legal access to the resource base, but only recently have they started to form small and medium forest enterprises (SMFEs) to add value to their timber and non-timber forest products (NTFPs). SMFEs represent a promising option for contributing to poverty reduction and resource conservation through sustainable forest management. Their development into economically viable businesses requires an enabling environment in terms of laws and policies that promote legal access to the resource base, provide incentives for sound forest management, support increased value adding, and promote the formation of human, social, physical and financial capital for effective forest and business management. This policy brief argues that there are still significant challenges to the promotion of viable SMFEs and that government and non-governmental agencies, as well as SMFEs and their business partners, have important roles to play in the process. The discussion draws heavily on the experiences captured during an International Conference on Small and Medium Enterprise Development for Poverty Reduction: Opportunities and Challenges in Globalizing Markets (Costa Rica, 23 to 25 May 2006). The conference brought together nearly 200 experts, practitioners and business and community leaders from around the world to discuss institutional and policy options for promoting more viable and sustainable SMFEs.

Major conference conclusions

- **Governments can play a critical role in strengthening SMFEs to reduce poverty.** They can start by granting and enforcing legal access to forest resources. Curbing illegal logging and unsustainable harvesting of NTFPs will reduce unfair competition. Simplifying bureaucratic procedures for SMFE registration can reduce costs and enhance value adding opportunities. Financial incentives, including tax breaks for start-up SMFEs, are an additional positive step. Local and/or green purchasing policies also have a role to play.
- **SMFEs can improve their own competitiveness in national and international markets for forest-based products.** Upgrading technical, business and financial capacities and creating specialized institutions for business management helps add value to timber and NTFPs, reduce production and administration costs, facilitate new business partnerships, and provide a basis for negotiating more favourable terms of trade. The organization of SMFEs into second-level associations may facilitate the upgrading process.
- **Business development services (BDS) for SMFEs require**

greater coverage and quality. Special emphasis needs to be given to the training and education of a critical mass of rural BDS providers. Market-based mechanisms for service delivery are essential to ensure the impact and sustainability of these services.

- **Financial services are critical for the start-up and development of SMFEs.** Specific credit lines and related services and mechanisms need to be developed according to the needs and nature of SMFEs.
- **Non-governmental organizations (NGOs) and development agencies can strengthen the existing capacities of SMFEs.** Facilitating access to market and technical information is a priority. SMFE communication networks can be funded to improve information flows, stimulate company?community partnerships, and facilitate access to trade fairs and better articulation among technical, business development and financial services. Facilitating multi-stakeholder negotiations for better policies, improved business environments, and conflict management can help to address context-specific challenges. Support is often also needed to obtain access to niche markets (e.g., for certified timber or fair trade NTFPs) and to improve marketing and negotiation skills. Clear labour divisions are needed among NGOs, development agencies and commercial BDS providers.



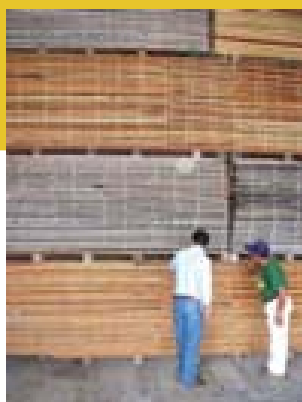
Key questions:

How have approaches to forest sector and community forestry development evolved?

What constraints in the political-legal framework impede SMFE development?

What investments are required to build the technical, business and financial capacities of SMFEs?

What are key elements of an enabling environment that effectively supports the development of SMFEs?



Introduction

The Millennium Development Goals commit most countries to halving global poverty by 2015. The stakes for meeting this goal are perhaps at their highest in forest-dependent communities in tropical countries, where poverty tends to be more pervasive and deeper than in urban and more favoured rural areas. According to the World Bank, approximately 90 percent of the poorest people rely on forests for subsistence and income. The development of small and medium forest enterprises (SMFEs) represents an opportunity for strengthening the livelihoods of these people and conserving the natural resource base through sustainable forest management and processing of timber and non-timber forest products (NTFPs). Local benefits from SMFE development may include wages and employment, profit sharing, capital accumulation, cultural and political empowerment, investment in public goods, and increased conservation of forest ecosystems through long-term sustainable management.

This policy brief focuses on SMFEs that extract, process and market timber products (logs or sawnwood) and/or NTFPs. These SMFEs are located at or near the resource base, and typically pursue multiple objectives, including employment and income generation, distribution of dividends among stakeholders, community development, greater participation in political dialogue, and improved local safety nets. Access to forest-based resources may be collective or private. Enterprise governance is usually influenced strongly by local rules, practices and customs. Owners of SMFEs may include anything from a handful of founding members to hundreds of small-scale producers or community members. Most forest enterprises fall into the category of small and medium on the basis of their sales volumes, numbers of employees and capital investments.

Several market trends favour the development of SMFEs. These include:

- growing scarcity and consequent price increases of a number of tropical hardwoods from natural forests;
- increased tourism, providing expanding markets for handicrafts and ecotourism;
- specialized export markets, e.g., certified wood products, fair trade NTFPs, and bio-ingredients;
- growing domestic markets for furniture, construction wood and certain NTFPs, such as bamboo, rattan and palm hearts;
- greater awareness of forest certification and ecosystem services and the need to pay for them.

However, most SMFEs are not able to capture fully the benefits from these opportunities. They struggle to advance beyond the start-up stage of business development, exhibiting low levels of output, productivity, value adding and profit. Overcoming these challenges requires concerted action and long-term investments among stakeholders, including SMFEs themselves, their business partners (processors and buyers) and service providers, as well as government agencies and non-governmental organizations (NGOs).

Community forestry goes business

How have approaches to forest sector and community forestry development evolved?



During the 1960s and 1970s, government policies for forest sector development concentrated on inducing growth through large-scale forest exploitation, coupled with increased investment in large-scale timber industries and plantations. Few incentives existed for local development, and little consideration, if any, was given to institutional aspects or the building of local capacity for resource management or business development, resulting in failure in most cases.

Criticism in the 1980s led donors and NGOs to promote greater involvement of local communities in the management of forest resources. Development interventions targeted technical approaches to reforestation and management of natural forests. Following the 1992 Rio conference, conservation, along with economic and social development, began to feature prominently on donor and NGO agendas. Interventions focused on securing resource access and land tenure, decentralizing decision-making in the forest sector, and improving local capacities for sustainable forest management.

Over recent years, a new approach has been emerging that focuses on SMFE development. In countries where communities and small producers have secure land tenure, including rights to harvest and sell forest products, SMFEs have emerged and developed. Mexico now counts hundreds of timber-based SMFEs, many of which have vertically integrated into milling activities. Guatemala's Peten region has an active SMFE sector, with 11 of a total of 14 community concessions organized under a second-tier community forest enterprise. Case studies also highlight the emergence of SMFEs in Bolivia, Peru, Ecuador, Nicaragua, Honduras, Burkina Faso, the Gambia, Nepal and Papua New Guinea. The success of this approach will be determined by the ability and willingness of stakeholders to create an enabling political-legal framework, strengthen the technical, business and financial capacities of SMFEs, and orientate technical, business development and financial services towards the needs of actors along supply chains.

Approaches to forest sector development, 1960s to 2000s

	1960-1970s: export-led growth	1980s: reforestation and food security	1990s: sustainable forest management	2000s: SMFE development
Main development focus	Capital accumulation via exploitation of forest resources	Technical skills development: reforestation and small-scale natural forest management	Social, environmental and economic dimensions of forest management	Increased income through environmentally sound and economically viable community forestry
Principal stakeholders	Export-oriented timber industries	Forest-based communities and industrial reforestation projects	Forest-based communities and timber concessionaires	Forest-based communities and community forest enterprises
Product and/or service focus	Precious woods	Fast-growing plantation species	NTFPs, lesser-known species (LKS) and precious woods	Precious woods, LKS, NTFPs, environmental services and tourism
Key drivers	Governments	Donors and NGOs	Donors and NGOs	Businesses, NGOs and donors

What constraints in the political-legal framework impede SMFE development?

Levelling the playing field

Despite the progress achieved in land tenure for communities and small producers, the overall political-legal framework in tropical countries does not favour the development of SMFEs. The forest sector remains one of the most regulated sectors. Regulatory frameworks were designed mainly to mitigate the environmental impact of large-scale forest extraction, rather than to promote the development of community forest management operations and related value adding. Regulations governing forest product extraction and commercialization, such as permit requirements, are often complex. In some cases, SMFEs are forced to operate without the required permits in order to compete effectively, even when they

sustainability manage their forests. Requirements that SMFEs hire professional foresters to elaborate and execute forest management plans impose additional costs on SMFEs given their typically low production volumes. Government agencies may also require SMFEs to seek approval of the statutes and internal regulations governing implementation and monitoring of their forest management plans. In some cases, appropriate forms of business organization have yet to be developed that take into account the unique institutional arrangements of SMFEs and their pursuit of both social and economic objectives. For example, an SMFE may have little option but to register officially as an NGO or association, thus preventing it from accumulating capital or distributing profits among SMFE stakeholders.

SMFEs consequently develop in a context of incomplete, unrealistic and counterproductive regulations. They often have insufficient social and financial capital to manoeuvre through the bureaucratic processes, and their remoteness only adds to the costs of obtaining information and doing business. Weak or selective enforcement of existing regulations has failed to curb illegal logging and creates unfair competition for SMFEs.

National governments can level the playing field by offering financial incentives for start-up SMFEs. Governments can also reduce the regulatory burdens on SMFEs or favour those with track records for sustainable forest management and, possibly, forest certification. In addition, governments can address regulatory issues related to land tenure clarification, export promotion, and the simplification of bureaucratic requirements for sustainable forest management and processing of forest products. Other promising options are green and social purchasing policies (buying forest products that originate from environmentally friendly and/or socially responsible SMFEs). The market can also be harnessed, for example, by facilitating payments of environmental services, such as biodiversity conservation, watershed protection, carbon fixation and maintenance of scenic beauty through sustainable forest management.

What investments are required to build the technical, business and financial capacities of SMFEs?

Towards more competitive SMFEs

To capture increased benefits in supply chains for forest-based products, SMFEs need to increase their productivity and efficiency. They can start by putting in order their own sets of rules and regulations that govern their organization and administration. Internal conflicts over economic and social objectives (e.g., profits versus employment or social investments) have resulted in increased production and administration costs and lost opportunities for increased value adding through quality enhancement.

SMFE leaders seldom have much experience in business management, accounting or marketing. In many cases, senior management posts are occupied by members of the board of directors, rather than

professional managers, and consequently tend to rotate every few years. This leads to zigzagged learning curves, which require additional investments in human capital formation if economic and other losses caused by improper management decisions are to be avoided. Conflicts may also arise when SMFEs organize into second-level associations for collective (centralized) processing and marketing efforts. Conflicts often relate to the large trade-offs between increased on-site employment at the first level and increased productivity and efficiency through centralized processing at the second level. These situations reflect an overall lack of entrepreneurial vision and restricted access to the specialized support services required for SMFE development.

Most SMFEs need to strengthen their capacity to establish lasting partnerships with other businesses along the supply chain, including specialized processors and buyers. On the one hand, partnerships may offer increased benefit capturing through the formulation of benefit/risk sharing mechanisms, clear labour division and related value adding, and access to specific information and embedded technical, business and financial services. On the other hand, they require that SMFEs communicate and coordinate effectively, and deliver quality products on time and in sufficient volumes. Investments in infrastructure and productivity enhancing technologies and related capacity building are often necessary to meet these requirements, as is innovation in product design and business organization.

Providers of technical, business and financial services, such as government agencies, NGOs, projects, consultants and private businesses, can play a critical role in promoting the development of SMFEs and their successful integration into supply and value chains. Service providers have tended to focus their efforts on building the technical capacities of SMFEs for forest management and conservation and, more recently, for the processing of timber and NTFPs. Relatively little attention has been paid to providing services that promote business development and chain integration. Specialized business development services (BDS) are required for local institutional strengthening and capacity building in business administration, market analysis, strategic planning and business leadership. Providers of financial services have been reluctant to offer services because of the especially high risks involved in SMFEs. Perceptions of high risk stem from the remoteness and isolation of many SMFEs, the cumbersome political-legal frameworks in which they operate, and their limited possibilities for insurance against risk (collateral), in addition to poor understanding of forest product markets and related opportunities and risks.

Market-based delivery mechanisms for business development and financial services can increase the quality and coverage of services available to SMFEs. But their implementation will require significant investments on both the demand and supply sides. For example, on the demand side, SMFEs will need to increase their willingness and capacity to pay for services, as well as increasing their awareness of the services required for long-term SMFE development. On the supply side, there is need to strengthen the capacities of a critical mass of service providers to respond effectively to the demands and needs of SMFEs.

The way ahead

Overcoming the challenges facing SMFE development requires concerted action by the various stakeholders.

The following recommendations emerged from the conference.

SMFEs need to:

- seek out new business opportunities and acquire the capacities to initiate new business models and form mutually beneficial partnerships with other businesses along the supply chain, including processors and traders;
- invest in associations that unite SMFEs for increased economies of scale in processing and marketing, and greater bargaining power;
- foster alliances with technical, business and financial service providers that have an impact on the bottom line and promote strengthened rural livelihoods among community members;
- ensure that productivity and efficiency receive at least as much attention as social and environmental goals through the development of specific institutional arrangements for business management at the community level and among SMFEs.

Service providers and NGOs need to:

- broaden support to include services that effectively promote business development and supply and value chain integration;
- assist SMFEs in formulating their demands for technical, business and financial services, through a process of awareness raising, critical self-assessment, negotiation and mutual trust building;
- identify and strengthen core competencies and establish partnerships with other service providers and businesses that can provide complementary services;
- promote market-based approaches to the delivery of technical and business development services by designing and implementing effective cost/benefit sharing mechanisms with SMFEs;
- make credit accessible to SMFEs: expand the range of credit and saving products available, broaden customer bases, and take measures to reduce transaction costs, for example, by allowing for alternative forms of collateral, improving management information systems, and reducing excessive paperwork.

Governments and international organizations need to:

- create an enabling environment for SMFE development: clear tenure rules, simple business registration and export procedures, and accessible tax and financial incentive schemes;
- facilitate information flows along supply chains, and trade fairs for speciality timber and NTFPs;
- foster market-based approaches to service delivery through innovation payment mechanisms (e.g., vouchers) and upgrading the capacities of service providers to identify and respond to the needs of SMFEs;
- promote increased cooperation among individual service providers for increased impact;
- facilitate multi-stakeholder platforms for facilitating conflict management and community-company links;
- promote communication platforms and networks among SMFEs, providers of technical, business and financial services, and other actors along the supply chain;
- support research for increased understanding of successful cases and sound practices of SMFE development, the underlying critical success factors, and the potential for scaling up.



For further information

For more information about the International Conference on Small and Medium Forest Enterprise Development for Poverty Reduction: Opportunities and Challenges in Globalizing Markets, held in Costa Rica, 23 to 25 May 2006, please visit www.catie.ac.cr/econegociosforestales/conference and www.fao.org/forestry/site/35689/en.

For more information on activities related to SMFE development, please visit:

The Tropical Agricultural Research and Higher Education Center (CATIE): www.catie.ac.cr/cecoeco

Food and Agriculture Organization of the United Nations (FAO): www.fao.org/forestry/site/25491/en

The Interchurch Organization for Development Co-operation (ICCO): www.icco.nl

The International Institute for Environment and Development (IIED): www.iied.org/NR/forestry/index.html

The Netherlands Development Organization (SNV) Collaborative Forest Management Web page:

www.snvworld.org/irj/portal/anonymous?navigationtarget=navurl://a535117edd7b3116e7c7134f47833f26

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