



Supporting small forest enterprises

A cross-sectoral review of best practice



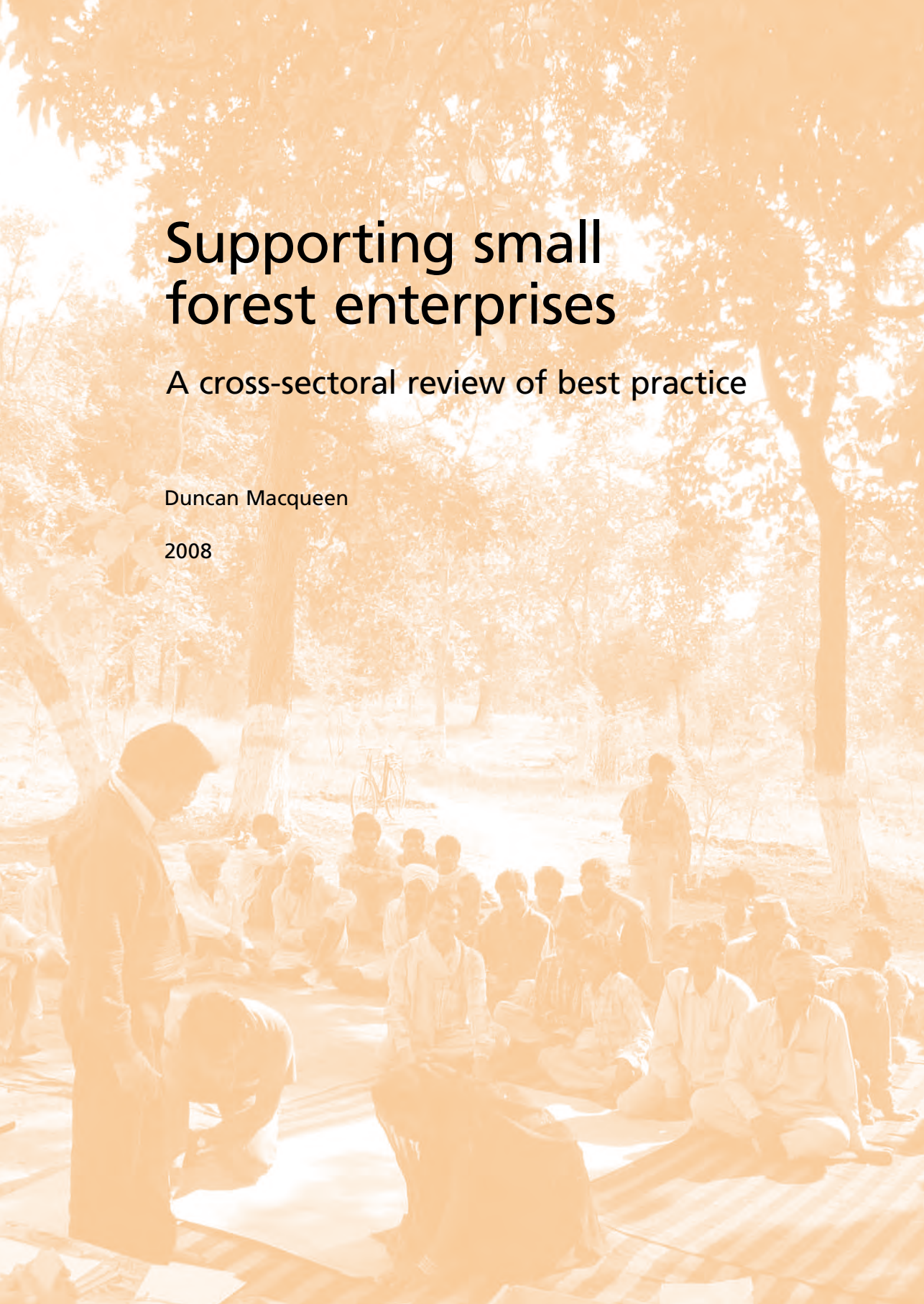
Duncan Macqueen

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2008



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Background: Participatory forest enterprise analysis with rural communities in India.

Top left: Practical training in sawdoctoring in Guyana.

Top right: Transporting logs from remote rural areas in Mozambique.

Bottom right: Timber sales in semi-urban markets in Mozambique.

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The studies listed above pointed on the one hand to the critical role played by local associations in addressing the needs of SMFEs and on the other, the need for a greater understanding of the factors underpinning SMFE association formation, survival, equity and contribution to poverty eradication. Collaborative research on SMFE associations was coordinated in the same six countries from 2004 to 2006. Researchers included Luciene Figueiredo, Noemi Porro and Ligia Pereira (Brazil), Horst Weyerhaeuser, Shao Wen and Fredrich Kahrl (China), Sharon Ousman, Duncan Macqueen and Grace Roberts (Guyana), Sharmistha Bose, Pankaj Lal, Praveen Pareek, Manish Verma and Sushil Saigal (India), Septi Bukula and Mzwanele Memani (South Africa), Cornelius Kazoora, James Ackworth, Charles Tondo and Bob Kazunga (Uganda). From these studies, three important challenges for SMFEs and their associations became apparent:

- ◆ governance biases against small scale (currently a major theme in the IIED-led *Forest Governance Learning Group* (FGLG) that involves teams in seven African and three Asian countries);
- ◆ inadequate market mechanisms to support small forest producers (currently being addressed by IIED-led work on options to 'distinguish community forest products in the market' in Brazil, Guatemala, Mexico and Papua New Guinea) and;
- ◆ lack of institutional mechanisms to connect SMFEs to markets, FS and BDS providers and policy processes that shape the BE (currently being addressed through the Forest Connect within which this document forms a background report).

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Acronyms and abbreviations

ACOFOP	Association of Forest Communities of Petén
ADBN	Agricultural Development Bank of Nepal
AR	Action Research
ASME	Armenia Small and Medium Enterprise, Armenia
ATM	Automated Teller Machine
BDS	Business Development Service
BE	Business Environment
BIOFOR	Biodiversity and Sustainable Forestry project of USAID, Guatemala
CEFE	Competency-based Economies through Formation of Enterprise
DANIDA	Danish International Development Assistance
DFID	UK Government's Department for International Development
EDIAIS	Enterprise Development Impact Assessment Information Service
FAO	United Nations Food and Agriculture Organization, Italy
FGLG	Forest Governance Learning Group
FORCERT	Forest Management and Product Certification Service
FS	Financial Services
GDP	Gross Domestic Product
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
ICT	Information and Communication Technology
IFC	International Finance Corporation
IIED	International Institute for Environment and Development
ILO	International Labour Organisation
MA&D	Market Analysis and Development
MEDEP	Micro Enterprise Development Programme, Nepal
METR	Marginal Effective Tax Rate
nfp	national forest programme
NGO	Non-Government Organisation
NTFP	Non-Timber Forest Product
RIA	Regulatory Impact Assessment
RMA	Rapid Market Appraisal
SDC	Swiss Agency for Development and Cooperation
SEED	Boosting Employment through Small Enterprise Development programme of ILO, Switzerland
SEEP	Small Enterprise Education and Promotion Network of USAID
SIDBI	Small Industries Development Bank of India
SIYB	Start and Improve Your Business, ILO, Switzerland
SMFE	Small and Medium Forest Enterprise
SSA	Sub-sector Analysis
UNCTAD	United Nations Conference on Trade and Development
USAID	United States Agency for International Development
VCA	Value Chain Analysis
VCD	Video Compact Disk
WWF	World Wide Fund for Nature

Executive summary

Small and medium forest enterprises (SMFEs) are the norm in many developing country contexts. They often make up 80–90% of enterprise numbers and more than 50% of forest-related jobs. While there is little evidence that large-scale commercial forestry plays a substantial role in reducing poverty, SMFEs offer better prospects – especially when they work together in associations.

SMFE associations offset scale disadvantages and cut costs, allow surpluses to be used in strategic upgrading, and strengthen bargaining power. They also help to reduce poverty in that they: accrue wealth locally, help to secure resource rights for local communities, empower local entrepreneurship, foster the creation of social capital as they strengthen their voice in local associations, engender greater local environmental accountability and maintain cultural preferences and diversity.

Despite their potential, SMFE associations often struggle, especially in weak economic contexts. Poor transport and communication infrastructure exacerbate business deficiencies. The burden of taxes and regulations often forces SMFEs into informality. This leaves them isolated from markets, ignored by Financial Service (FS) and Business Development Service (BDS) providers and marginalised by prevailing patterns in the Business Environment (BE) – for example, they are often discriminated against in forest access and use legislation or overlooked in the national forest programme (nfp) development processes. The central problem is often lack of connectedness.

A wealth of guidance exists on support to enterprises in general and small- and medium-scale enterprises and their associations in particular. But there is much to do to ensure that this guidance percolates into and transforms the forest sector. And more effort is needed to ensure that non-forest sector support structures are tapped by forest sector initiatives.

There is increasing awareness of the different contexts in which enterprise support is delivered. Useful typologies now exist that differentiate between support in resource-poor, unexploited resource-rich and dynamic economic contexts. Efforts have also been made to identify particularly promising economic opportunities for different categories of the poor in different forest contexts. Central to these developments has been the understanding that enterprise support can have differential impacts on different types of poor people – and that it is important in the design of support programmes to predict and plan to monitor these impacts.

The report reviews the growing consensus on best practice support structures for small and medium enterprises in a framework widely known as ‘market system development’. This framework unites attempts to strengthen enterprise associations, provide Financial and Business Development Services and transform the Business Environment.

Within the market system development framework there is a shift in emphasis – away from providing FS, BDS or BE advocacy directly to a ‘core market’ towards the facilitation of self-

sufficient 'foundation' markets for such services and advocacy functions. A pivotal role in this new approach is that of a neutral facilitator, helping to connect SMFEs to one another, to markets, to FS and BDS providers, and to forest decision-making processes.

An initial dilemma is what to prioritise among the many potential support options. A range of tools exists to help find an entry point. Some of these tools – grouped under the umbrella term of 'value chain analysis' – have already been used in forest sub-sectors, especially furniture, logs and sawn timber, NTFPs and craft, and fuelwood or charcoal. But with a few notable exceptions the goals of such work have been limited to rather restricted recommendations for policy change – rather than full-blooded attempts to bring about SMFE upgrading within an entire core market.

Upgrading for SMFEs can take a number of potential forms – improving production processes, launching new products, cutting out unnecessary intermediaries, diversifying into completely new products or services. Achieving such upgrading usually requires the facilitation of some combination of well-directed FS, BDS and changes in the BE – and often all three together. For example, access to forest sector FS may be conditional on certified sustainable management, which itself requires technical support from BDS and incentives in the BE.

Many guides now exist about providing FS to small and medium enterprises, either through dedicated financial institutions or through lead businesses within the value chain. Strategic alliances between more centralised financial institutions and more localised enterprise associations can often be used to reduce risk and increase outreach to the benefit of both sides. Furnishing clear information on SMFE capabilities and risk assessment helps to encourage FS development.

In many cases BDS markets may also be embryonic. Facilitation can help to develop such markets by providing clear information on what SMFEs need, catalysing collective organisation of SMFEs to reduce transaction costs in service delivery, building the capacity of BDS providers in a 'train-the-trainers' approach, negotiating voucher schemes for BDS together with government agencies and so on. The creative use of new information and communication technologies (ICTs) can be very effective.

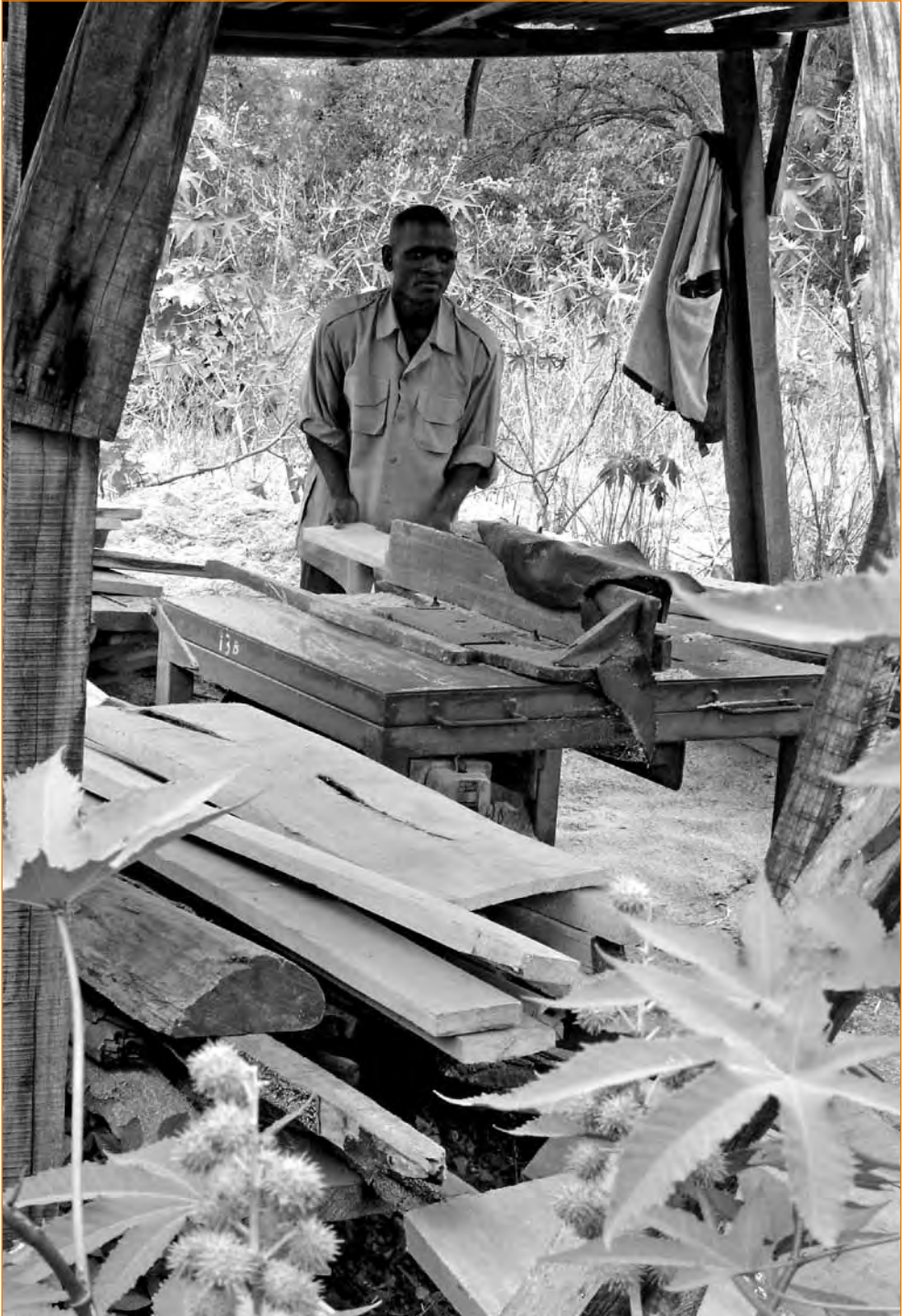
In many forest contexts the BE is stacked against SMFEs. The reasons for this vary – from outdated notions that sustainable forestry requires large-scale investments and long-term concessions – to simple imbalances in financial power and political influence between large and small enterprises. Addressing such issues can be achieved by benchmarking one country's BE against its competitors, publicising specific research that analyses regulatory barriers and impacts, or seeking to improve SMFE representation in public-private dialogues. Facilitators who wish to improve the BE can restrict their inputs to such issues as tax reforms or seek to catalyse major policy overhauls (e.g. using tools such as the 'regulatory guillotine' that renders any legislation invalid unless it is placed on a register by interested parties before a set time limit has elapsed).

In order to provide direction to support programmes for SMFEs it is important to establish adequate criteria for monitoring and assessment. This should go beyond internal perspectives

(such as number of enterprises trained) toward broader indicators based on client perspectives, external evidence of sectoral change and institutional and process development that show longer term market transformation. Because there are likely to be differential impacts of support programmes on different groups of the poor, it is worth paying particular attention in monitoring to the perspective of different 'client' groups – to ascertain how broad indicators of their well-being have been affected by programme activities.

Within the forest sector there are still major information and institutional gaps. These include the persistence of approaches that seek to support SMFEs directly (thereby distorting and damaging the longer term development of FS and BDS markets). Too few detailed value chain analyses of different sub-sectors in different countries exist to provide an informed framework for market system development. There is a general lack of institutional capacity to oversee SMFE support programmes. This is exacerbated in situations where the main forest sector institutions appear blind to business support programmes in adjacent sectors. In addition, enterprise support is frequently seen as an end in itself, and programmes fail to look in detail at the broader impacts of enterprise support on poverty reduction.

A set of recommendations based on the findings of this research are presented in the final chapter with two key audiences in mind: external SMFE support agencies and national facilitators for market sector development in key SMFE sub-sectors. While this report offers some useful preliminary observations, real progress will require a process of action learning in many countries – capturing forest-specific tactics that work within a modular set of guidance materials (a 'toolkit') that allow much greater transferability and spread of these approaches.



Using timber offcuts from a Federal sawmill in Oromia, Ethiopia

Introduction

Preferential support for small and medium forest enterprises (SMFEs) requires some justification. It flies in the face of much conventional practice in which large-scale enterprises are given favourable treatment in forest land allocation, tax regimes, bureaucracy and service provision. This chapter makes the case that SMFEs, especially when organised into associations, merit support on grounds of poverty reduction in its broadest sense. It also introduces a framework to guide what sort of support makes most sense.

1.1 The role of small and medium forest enterprises in addressing poverty

Poverty is more than low income. It involves broader deprivation of well-being, including social isolation and powerlessness (Narayan *et al.*, 2000; Sunderlin *et al.*, 2005). Causal diagrams of the most important common problems of the forest-dependent poor revealed four interlinked issues (Macqueen *et al.*, 2001):

- ◆ the *lack of representation* of the poor and their enterprises in policy and decision making
- ◆ *inappropriate laws and policies* which result
- ◆ *locally weak institutional relationships* without sufficient clout to influence these laws and policies
- ◆ the *isolation* of the poor from supportive infrastructure and services

These findings echo other definitive reviews of the forest–poverty link (Angelsen and Wunder, 2003). The implications are clear. If we are to address forest-based poverty we need to tackle social isolation and powerlessness. In other words, we need to connect SMFEs better to the sources of support that they require in order to be economically viable, socially acceptable and environmentally sustainable. The need to connect SMFEs to sources of support is most acute in weak economic contexts where government resources do not provide the infrastructure, information technology or networking opportunities for small forest enterprises to flourish on a sustainable basis.

There is much at stake. Approximately 60 million indigenous people depend primarily on natural forests for their livelihoods. A further 350 million rural people rely on the forests as a safety net or for supplemental income. Up to 1 billion more grow trees on farms or manage remnant forests for subsistence and income. Some 45 million people run or are employed by forest enterprises (Scherr *et al.*, 2004).

Huge numbers of small and medium forest enterprises already exist. Rough estimates suggest that they make up 80–90% of forestry enterprises and over 50% of forest sector employment in many developing countries (Macqueen and Mayers, in prep; Mayers, 2006a; Kozak, 2007).

SMFEs are here defined as ‘business operations aimed at making a profit from forest-linked activity, employing 10–100 full-time employees, or with an annual turnover of US\$10,000–

US\$30 million, or with an annual roundwood consumption of 3,000–20,000 m³. They may operate in any one of a number of different sub-sectors:

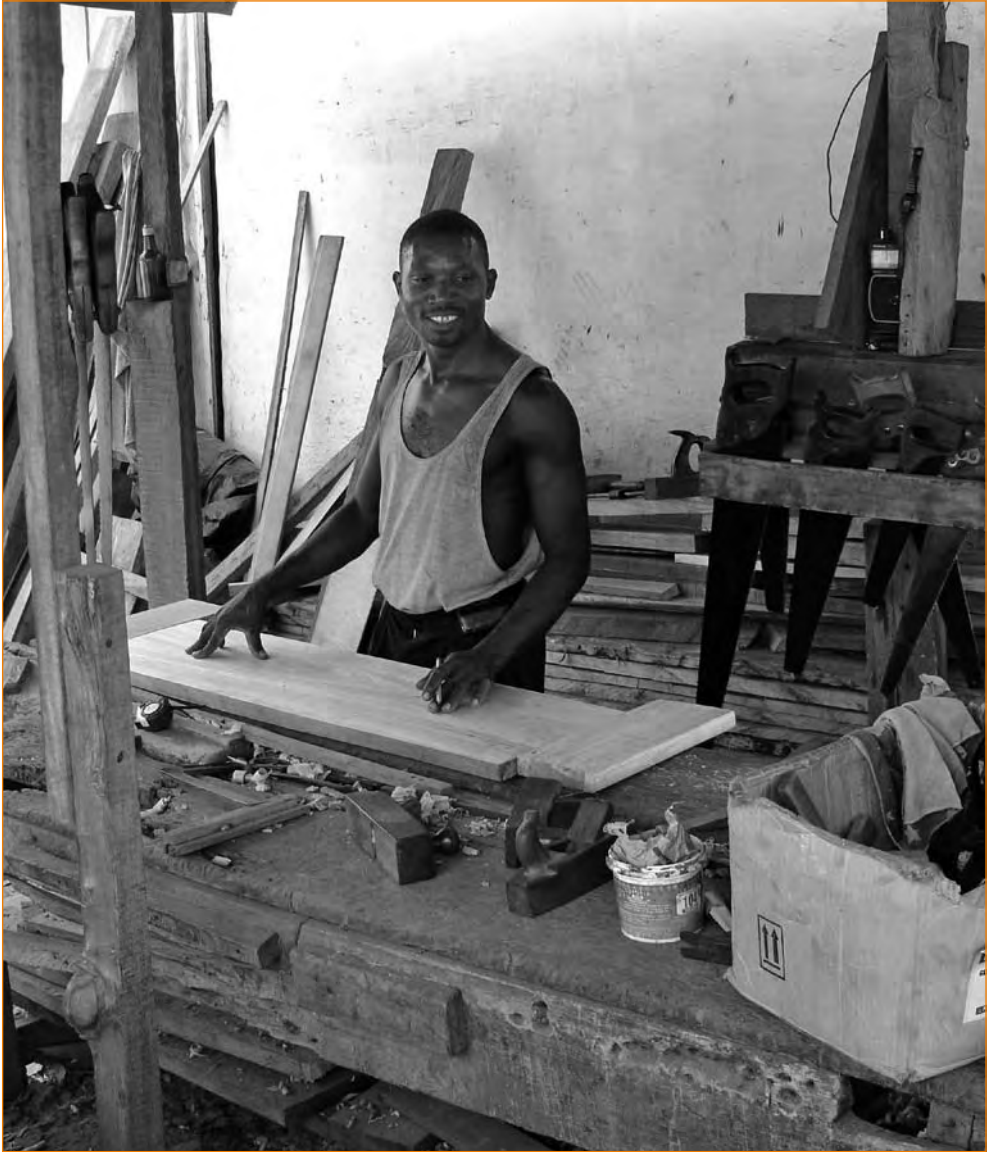
- ◆ woodfuel and charcoal
- ◆ industrial roundwood
- ◆ primary processed products
 - ◆ sawn wood
 - ◆ wood-based panels
 - ◆ pulp for paper
 - ◆ paper and paper board
- ◆ secondary processed wood products
 - ◆ furniture and parts (wooden chairs, office, kitchen or bedroom items etc)
 - ◆ builders' joinery or carpentry (cellular wood panels, parquet panels, shingles and shakes)
 - ◆ shaped wood (unassembled parquet, strips, friezes, tongued, grooved, beaded, moulded, rounded etc)
- ◆ non-timber forest products
 - ◆ fruits, nuts and seeds
 - ◆ oils and resins
 - ◆ fibre products
 - ◆ ornamental plants
 - ◆ medicinal plants
- ◆ services (tourism, biodiversity conservation, watershed protection, carbon sequestration etc)

SMFEs share many features with non-forest SMEs. But they also face four peculiar challenges of complexity:

Tenure and resource access is complex. SMFEs based on natural forests (less so for plantation forests) involve extensive areas of land over which the tenure and resource rights may be poorly defined or disputed. Long-term sustainability depends very much on the security with which local enterprises can defend their resource rights in competition with other land users.

Ecological sustainability requires complex technical expertise. The sustainable management of natural forests requires a detailed understanding of natural ecology and regeneration based on the application of complicated inventory, growth and yield modelling, extraction planning and reduced impact logging techniques.

Commercial profitability is dependent on complex markets. Natural forest product sales require the ability to find markets for multiple species (both timber and NTFPs) whose prices depend on species, quality grading and known processing information. Again this requires a high degree of technical competence and often investment in processing technology.



Local carpenter making beehives for sale in rural Ghana

Patterns of consumption are complex. Forest products (excepting some NTFPs and fuelwood) are not generally consumed on a day-to-day basis. For consumers, their purchase often involves significant lifestyle choices. Design and marketing are therefore especially important for many SMFEs, which again requires technical competence and financial investment.

In summary, SMFEs are peculiarly dependent on the stability of the Business Environment (BE) and on the availability of Financial Services (FS) and Business Development Services (BDS) providers (see Auren and Krassowska, 2003; Lewis *et al.*, 2003; May *et al.*, 2003; Saigal and Bose, 2003; Sun and Chen, 2003; Thomas *et al.*, 2003).

Although there is little substantive evidence for poverty reduction from commercial forestry jobs or income (Mayers, 2006b), SMFEs offer better prospects because of specific social advantages compared with large forest enterprises. For example, SMFEs tend to be better placed to address some of the broader dimensions of poverty that affect the forest-dependent communities (Macqueen, 2004; Macqueen 2007b) by accruing wealth locally, securing resource rights and access for local communities, empowering local entrepreneurship, helping to build social capital through local business associations, engendering greater local environmental accountability and responding to cultural niches, thereby preserving cultural identity.

1.2 The importance of SMFE associations

Many small forest enterprises spontaneously work together in successful associations to reduce transaction costs, adapt to new market opportunities and shape the policy environment in their favour (see Bose *et al.*, 2006; Bukula and Memani, 2006; Campos *et al.*, 2005; Figueiredo *et al.*, 2006; Kazoora *et al.*, 2006; Ousman *et al.*, 2006; Weyerhaeuser *et al.*, 2006). This improves the viability of SMFEs and their ability to address poverty (Macqueen *et al.*, 2006). Forest-based associations fall broadly into two categories:

- ◆ large industrial groupings or umbrella bodies that champion the needs of a particular sector (e.g. manufacturing associations, timber or forest product associations, non-timber forest product associations)
- ◆ small forest enterprise associations, often community-based, that act together in support of local livelihoods

Research has shown that the former often champion large-scale interests while the latter are critical, or could be critical, in meeting basic needs. They act as the front line for poverty eradication – managing rural enterprises for income generation, controlling access to resources to ensure some semblance of sustainable management and resolving local conflicts at the fragile forest/agriculture interface.

Forest associations of the latter type are often poorly resourced. Many fail and the reasons for this are poorly documented. In some cases associations are subverted and commandeered to serve covert purposes. For example, an association official that represents powerful interests may turn the decision-making process to the advantage of his/her sponsor – quickly bringing an association into debt peonage (“I lend your association my tractor/trailer and you pay me

back with quantities of timber which far exceed the value of the original loan"). More work is needed to understand these types of failures and to compare successful associations with the advantages and disadvantages of sporadic and specific temporary alliances – to shed better light on when an entrepreneur should use alliances and when he/she should work alone.

1.3 The central problem of lack of connectedness

SMFEs and their associations are embedded in social and commercial networks that affect critical business inputs, and their competitiveness depends to a large extent on the quality of these linkages (Altenburg, 2007).

A number of factors conspire to make it difficult to link SMFEs in more useful ways (see Figure 1). For example, their geographical dispersal, the small individual scale of many SMFE associations and informality (particularly widespread in developing countries where tax and social security burden and the intensity of regulations/procedures are highest (Schneider, 2002; Becker, 2004) and often weigh against SMFEs joining the formal economy).

There are three main areas of isolation:

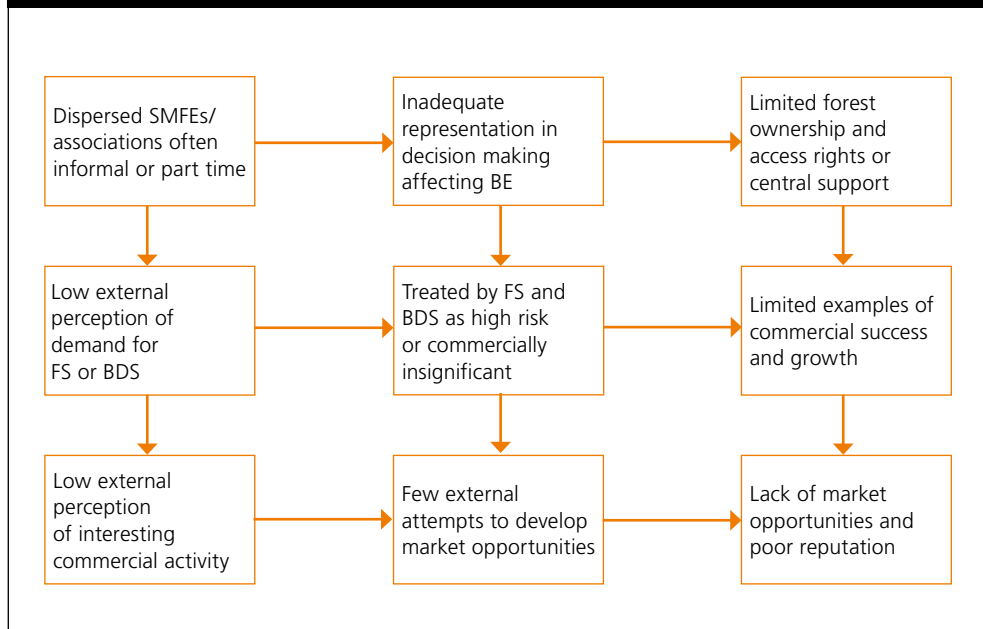
- ◆ isolation from buyers, who may be unaware of the products or services available
- ◆ isolation from FS and BDS providers, who are unaware of commercial opportunities to be developed
- ◆ isolation from policy processes such as nfps where their needs might be represented (for example in securing better ownership and access rights)

Examples of such lack of connectedness include Burkina Faso (Ouedraogo, Y. & Conditamde, 2006), the Atlantic coast of Nicaragua (Nicholsen *et al.*, 2006) and the indigenous areas of Western Canada (Mitchell and Brigham, 2006).

The lack of connectedness of small forest enterprise associations has important implications for market development. Market transactions require trust. Buyers need to have confidence that they will get what they have ordered. Communication difficulties with SMFEs and their associations often result in a failure to meet buyer specifications. Distance and poor transport infrastructure provide a major challenge to competitive pricing and timely delivery (Kwisthout, undated).

Lack of connectedness has negative implications for FS and BDS providers (Hitchins *et al.*, 2004). For FS providers, it confirms that forest-based enterprises are 'high risk', lacking business volume, and in particular, recognised collateral. Association members may have secure resource tenure, but may be prohibited by law or by social custom from using that tenure as collateral. For BDS providers, a lack of awareness of the scale and nature of SMFEs and their associations constrains their willingness to develop appropriate services.

Figure 1. Simplified matrix of the implications of lack of connectedness of SMFEs and their associations



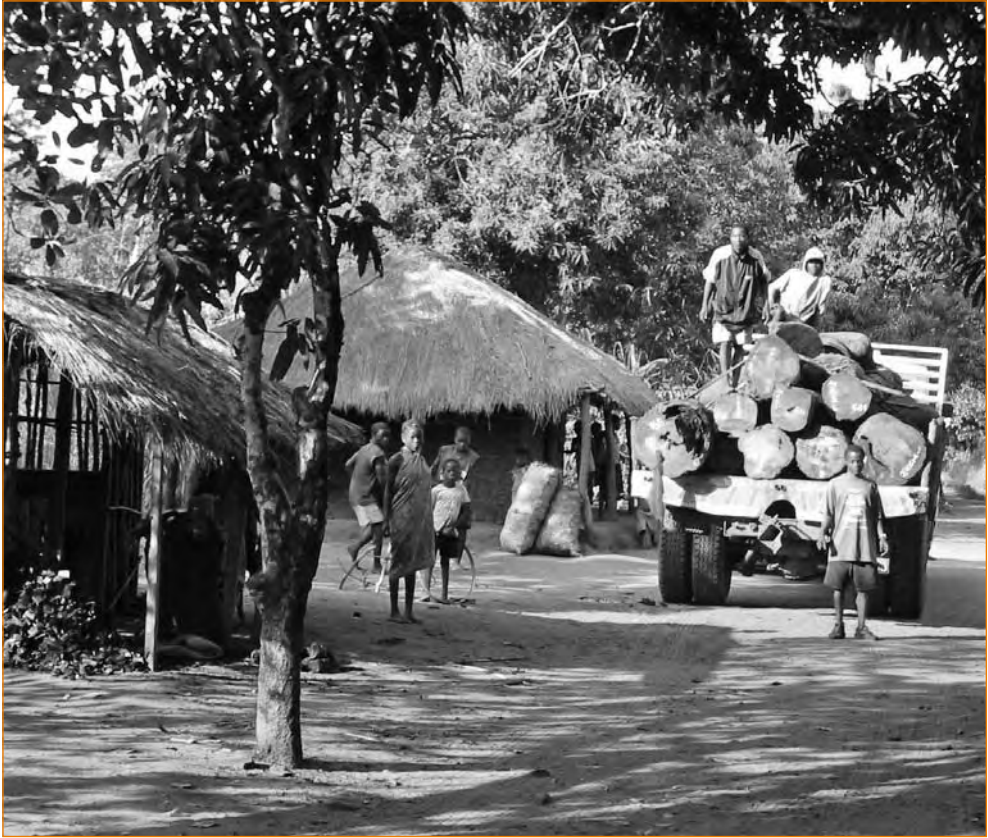
Lack of connectedness also has negative implications for the development of improved policies and legislation. Larger forest enterprises with offices in major cities are often better connected to policy and decision makers – and more likely to attend consultations that shape resource ownership and access legislation. The lack of representation from SMFEs and their associations can lead to the development of legal frameworks that treat them unfairly.

1.4 The need for a concept such as Forest Connect

Connecting SMFEs requires in-depth analysis and direct facilitation that builds a multi-directional flow of information between SMFEs and their associations and buyers/service providers/policy processes. Any framework of facilitation must address at the very least:

- ◆ what information is needed, and by whom
- ◆ how that information can be made available to those people (on a basis that is commercial and therefore sustainable)
- ◆ which institutions should be responsible for making that happen (given the specific context in each country)

There are several good examples of facilitation that have helped SMFEs and their associations – for example, the Business Service Providers in Cameroon (Spik, 2006), the Servicio Florestal Amazonico in Ecuador (Romero, 2006), the CUPROFOR foundation in Honduras (Cerna, 2006),



Transporting logs from remote rural areas in Mozambique

the Bolivian CIEPLANE system (Alvarado and Torres, 2006), and the service provision arm of the Grupo de Trabalhadores da Amazonia in Brazil. Such facilitation can:

- ◆ Promote the formation of associations and strengthen existing ones through capacity building
- ◆ Connect specific SMFEs or their associations to markets, service providers and policy processes such as nfps
- ◆ Enhance generally the visibility of SMFEs and their associations to one another, potential buyers, service providers and policy and decision makers
- ◆ Enhance the visibility of service providers and the coordination between them to SMFEs
- ◆ Identify and communicate gaps in service provision or the enabling environment (e.g. for using standing forest as financial collateral for loans)

- ◆ Strengthen service provision capacity through the creation of an information service/ support network
- ◆ Involve government nfp processes from the beginning to enhance official buy-in, if desirable – but not always (corrupt intervention is worse than absence of government buy-in)
- ◆ Manage the transition to a self-financing institutional model

While some good institutional examples exist, they are rather thin on the ground. The alliance that is 'Forest Connect' aims to spread good practice more broadly. It is still rare to find specialist SMFE support units either embedded in government forest services or operating independently in the market. In the following chapter we chart some of the latest advances in the theory of supporting SMEs – and how these have begun to emerge in the forest sector.

Best practice trends that could help small and medium forest enterprises develop

Poverty reduction will not solely be brought about by income generation. It is also important how that income is distributed and whose rights, security, entrepreneurship, social capital, environmental accountability and culture are strengthened in the process. This chapter introduces the main ingredients that are usually found in SME support programmes (for further information please see Annex 1). It goes on to explore recent advances in approaches and tools for small enterprise support – and then concludes with some examples of the emergence of these approaches and tools in the forest sector.

2.1 Introduction to small and medium enterprise support programmes

Support programmes for SMEs need to pay careful attention to the context in which they hope to operate. In remote rural areas a useful emphasis might be the provision of infrastructure such as communication services (mobile telephony etc), while in more dynamic economic contexts a useful area of support might be reducing bureaucratic transaction costs (Lanjouw and Feder, 2001).

Critical to any preliminary analysis of enterprise support is an assessment of potential areas of growth. Interventions may increase supply only to lower prices, or redistribute supply between producer groups – potentially hurting the most vulnerable groups. Useful typologies and decision trees have been developed to characterise the overall enterprise environment and pick site-specific motors of growth (Haggblade *et al.*, 2002).

In the forest sector, different approaches are needed for forest rich and forest poor areas, or for stable and post-conflict situations. Scherr *et al.* (2004) develop a useful typology of the more promising options for different categories of the forest-dependent poor in different situations. It is important to distinguish between (i) support to help the very poor survive and avoid descending into greater poverty, and (ii) support that will build assets sufficient to climb out of poverty.

For successful support it is also vital that equity concerns are made central throughout. For example, it matters what type of enterprise is targeted for support (Macqueen, 2007). Targeting support towards for-profit corporate models of business may have very different poverty impacts from the same support targeted at non-profit cooperative models of business. Evidence from the forest ejidos of Mexico suggests that the latter forms of business can indeed be economically competitive and resilient – while also delivering greater economic equity and environmental stewardship (Antinori and Bray, 2005).

The main ingredients in support programmes to date have been threefold:

- ◆ Support for the provision of financial services
- ◆ Support for the provision of non-financial business development services
- ◆ Support for changes within the business environment

Financial Services (FS) provide investment, working capital, insurance and savings facilities (UNCTAD, 2001; FAO, 2005), sometimes provided by businesses to one another in the value chain and sometimes from financial institutions such as:

- ◆ Commercial banks
- ◆ Specialised financial instruments for SMFEs
- ◆ Venture capital funds (equity finance)
- ◆ Financial cooperatives and credit unions (e.g. group lending schemes)
- ◆ Insurance companies
- ◆ Leasing programmes

Business Development Services (BDS) provide a range of non-financial inputs (Tanburn *et al.*, 2001):

- ◆ Operational or generic services
 - ◆ Information technology services and advice
 - ◆ Training and skills development (e.g. management of accounts)
 - ◆ Business advice and counselling (e.g. compliance with regulations)
 - ◆ Technology information and advice
 - ◆ Courier and delivery
- ◆ Strategic or specific services
 - ◆ Strategy and operations consulting
 - ◆ Networking and brokering
 - ◆ Market information and research
 - ◆ Product and packaging design
 - ◆ Advertising and trade fairs

The Business Environment (BE) includes the range of policy, legal and regulatory and institutional frameworks (White, 2004) that shape the macro-economic environment and influence business performance together with the infrastructure and socio-cultural context that impinges on businesses. The main components of the BE can be defined as:

- ◆ Macro-economic policies in general
- ◆ The legal and regulatory framework that translates policies into practical laws and regulations – with their associated cost of compliance
- ◆ The institutional (or organisational) framework that coordinates the regulation, promotion, monitoring and representation of the macro-economic environment and small and medium enterprises in particular

- ◆ The provision of infrastructure such as roads, market outlets, communication technology and the above mentioned services
- ◆ The socio-cultural context, including issues such as levels of health, education, attitudes to work, trade and profit

2.2 The move towards facilitation of market system development rather than provision of services

Traditional approaches to support SMEs have sought either to intervene at the level of FS or BDS, providing public services directly to small enterprises or permanently subsidised services delivered by other FS and BDS service providers. In other words they have favoured supply side intervention rather than more flexible demand-led interventions (EDIAIS, 2003a and EDIAIS, 2003b). In general they tended to have poor reach and low sustainability, often driving out more sustainable private provision of the same services.

As a result, there has been a recent paradigm shift away from direct provision towards the **facilitation of a sustained increase in the demand and supply of services** (Tanburn *et al.*, 2001) (see Figure 2).

The new paradigm is often referred to as **market system development** – distinguished by its broad vision of a well-functioning market, defined (Miehlbradt and McVay, 2006) as:

- ◆ An expanding market (growing sales, increasing numbers of firms or employees and strong linkages to other markets)
- ◆ A resilient and responsive market (increasing diversity of products, trusting business relationships, innovation in the face of market shifts, and improving information services)
- ◆ A market that channels benefits to the poor (increasing poor peoples' participation, offering increasing choice, and meeting core social and environmental standards)
- ◆ A supportive business environment (policies and regulations free from corruption, transparent, efficient and enhancing public-private cooperation)
- ◆ The presence of a change driver (facilitating the above)

The notion of facilitation is at the heart of this new approach. There are many potential endpoints of such facilitation, for example (Dunn *et al.*, 2006):

- ◆ Process upgrading – increasing production efficiency – either to produce more outputs for the same input or the same level of output for less input
- ◆ Product upgrading – qualitative improvements that make a product more desirable to consumers

- ◆ Functional upgrading – entry of an enterprise into higher value-added levels by taking on the role of intermediaries
- ◆ Channel upgrading – entry of an enterprise into higher value-added levels by product diversification

Critical to this approach is that facilitators do not provide actual services; they act independently (and often temporarily), performing functions such as: identifying needs for services, building capacity to provide those services and linking service providers with those who most need them. They may be financed externally by donors or internally by institutions such as enterprise associations.

Neutral facilitation (with no commercial stake in the market) is often preferable to ensure transparency and trust and to maintain a focus on poverty eradication (Kaplinsky *et al.*, 2003; Roduner and Gerrits, 2006). Facilitation requires an impartial understanding of the roles of different players in the market – and who is supplying who and on what basis.

Some guiding principles of best practice suggest that such facilitation seeks to:

- ◆ Install the notion of a market approach (e.g. that service provision should involve commercial transactions, whether full fees are charged or not)
- ◆ Ensure that the interventions are demand driven (i.e. perceived by the recipient enterprise, endorsed or stimulated by the analysis of the service provider and sufficiently important to generate willingness to pay)
- ◆ Promote a strong sense of ownership by both recipient and service provider – giving preference to service providers who are from or understand the context of recipients
- ◆ Strive for maximum outreach – using channels which are likely to deliver that aim, which will often involve promoting competition between service providers
- ◆ Aim for quality and cost effectiveness such that recipient enterprises see value for money – and service providers expand their business
- ◆ Encourage regular monitoring of the impact of service provision so that it evolves in line with the needs of recipients

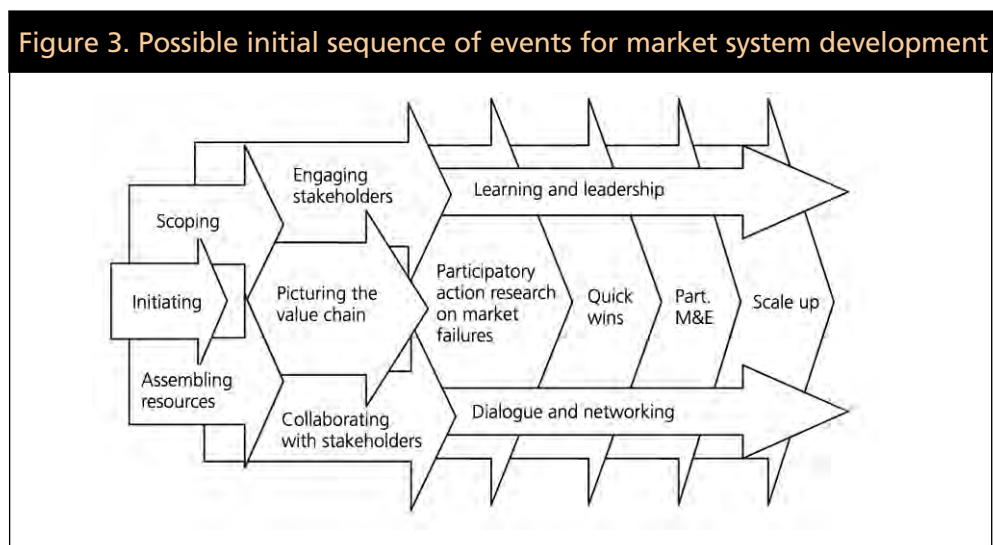
2.3 Entry points for facilitating market system development

There are various entry points for facilitation of market system development. Options include (Miehlbradt and McVay, 2006):

- ◆ Leading with an analytic approach (Emerging Markets Group, 2006), for example conducting a market survey
- ◆ Launching into action research to learn more about the market as engagement takes place and allow lessons and business partnerships to emerge (Adhikary and McVay, 2006)
- ◆ Engaging and backing industry leaders such that market expansion stimulates an overall industry change process
- ◆ Catalysing, through market analysis, the formation of organised groups such as community groups or business associations (Albu and Griffith, 2005)
- ◆ Letting social issues drive the strategy – for example strongly felt views on working conditions, gender issues or the environment (Millard, 2006)

Once a core market (a clear set of products or services and all businesses involved in trading them in a set geographical area) and entry point have been defined, market system development typically involves a 'cycle of engagement' or an '**iterative sequence of steps**' (see Figure 3).

The sequencing shown ties in closely with the description of generic steps that are needed to facilitate better service provision (EDIAIS, 2003a):



Source: Adapted from Miehlbradt and McVay, 2006, based on Wältring, 2006

- ◆ Survey the existing market in which SMFEs and their association procure FS and BDS (see section 2.4). Analyse the survey findings. Try and distinguish which shortcomings are due to a lack of FS and BDS provision and which are due to more general problems in the enabling environment. Together with the existing FS and BDS providers, assess how best to address the shortcomings that are specific to FS and BDS provision
- ◆ Focus on particularly promising locations, sub-sectors and SMFEs and their associations. Identify who might best facilitate better service provision within those particular contexts
- ◆ Examine the issues relating to the business environment. Identify a strategy and contact person to link better to decision makers who can effect changes in the enabling environment to improve the situation for SMFEs and their alliances
- ◆ Develop an exit strategy such that facilitation eventually passes to SMFE associations and to FS or BDS providers who have strong incentives to continue to expand their provision of services to SMFEs

Especially in weaker economic contexts it may be difficult to follow a strictly market-orientated approach. This is because there may simply be too few FS or BDS service providers to constitute a 'market' for such services, in any real sense of the word. Wältring (2006) notes that in some contexts it may be necessary first to invest considerable time in creating awareness of the importance of market system development. Initial options may be restricted to institutional strengthening, support of a few specific service providers, and small demand-led interventions. For this reason, a strong public relations capability is an important prerequisite for any facilitator, with the capacity to publicise early 'quick wins' and so generate further interest.

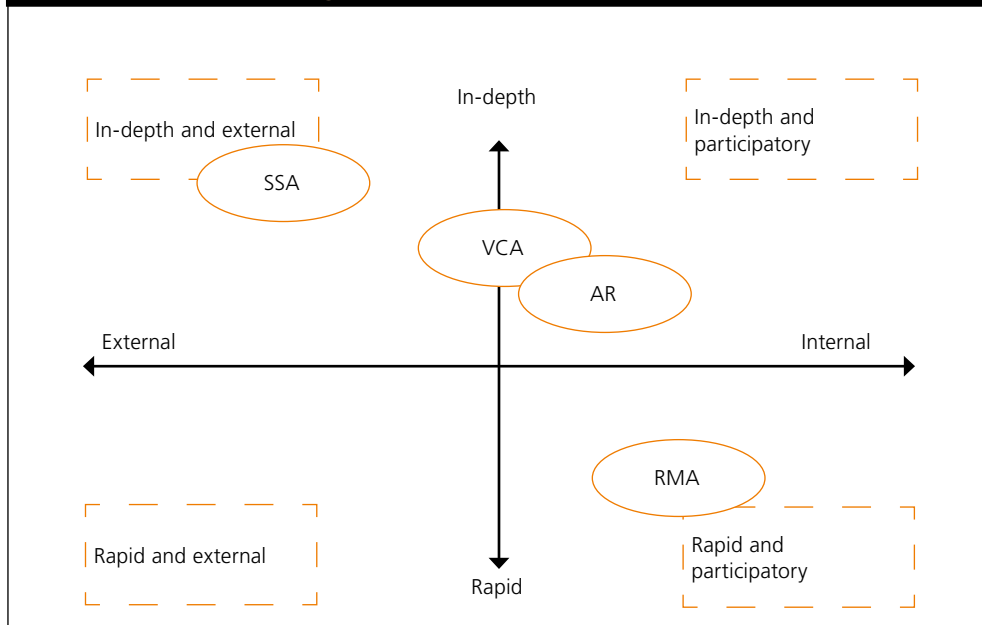
2.4 Tools to guide facilitation of market system development

Except in cases where donors induce a value chain out of nothing (e.g. through enterprise start-up), there are always enterprises, market structures and processes in place. Between such enterprises, there exist business relationships with associated fee-based, embedded or informal services, formal and informal laws and rules of behaviour, and prevalent power relations (Roduner and Gerrits, 2006).

Any facilitation that seeks better links to markets, service providers and policy processes must first understand the nature of these value chains that exist. There are tools to help gain such an understanding – together broadly referred to as **value chain analysis**. Different tools exist depending on the degree of participation required, and the time available. For example, sub-sector analysis (SSA), value chain analysis (VCA), action research (AR) and participatory rapid market appraisal (RMA) all occupy different positions in these two dimensions (see Figure 4).

SSA and VCA are both in-depth analytical approaches which emphasise gathering information about how the sub-sector or value chain is structured and how this affects the behaviour or conduct of enterprises within that sub-sector or value chain. It requires the collection of data in a systematic fashion and is thus time and skills intensive and often externally funded.

Figure 4. Possible value chain analysis tools that involve differences in participation and timing



Source: Roduner and Gerrits (2006)

AR is less systematic and seeks to gather information about the value chain while working with enterprises, service providers and policy makers to address key issues of concern.

RMA builds on approaches such as participatory rural appraisal and pays much more attention to the participation and perceptions of key actors in the value chain – i.e. the ownership of the information generated.

In practice, many tools and attempts at value chain analysis merge these different approaches. At its simplest, value chain analysis involves (Mayoux, 2003):

- ◆ Mapping the chains involved in particular production sectors – the different types of activities, geographical location and actors in different roles at different levels
- ◆ Following up with quantitative and qualitative research that investigates the relative distribution of ‘value’ and the reasons for inequalities and/or inefficiencies and blockages in the chain
- ◆ Based on that analysis – identification of potential ‘leverage points’ for upgrading the chain as a whole or redistributing the value within it in favour of those who gain least from it

The precise focus will be determined by the aims of the analysis. For example, some institutions may wish to ensure decent work opportunities over and above giving more enterprises market

access. For others, market access for enterprises may take precedence over considerations such as employment conditions (Altenburg, 2007).

Many practical guides have been produced to help facilitators through the process of value chain analysis. Of particular note are the guides produced by FAO on Market Analysis and Development (MA&D), which treat forest issues in particular and cover not only value chain analysis, but also give considerable guidance on participatory capacity building for SMFEs (Lecup and Nicholson 2000; 2006). Many other good guides to value chain analysis are listed below:

- ◆ The handbook for value chain research (Kaplinsky and Morris, 2000)
- ◆ Manual for value chain research on homeworkers in the garment industry (McCormick and Schmitz, 2002)
- ◆ Participatory value chain analysis (PVCA) for pro-poor enterprise development (Mayoux, 2003)
- ◆ Capacitating sector analyses – a practical training methodology to analyse value chains (HPC, 2003)
- ◆ Info-Cadena. Instruments to foster value chains (Springer-Heinze, 2004)
- ◆ Value chain analysis for policy makers and practitioners (Schmitz, 2005)
- ◆ Mapping the market: a framework for rural enterprise development policy and practice (Albu and Griffith, 2005)
- ◆ Design of Strategies to Increase the Competitiveness of Smallholder Chains Field Manual. (Lundy *et al.*, 2004)
- ◆ A guide for value chain analysis and upgrading (ILO, 2006)
- ◆ ValueLinks Manual. The methodology of value chain promotion. (GTZ, 2007)
- ◆ Making value chains work better for the poor – a toolbox for practitioners of value chain analysis (Van den Berg *et al.*, 2007)

These guides often break down value chain analysis into a series of more discrete tools or analytical approaches. For example, Van den Berg *et al.*, (2007) describe eight tools for: prioritising value chains that are likely to be pro-poor, mapping them, calculating costs – and margins of actors within them, analysing technology and upgrading options, incomes and employment, assessing governance and service provision, and identifying useful linkages.



Selling FSC certified timber from Amazonian communities in a major DIY retailer, Sao Paulo, Brazil

2.5 The emergence of these new approaches and tools in the forest sector

Early work on small and medium forest enterprises from the 1980s is reviewed by Townson (1995). It was soon clear that it was necessary to differentiate between value chains that performed 'safety nets' functions (with little prospects for pulling people out of poverty) from more rewarding value chains (Arnold, 2006). With the advent of value chain analysis, a growing number of studies have looked in detail at specific forest sector value chains including logs and processed timber, charcoal and fuelwood, non-timber forest products and woodcarving.

Notable examples of log value chain analyses include those of the softwood and hardwood log trade from Russia and Myanmar to China (Weiming *et al.*, 2007; Kahrl *et al.*, 2005). These analyses examine who was profiting from the current value chains that included both large and small enterprises. They highlight both how precarious SMFE survival can be if based on unsustainable logging, and how necessary it is to work together in order to improve market information and bargaining power in the marketplace. Recommendations from these reports are largely aimed at improving the business environment and inter-firm collaboration.

The global wood furniture value chain with a specific analysis of prospects in South Africa was more closely focused on market system development (Kaplinsky *et al.*, 2003). By looking at the full value chain, from developing country producers to specialist buyers, and single and multi-store retailers, it was possible to identify particular options for upgrading in South Africa. Buyers might play a limited role in such upgrading. They saw their role as giving clear signals to suppliers on demand – and were prepared to help on functional upgrading – but would discourage any attempt to gain expertise in buying/retailing (their core area of expertise). Upgrading therefore also requires cooperation at the supplier end in developing countries.

Critical to the South African case was the development of a network of government departments, timber product manufacturers, timber traders, timber growers and mills, and industrial specialists. This network allowed cooperation between firms with considerable progress in upgrading inter-firm processes (and more limited success in product upgrading and functional upgrading). Neutral external facilitation was a critical element in the success of the network – overcoming mistrust between firms that had hampered early attempts to improve value chains (Kaplinsky *et al.*, 2003).

Other notable examples of furniture value chain analysis come from Bangladesh (Katalyst, 2005) and Indonesia (Posthuma, 2003, Loebis and Schmitz, 2005). In Bangladesh a number of FS and BDS service priorities were identified. In Indonesia, the main concerns of these analyses are the race to the bottom that might ensnare small and medium enterprises that become reliant on widely available illegal and unsustainable timber. A priority for BDS was the strategic deepening of specialised skills (including design, branding and marketing) and entrepreneurial talents. Because some value chain relationships are hierarchical and lead firms do not allow the development of design capacity – it may be necessary for clusters of furniture producers to target specialised market relationships where the development of design capacity is encouraged.

The charcoal trade has also been the subject of value chain analysis in several countries – again primarily addressed at improving the business environment. Analysis in Senegal noted how real markets, and the value added at each stage of the value chain, are affected by a huge range of factors, many of them beyond the ambit of formal policies and laws (Ribot, 1998). Simply increasing local control over forest resources, or insisting on the formation of producer cooperatives, or removing the state requirements for charcoal merchants to obtain a licence may not help charcoal SMFEs in situations where what happens on the ground is not controlled by policies and laws, but by powerful elites and vested interests.

In Malawi, value chain analysis of the charcoal trade has identified the complex web of vested interest, corruption and illegality that favours some producers over others (Kambewa *et al.*, 2007). By legalising charcoal production in non-reserve areas, and introducing an appropriate taxation system, charcoal enterprise could be encouraged to upgrade both the efficiency and sustainability of production. But all charcoal production is currently deemed illegal – and what can and cannot be traded therefore depends on the discretion of powerful elites, not on the competitiveness of the enterprises in question.

In the field of Non-Timber Forest Product (NTFP) commercialisation, value chain analyses have been conducted in specific countries such as Bolivia and Mexico (Marshall *et al.*, 2006). Detailed analysis of particular value chains can identify key entrepreneurs who spread successful practices of commercialisation through informal or formal networks/associations – and how these can then become the targets of facilitation towards market system development (Willem te Velde *et al.*, 2006). Specific gendered value chain analysis can help to identify ways to promote inclusion of women in value chains and value adding (Anon, 2004).

These same messages are echoed in recent overviews of the woodcarving industry (Cunningham *et al.*, 2005). In regions such as Bali, Indonesia, highly skilled and well-organised woodcarvers are linked to entrepreneurs connected to export markets, supported by enabling government policies (e.g. the distribution of seedlings of carving species). The carving industry is not only highly profitable, but also environmentally sustainable, with 24,000 woodcarvers in Bali, most making a good living from their trade. Similar progress has been made in Kenya, where the organisation of a carving cooperative is now complemented by the organisation of the Coast Tree Farm Association of tree growers – both Forest Stewardship Council and Fair Trade Organisation certified (Jembe, 2006). By way of contrast, Zimbabwean woodcarvers produce large quantities of relatively low-quality, low-value carvings from an open-access resource. The result is over-exploitation of some of the country's forests and continuing poverty among producers (Matose, 2005; Cunningham *et al.*, 2005).

In summary, the tool of value chain analysis (in its broadest sense), and the approach of market system development have emerged in at least some forest sector programmes. The following chapter looks in more depth at some of the mechanisms that are employed to translate analyses into practical support.

Mechanisms that could improve support for small and medium forest enterprises

This chapter looks in depth at how to achieve the goal of facilitation – a well-functioning market that channels benefits to the poor. Facilitators must have an understanding of the cycle of potential innovation within a particular value chain – and what financial services (FS), business development services (BDS) or business environment (BE) inputs are needed to enable upgrading of different sorts (see Figure 5). It should be noted that different types of upgrading do not necessarily follow a cyclical or linear pathway.

Research on innovation in the forest sector suggests that successful upgrading is most likely when there is strong market pull, for example the need for a new, better or cheaper product. It is less successful when driven by a technology or resource push, for example, the availability of lots of timber residue that could be used (Bull and Ferguson, 2006). Successful upgrading is also linked to a high degree of specific knowledge about what needs to change (Rametsteiner and Weiss, 2006). Successful upgrading is also assisted by an enterprise culture in which an individual champions the innovation, but with firm-wide support and flexible management for change (Bull and Ferguson, 2006).

In the sections that follow we explore recent thinking on supporting such innovation and upgrading through the provision of FS, BDS and enabling BE – plus monitoring of the above.

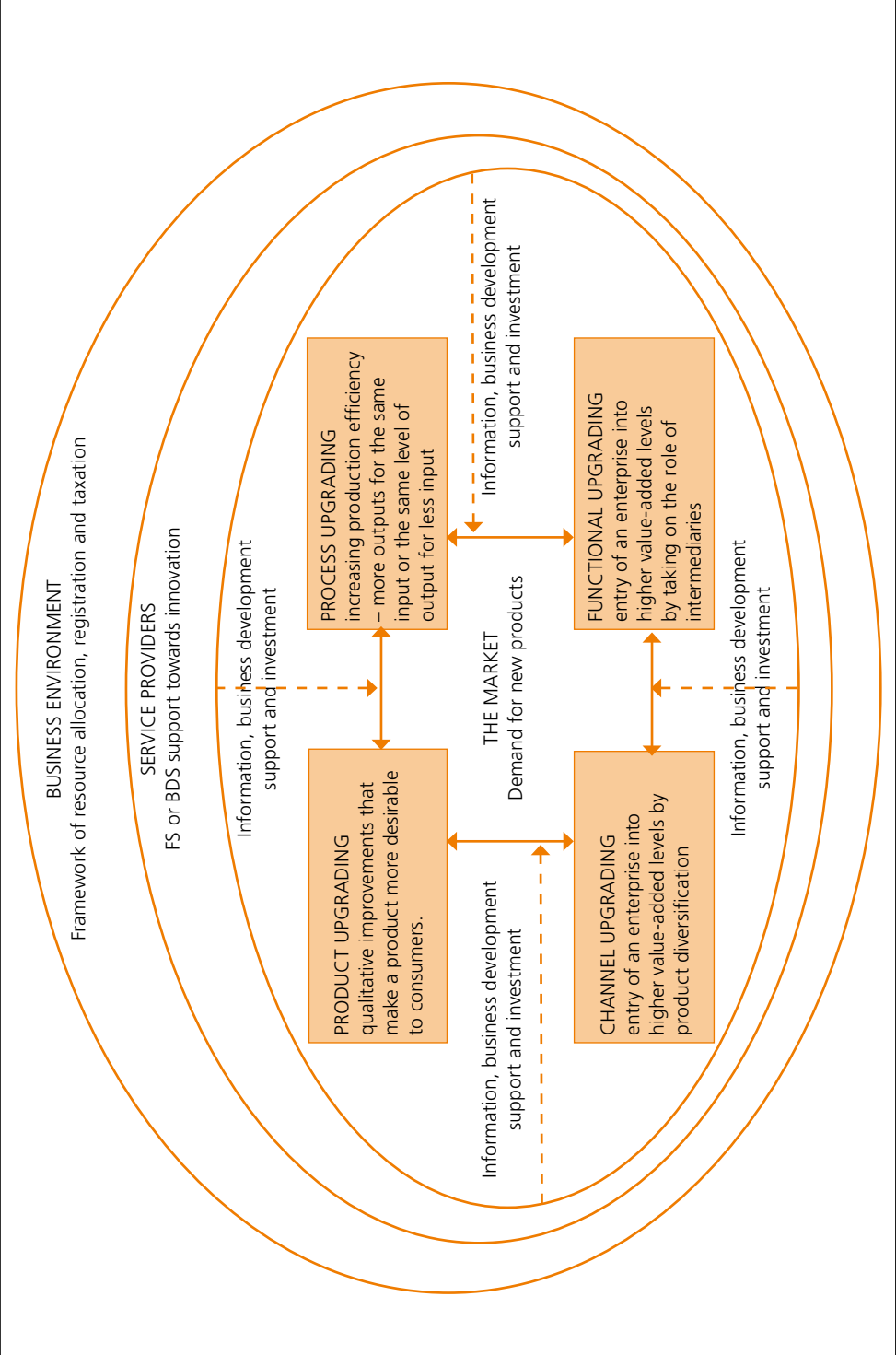
3.1 Facilitating better financial services

FS allow people to convert their assets (guarantees about what they have or might have in the future) into lump sums. These lump sums can then be invested in ways that increase income, reduce vulnerability (e.g. insurance), cover cash-flow needs and acquire useful consumer durables. FS are often essential to upgrading and there is an undeniably strong correlation between a functional financial sector and economic growth (Spencer and Wood, 2005).

In weak economic contexts, formal FS providers are often limited and vulnerable to collapse. Public financial institutions often dominate to the detriment of more flexible private financial services. For example, in the Democratic Republic of Congo, the Central Bank of Congo dominates the sector with less than 0.01% of the public having access to a bank account (Isern *et al.*, 2007). Public institutions frequently fail to engage with productive enterprises and charge high interest rates when they do.

Especially in such weak economic contexts, many FS in rural areas are provided by **value chain finance** – that is, the flow of financing within a sub-sector, among value chain actors, for the purpose of getting product to market. For example, value chain finance includes credit from dealers, processors and traders who have close market links with small producer enterprises. Short-term **trader credit** (between buyer and supplier) is a very significant source of finance for many small enterprises (Steen *et al.*, 2005). In addition, **subcontracting inputs** from

Figure 5. Cycle of innovation in which appropriate forms of upgrading are supported by FS and BDS inputs and an enabling BE



a buyer often involves such elements as credit, technical advice, information and oversight (Jansen and Fries, 2005). In many cases **leasing** is also a form of fixed-asset financing of which vehicle or equipment leasing is the most common form (Steen *et al.*, 2005).

In cases where FS provision is a major perceived barrier to market system development, failures often include the following (EDIAIS, 2003b):

- ◆ Inadequate information about potential small and medium enterprises, which undermines the belief that providing FS to such enterprises can be profitable and that transaction costs and risks can be overcome
- ◆ Lack of knowledge about, capacity to regulate, and consequent reluctance to promote microfinance institutions and business-to-business financing that may be better placed to provide FS
- ◆ Lack of legally recognised collateral (e.g. land and standing forest resources) and enforceability on loan repayments or calling in of collateral
- ◆ Discrimination within communities against the poor, women or other social groups that limit their engagement with FS providers

Fortunately, many of these failings can be addressed by careful facilitation – be it subsidised or not. For example, each of the bullet points above has a corresponding response that facilitators can help to bring about:

- ◆ Generating information about small and medium enterprises in particular sub-sectors (e.g. SMFEs), and developing credit scoring systems to highlight profitable investment opportunities and reduce the perception of risk (UNCTAD, 2001). Complementary efforts to train SMFEs in risk self-assessment would also be useful
- ◆ Spreading understanding of business-to-business financing and microfinance and potential collaborative links with the formal financial sector that involve better prudential regulation and supervision
- ◆ Working towards legal land titling, resource access and the use of resources (e.g. standing forest resources, timber in holding yards etc) as collateral for loans – helping to establish associations that can back loan applications with mutual guarantee schemes and help to offset risk (e.g. by agreeing to cover non-payment of members)
- ◆ Special studies and awareness campaigns that increase awareness of the exclusion of women or minorities and propose responses

A starting point for facilitating better FS provision is to include a **financial services ‘lens’** within value chain analysis. In other words, it can be useful in mapping out the various value chain actors to ask specific questions relating to the provision of financial services. For example, in India this approach was used successfully in Litchi and honey value chains to

identify what the main FS needs were – and then negotiate with FS providers on products that work for those businesses (Kumar, 2006).

There are also a number of generic ways that FS providers can improve their interactions with small and medium enterprises. For example, they can offer advisory services, especially to recent start-ups (often the highest risk category). They can use new information technologies to streamline loan application procedures. They can sensitise staff to the particular needs of small and medium enterprises. For example, in Thailand more women were employed at financial institutions, counters to better address the needs of small entrepreneurs, most of whom are women. They can explore new ways to offer FS through intermediary businesses or associations.

For agricultural FS provision, Christen and Pearce (2005) combine the most promising elements of traditional micro finance, agricultural finance and other approaches (such as leasing, area-based insurance, use of contracts, infrastructure and technology of agribusiness dealers, processors or traders) into a hybrid defined by 10 **generally successful features for FS provision**:

- ◆ Repayments are not linked to loan use – but take account of the complexity of small (often household) enterprises and their multiple income generating activities and coping strategies
- ◆ Character-based lending techniques are combined with technical criteria in selecting borrowers, setting loan terms and enforcing payments – for example, group guarantees are used, or close follow-up on late payments is made by people who understand the production system in question
- ◆ Savings mechanisms (not just loans) are provided – experience shows that saving for lean times can greatly improve loan repayments
- ◆ Portfolio risk is highly diversified – micro finance institutions spread lending across multiple different types of business and crops
- ◆ Loan terms and conditions are adjusted to take account of cyclical cash flow and investments – for example, that follow the harvesting seasons
- ◆ Contractual arrangements enhance production quality, reduce risk and help guarantee repayment – for example, combining credit and technical assistance
- ◆ Financial service piggybacks on existing institutional infrastructure or is extended using technology – for example using ATM machines, point of sale devices and personal digital assistants (used by loan officers)
- ◆ Membership-based associations facilitate rural access to financial services or provide it themselves – there are often much lower transaction costs in dealing with an association than multiple individuals

- ◆ Area-based index insurance helps to protect against the risk of rural lending – linking payouts to specific regional levels of rainfall, commodity prices and the like
- ◆ Insulation is maintained from political interference – such as moratoriums on loan repayments or other meddling in well-functioning systems of rural finance

Numerous different cases show the potential of being more flexible in thinking about how financial services are supplied. This facilitation of **strategic alliances or partnerships** between FS providers and businesses in the value chain is a core theme of the ongoing practitioner learning programme funded by USAID (Villeda and Hansel, 2005). It is also a feature of many other successful attempts at FS provision. For example, in Croatia, the largest dairy company, Lura, used referrals based on multi-year contracts with producer farmers to secure bank loans for those producer farmers.

Many of these best practice mechanisms for the provision of FS are equally applicable to the forest sector. A recent overview of micro finance and SMFEs detailed some examples of emerging strategic alliances to improve SMFE financing (FAO, 2005). For example, in Nepal, the government Micro Enterprise Development Programme (MEDEP) helped to assure the quality of loan applicants (an average of US\$60 per applicant) to the Agricultural Development Bank of Nepal (ADBN). This helps ADBN make better use of their existing branch and sub-branch network across Nepal. By 2005, approximately 36% of the loans related to forest-based enterprises – to a total of US\$15,300.

In another example from the same overview (FAO, 2005), the Guatemalan Bank Bancafé began making loans to community forest concessions – linked to promises of support from the USAID Biodiversity and Sustainable Forestry project (BIOFOR) and the Association of Forest Communities of Petén (ACOFOP). Here the ACOFOP agreement to cover any non-payment is a major source of risk reduction for the bank.

While FS provision is often handled separately to BDS provision, there are possible synergies (with benefits to recipient enterprises and service providers) **by linking FS and BDS** in voluntary partnership or parallel/unified provision arrangements (Sievers and Vandenberg, 2004). While it is important that this does not lead to a loss in competence in either service, there are obvious advantages on both sides if FS providers are able both to ‘grow’ and keep their more successful small enterprise clients through BDS provision. One example comes from Peru, where Financiera Solución decided to offer the International Labour Organisation’s (ILO) Improve Your Business (IYB) management training to existing clients as a marketing instrument and reward for client loyalty. Now bought out by Banco del Crédito del Perú, Financiera Solución has opted to continue to provide this training on a commercial basis – as it had proved such a good idea.

The Small Industries Development Bank of India (SIDBI) introduced innovative financial features. For example, small enterprises that incurred delayed payment from large buyers were able to defer repayment of loans until the date on the bill had expired. The bank coupled such FS features with promotional and developmental (P&D) schemes to ensure technology upgrading, human resource development, environmental and quality management and market promotion (UNCTAD, 2001).

The option to **link work in FS, BDS and the BE** may be particularly important in the forest sector where long-term financial viability is so dependent on sustainability, which is in turn so dependent on good forest governance. Recent meetings of the Forest Investment Forum, for example, note that forestry access to private investment funds requires substantial improvements to forest governance and technical assistance in developing countries (World Bank, 2003).

Examples show how FS and BDS provision can go hand in hand – building on forest certification as a mechanism to overcome governance deficiencies. For example, the IFC's work in Indonesia has not only helped to finance *Acacia mangium* forest plantation owners to pursue forest certification, but has also financed technical training for furniture SMEs on how to use Acacia wood and the benefits of certification markets. In addition the IFC has promoted Acacia products with 16 manufacturers at international trade fairs to open up market access (McLeish, 2007).

Other examples include that of the Nordic Development Fund operating in Mozambique, which signed a financing agreement to set up a €3 million credit facility alongside support programmes for sustainable forest management and institutional capacity building (Spears, 2006). In Nicaragua, the World Wide Fund for Nature (WWF) and IFC have together provided technical and financial assistance to two community forest businesses (to become certified) linked to five carpentry businesses (to target high-end international furniture markets sourcing environmentally sustainable wood). While this looks like classical subsidised service provision, the aim now is to facilitate the formation of a 'Forest Management Company' to continue to provide technical assistance on a commercial basis – together with a capital fund for local carpentry firms (IFC, 2006a).

3.2 Facilitating better business development services

Business Development Services (BDS) are the non-financial inputs that enterprises need to be able to: find customers, design products, access the right technologies, train staff to use them and thereby meet customer quality, meet quantity and delivery demands, manage and administer the business efficiently, develop and communicate effectively with partners and customers and comply with legislation. As with FS provision, the emphasis shifts from direct attempt at service provision towards creating a well-functioning BDS market.

BDS may be provided either by lead businesses within the value chain – especially where BDS markets are poorly developed (embedded services) or by hiring in fee-based contractors to deliver services (stand alone services). Experience suggests that stand alone services tend to follow growth in a core value chain, and that **a combination of both embedded and stand alone BDS services is required** if competitive rates are to emerge in ways that serve poorer groups (Emerging Markets Group, 2006).

Once again – a key initial step in any facilitation process is to include a 'business development' lens in any initial value chain analysis. This analytical step helps to clarify what the key service needs are and what options exist for filling any service gaps. A good example of the effective use of such an analysis in forestry is the report on the furniture sector in Bangladesh (Katalyst, 2005). By mapping the sub-sector actors and value chain, existing BDS

providers and sub-sector dynamics, Katalyst was able to prioritise a number of interventions (see also Katalyst 2006):

- ◆ Operational or generic services
 - (i) Facilitating better communication channels to link furniture producers with machinery and power tool suppliers
 - (ii) Facilitating training and skills development – in accounting and access to finance, modern furniture making techniques etc.
 - (iii) Facilitating business advice and counselling for exporters through the creation of an ‘Exporter’s Forum’
 - (iv) Facilitating access to marketing and trade promotion services – including trade fairs
 - (v) Facilitating courier and delivery services to allow use of sawmill waste for particle board manufacture

- ◆ Strategic or specific services
 - (i) Facilitating the formation of a joint company to upgrade products through the installation of kiln drying for their products
 - (ii) Facilitating new local furniture design businesses to provide services to the growing local furniture sub-sector
 - (iii) Facilitating access to improved design techniques and prototyping know-how for new furniture lines
 - (iv) Facilitating access to appropriate lacquer finishing techniques for medium density fibreboard production



Storing timber while awaiting sales in rural Mozambique

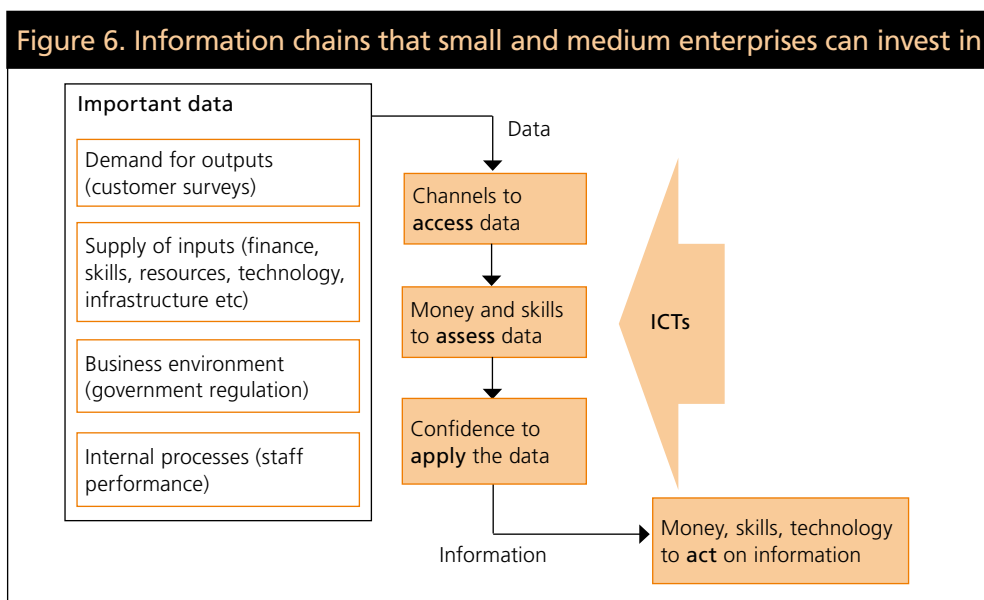
In some cases, university, technical institutes or extension services might be supported or encouraged to teach technical skills, marketing skills, or knowledge transfer skills that particular value chains require (Adhikary and McVay, 2006). Alternatively, mentoring arrangements can be used to build the capacity of potential specialist service providers – even where these involve large embedded multi nationals such as Syngenta in Bangladesh (Gibson, 2005). Where small stand alone consultant firms need capacity building to provide business services, it can be useful to develop a ‘train-the-trainer’ approach in which an experienced firm provides training for less experienced BDS providers – for example accounting, finance and tax training in Bangladesh (Katalyst, 2007). Alternatively, facilitators can spread tools that were developed elsewhere so that they can be more readily picked up by local BDS providers (for example, Gagel 2007).

There are a number of approaches that can be used to facilitate the development of a thriving BDS market:

- ◆ **Providing information** – it sounds simple but the trick lies in getting the format and content right. For example, a facilitator might start a ‘business-to-business’ magazine or a ‘Yellow Pages’ of service providers, a radio programme or regular series of meetings to improve awareness both of the scale of a particular small and medium enterprise sub-sector, and the service providers who can address particular constraints. A good example is that of the FIT Zimbabwe’s ‘Business Connect’ magazine that not only broke even in its sixth issue but went on to cover much of the facilitator’s core costs (Hileman and Tanburn, 2000; ILO undated)
- ◆ **Catalysing collective action** – often the quantity of BDS that is required by a single small or medium enterprise is too little for BDS providers to bother developing a service. But this can be overcome if an association multiplies the scale at which a BDS is required. For example, the Federation of Rajasthan Handicraft Producers in India organises an annual symposium to share designs and invites experts to give seminars on trends in home furnishing, visual merchandising and export promotion. Leading members are selected to participate in European trade fairs (Bose *et al.*, 2006)
- ◆ **Strengthening business linkages with embedded services** – for example by providing events at which lead enterprises and potential small suppliers can interact, identifying opportunities for contracting out and service provision that lead firms might offer to the contractor. It can help to lay out best practice for lead enterprises (e.g. UNCTAD, 2004)
- ◆ **Facilitating technical assistance to BDS suppliers** – a first option is to identify standardised products that can be used for more generic purposes – for example the ILO Start and Improve Your Business courses (ILO, 2007) or GTZ’s Competency-based Economies through Formation of Enterprise (CEFE) training course (CEFE, 2007). A second option is to facilitate payment for an institution or individual with particular expertise in an area of specialised BDS provision who could be brought in to improve less skilled local BDS providers (the ‘train-the-trainers’ approach mentioned above). A critical point is that technical assistance should be designed in response to market demand – not pushed due to the availability of particular expertise (Field *et al.*, 2000). Ideally the local BDS service providers would cover the cost of the training

- ◆ **Arranging voucher or matching grant programmes** – while costly to implement, the idea here is that vouchers or matching grants can be issued to firms that do not usually use BDS so that they link to BDS providers who do not normally serve small and medium enterprises. Vouchers are more efficient to administer and can reach poorer groups quickly, but they may not have the overall success rate of matching grants, which require some financial input from the recipient firm (Angelelli and Suaznabar, 2004). Where finance of this scale is not available to the facilitator, it may be possible to develop a strategic alliance with a development bank or bilateral or multilateral donor
- ◆ **Supporting participation in trade shows or import promotion programmes** – entrepreneurs often learn simply by being exposed to what other businesses are doing. Identifying appropriate trade fairs and sources of support for participation (and N.B. preparation!) for such events can be a very useful role (see Annex 2)

The emergence of new opportunities through **Information and Communication Technologies (ICTs)** deserves particular mention. Increasingly, ICTs are helping not only to access data, but gain the means to assess and apply it (see Figure 6). Small enterprises have a fundamental need for good information on markets, FS and BDS. Facilitators can link small and medium enterprises to these spheres more efficiently. But ICTs are also increasingly affordable and can open up new mechanisms for buying and selling. In addition, FS and BDS providers can use innovative new ways of providing inputs through ICTs. For example, in Cambodia, ILO distributed programmes on VCD through very effective rural transmission channels – and among small enterprises surveyed, 40% have bought or seen the programme in local shops or ‘cinemas’ (Tanburn, 2004).



Source: Heeks and Duncombe, 2001

It is critical that any facilitator should adequately understand both what data are needed by small and medium enterprises, but also what range of technologies might help to improve access, assessment and application of these data. At another level, a facilitator might try to develop an information portal that serves as a 'virtual one shop stop' for information about both small and medium enterprises and service providers (see examples in Gagel, 2007). Of course, careful positioning would be required if good information portals already exist within the broader business environment – which we turn to below.

3.3. Shaping an enabling environment

Improving the Business Environment (BE) is particularly critical to the forest sector. Forests spread over large areas with multiple users and potential resource conflicts. They must remain intact over long time frames in order to reach commercial harvest. Good forest governance is therefore critical – especially in the transparent and secure allocation of forest land (see Spears, 2006).

Any attempt at market system development requires the basics of an enabling environment (Wältring, 2006):

- ◆ macro-economic stability
- ◆ transparent and entrepreneurial-friendly policies and laws at the macro-level
- ◆ transparency in the supply and demand of institutions that provide information and advocacy at the meso-level
- ◆ provision of basic communication and transport infrastructure
- ◆ access to information for improving entrepreneurial competitiveness at the micro-level

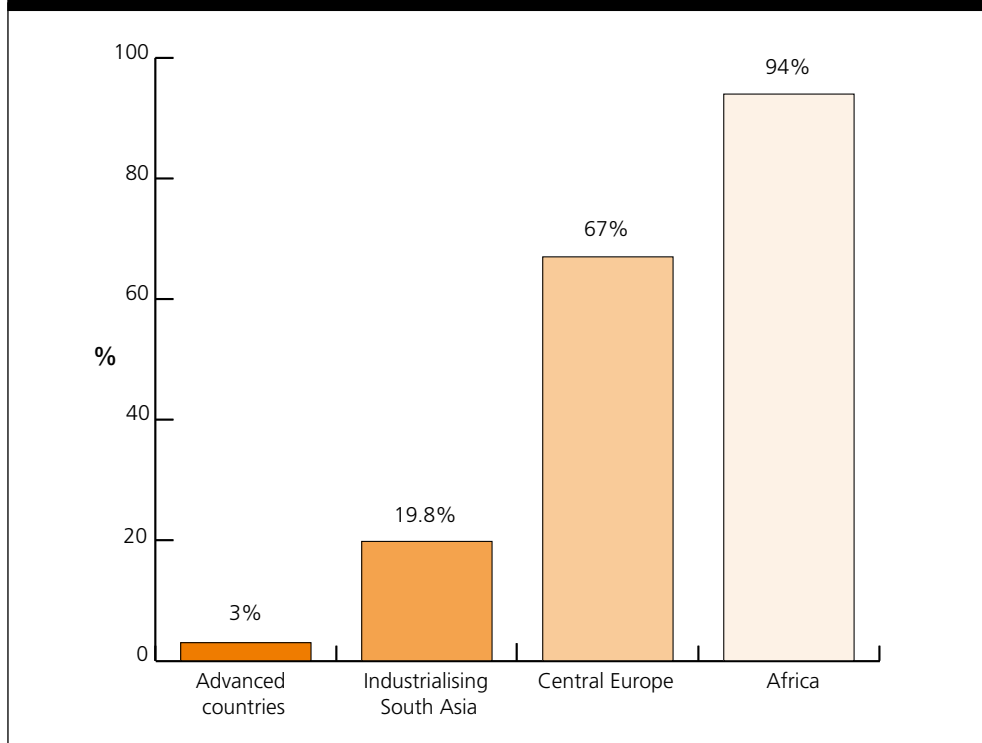
Rigorous research suggests that there is a clear need to differentiate between the impacts of the BE on small and medium enterprises and on large enterprises. Recent analysis shows that on legal, financial and corruption issues, small and medium enterprises perceive greater BE obstacles. Unlike large enterprises, they would be more likely to benefit and grow if those obstacles were removed (Vandenberg, 2005). Since there are a disproportionate number of women's enterprises that are small, especially in the informal sector – any reforms of this type would also have a gender dimension (IFC, 2005).

Donor interest in reforming the general BE in developing countries is now widespread – even if donors do not accept the case for size-specific reforms. The justification for such reforms as a development approach is found in figures that compare the costs of business entry across different country types (Figure 7).

The intention of BE reform put simply is to **move away from systems based on personal contacts and patronage towards those based on rules**, with a focus on optimising the efficiency of those rules (Donor Committee for Enterprise Development, 2005).

Reforms encompass a wide range of different areas – for example: improving judicial or other dispute resolution mechanisms, clarifying personal and property rights, streamlining corporate governance, fairly enforcing regulations and competition policies, simplifying and making more equitable tax and policy administration, and strengthening export development and trade

Figure 7. Business entry costs as a percentage of GDP per capita in 2002



Source: Djankov *et al.*, 2001 developed by Bannock *et al.*, 2002.

facilitation (Miehlbradt and McVay, 2006). Approaches to this type of reform tend to follow one of two courses – either:

- ◆ stimulate demand for reform among key stakeholders or
- ◆ build knowledge and capacity to implement reforms

Methods to stimulate demand for neutral BE reforms need a mechanism to draw attention to constraints to business in comparison with neighbouring countries. A common tool is **benchmarking**. This involves generating a score for the BE environment in countries, regions or cities based on a set of criteria. Sometimes the criteria are quite comprehensive as in 'Investment Climate Assessments' or 'Business Environment Surveys'. Sometimes they focus on specific elements such as perceptions of corruption, transparency, or regulation (see Silva-Leander, 2005a; 2005b). A good example of the latter is the World Bank's 'Doing Business' report. This gives annual assessments of how easy it is to do business within the regulatory framework of different countries (World Bank, 2007). In 2007, the report puts Singapore and New Zealand top and East Timor and the Democratic Republic of Congo bottom. Anecdotally, benchmarking does generate a strong demand for reform. Forest Connect countries are ranked out of 175 by the Doing Business report as follows from 2006 to 2007: Burkina Faso (163), Ghana (94), Guatemala (118), Guyana (136), Lao PDR (159), Mali (155), Mozambique (140), Nepal (100).

Another way to stimulate demand for reform of the business environment is **publicising research findings** that highlight failings – such as excessive bureaucracy or corruption. Detailed value chain analyses often provide a wealth of information about such policy bottlenecks. An excellent recent example in the forest sector has been the publication of an in-depth analysis of Malawi's charcoal sector – highlighting the amount of revenue being lost to bribes – and the potential benefits of reforming legislation to legalise sustainable production (Kambewa *et al.*, 2007). The report will be formally presented to the Parliamentary Committee on Agriculture and Natural Resources in order to stimulate policy change. An important potential role of any facilitator of market sector reform is to build the capacity of advocacy groups such that relevant findings are aired in public through the media (Williams and Vermeulen, 2005).

Moving to approaches that help to design BE reforms – there are now well-known methods for evaluating the costs, benefits, impacts and their distribution of new policies and regulations (or their removal). These are commonly referred to as **Regulatory Impact Assessment (RIA)**. RIA can help governments understand the real world impacts of their policies. It can help to integrate various policy objectives and weigh tradeoffs in any new legislation. As a process it can also improve government transparency and consultation and help to make governments more accountable to business (Rodrigo, 2005). Approaches have been developed specifically for the forest sector in developing countries – for example, the Good, Average, Bad (GAB) 'power tool' developed to assess the quality of official forest legislation in Mozambique. The aim was to distinguish between failures due to poor implementation and failures due to poor legislative design (Johnstone *et al.*, 2005).

Tools such as RIA can pave the way for a much more constructive **public-private dialogue** – which encourages government to listen more carefully and respond to the needs of the private sector. Experiences from more than 40 countries shed light on how to build such dialogue processes. Among the key challenges is the need to tackle vested interests by keeping the base broad, the need to avoid large enterprise capture by strengthening small enterprise associations and to avoid a political talk shop by setting clear agendas open to politicians of all parties (Herzberg and Wright, 2005). Nfp processes can be a critical vehicle for stimulating a useful public-private dialogue that is specific to the needs of forest businesses and SMFEs in particular.

Once the targets of reform have been identified through specific research and consultation, specific changes can be made. In some cases these changes can be dramatic – for example using a '**regulatory guillotine**'. The principle behind this is that an allotted time is given in which all regulations in force must be placed on a register. After the specified period, any legislation not placed on that register is declared invalid (Jacobs and Astrakhan, 2005). In other cases, less draconian measures may work best – and good toolkits exist to help teams work through a process of simplifying legislation (e.g. IFC, 2006b). Such tools are particularly effective at simplifying procedures such as business start-ups – which can have a disproportionate benefit for small and medium enterprises or those wishing to move from the informal to the formal sector.

Tax reforms are especially important in encouraging small and medium enterprise growth. Stern and Barbour (2005) note that firms in developing countries rarely see their tax



Participatory research to understand the constraints facing women fuelwood producers in India

contributions at work in the form of government services. If compliance costs – both financial and time – are added into a firm's cost-benefit analysis of paying taxes, the disincentive to comply with tax requirements becomes even stronger. On the government's side, too, there is also a strong disincentive to collect taxes from small businesses, as the cost of monitoring and collecting them from small businesses usually outweighs the revenues generated. Nevertheless, there are compelling reasons for addressing this issue, both to encourage SMEs to benefit from the financial and business services that can only be accessed by formal tax registration, and to create a culture of taxation in which firms continue to pay tax as they grow. An important analytical tool is the use of the Marginal Effective Tax Rate (METR) to measure the likely impacts on compliance of different tax regimes (Stern and Barbour, 2005).

Of course, any process of reform requires able **champions or change agents** to force change through. In the Forest Governance Learning Group (FGLG) that operates in 10 countries across Africa and Asia, key change agents meet to press for useful reforms. One of the key themes in 2007 is 'making small enterprises work better for social justice in forestry' (see Mayers, 2007).

Recent overviews of reform in the forest sector show how complex the policy response needs to be; it is not amenable to macro-economic reforms or single agency solutions and requires levels of inter-agency operation and implementation that are not immediately obtainable in many countries (Hobley, 2007). Facilitating an enabling BE cannot be achieved, therefore, in isolation. It requires at the very least a process that includes key government and industry representatives. Nfps can be a very useful framework for such processes.

The final section of this chapter turns to the approaches that might be used to **measure** facilitation towards market system development.

3.4 Recent advances in methods to monitor progress

With so many potential areas of facilitation, there is a need to think carefully about how to monitor progress. This is especially important because of the differential impacts that enterprise support programmes almost invariably have on different groups of poor people. Unwanted outcomes might include (Mike Arnold, pers. comm.):

- ◆ Poor groups encouraged to focus on products for external markets in which they prove to be unable to compete, or where the markets decline (as happened in many of the early attempts by environmental organizations to encourage sustainable forest enterprises)
- ◆ Promotion of demand for a manufactured product that diverts supplies of a raw material towards an enterprise and away from those in the community who need it for subsistence or other uses
- ◆ Development of an enterprise activity that effectively privatises a community forest resource, so that community models of control over resources and income flows are bypassed (as has been documented for example in the literature about models of the firm and the ejido forests in Mexico – Antinori and Bray, 2005)
- ◆ Adoption of regulations, requirements, standards etc. that in practice proves to disadvantage the smaller and poorer producers

Monitoring can help to tighten the focus of activities around those which deliver best results for a range of different groups. The conundrum of monitoring is that a balance must be struck between what is needed for credible attribution of impact and what can be achieved with the resources available. Overcoming the complexity of analysis and data shortages in forest sector projects can mean monitoring costs quickly rise to levels exceeding the costs of the initial interventions (Henderson, 1999). The conclusion is that generic intermediate indicators of progress are more practical than accurate measures of economic impact. For example, monitoring might involve collecting baseline and outcome data based around a 'balanced scorecard' of four different perspectives:

- ◆ Internal perspective – what was achieved in terms of internal planned programme activities and outcomes (e.g. training courses held, number of enterprises financed etc)

- ◆ Client perspective – what did the programme’s clients feel was achieved against their initial expectations (e.g. surveys of views on the impact of training, finance etc on performance)
- ◆ Evidence perspective – what external evidence exists (qualitative and quantitative) to substantiate claims of programme impact (e.g. statistics on market development, active FS or BDS providers etc)
- ◆ Uptake network perspective – what institutional and communication systems/pathways now exists to continue programme impact (e.g. surveys of enterprise associations, FS and BDS networks)

Recent small enterprise development literature includes examples in which pilot monitoring goes beyond simple statistics on ‘enterprises reached’ towards the monitoring of ‘causal chains’ that link activities with outcomes, and outcomes with direct, indirect and longer term impacts (see for example Ramm, 2005 or Monteiro and Brusky, 2006). Mapping out these causal links is important in being able to check if what was intended to happen does happen in the

Figure 8. Impact chains for the facilitation of market system development for SMEs – examples of possible approach and indicators

Service component	FS facilitation	BDS facilitation	BE facilitation
Activities	Negotiate new investment line	Survey of training needs	Lobby for tax breaks
Internal indicators	Investment line established	No. enterprises surveyed	Advocacy meetings held
Outcomes	Investment in new technology	Training course facilitated	Tax reduction for value added
Client indicators	Product upgrading	Process upgrading	Functional upgrading
Short-term impacts	New export market	Costs and price reduced	Processing capacity grows
Evidence indicators	SME sales and export figures	Market price and SME sales	% in-country value added
Long-term impacts	More SME FS providers	Associated finances training	Industry lobby group develops
Uptake network indicators	No relevant FS investment lines	No. BDS providers and courses run	Public-private dialogue on SME issues

Source: Adapted from Ramm, 2005

anticipated time frame. An adapted framework for such monitoring is shown in Figure 8. In such frameworks it is especially important – however difficult – to gauge the client perspectives of different groups of the forest-dependent poor – checking, for example, what especially vulnerable, marginalised or minority groups think of progress made.

As any facilitation programme moves from early pilots towards systemic change, there is a need to focus assessment ever more squarely on the indicators of short- and long- term impact. For example, in a programme to develop BDS for NTFP producers in Nepal, monitoring indicators focused on the numbers of business-to-business BDS providers established (BDS-MaPS, 2004). Many of the tools that are useful in monitoring changes to market system development are the same tools that are useful in earlier diagnostics of what is required (e.g. value chain analysis that has a particular FS or BDS lens). Using the perspective approach above, it is possible to hone in on relevant informants and data sources that allow cost-effective monitoring of progress.

While monitoring approaches have been developed to look at the financial impacts of market system development, there is often a **lack of emphasis on how changes in FS, BDS or the BE affect wealth distribution** across communities, enterprise resilience (income security), standards for decent work, investment in social networks, local environmental accountability or cultural identity. Monitoring such broader impacts is essential if full impact of enterprise support is to be understood. The following chapter assesses some of the other gaps that continue to exist – especially in forest sector attempts to support small and medium forest enterprises.

Information and institutional gaps

4.1 Installing market system development more widely in the forest sector

With the exceptions of a few excellent value chain analyses in the furniture and NTFP sub-sectors, many forest sub-sectors have not been analysed or analysis has been restricted to broad policy recommendations or generic calls for a greater level of enterprise organisation. What this means is that in many developing country contexts there is a **dearth/lack of useful information about the value chain dynamics** of mainstream value chains – as seen through the lenses of FS, BDS and BE.

Beyond the widespread lack of information there is also a continuing tendency for forest sector support activities to adopt **outdated approaches** to supporting SMFEs. For example, many support agencies opt for the direct provision of FS or BDS support or opt to directly lever policy change to improve the BE. Trust funds are set up on an ad hoc basis by donors, often tied to short donor cycles. Training courses, especially in sustainable forest management, are provided by donors on a project-by-project basis. Policy forums are financed with short-term wins in mind rather than long-term public-private dialogues. The result is that the market for FS and BDS provision is either distorted by heavily subsidised services or never evolves at all.

Despite the general picture described above, there are some NGO-private sector initiatives that are looking to improve the situation in different regions.

In the WWF-Bolivia Forest Trade Network, important alliances have been facilitated between forest companies and rural communities – in part through the organisation of Expoforest, Bolivia's forest-related exhibit and trade fair (Von Oven, 2007). Three successful examples include the link between the Zapocó Indigenous Communal Land and the Los Petunos company, the Monteverde; community with INPA Parket and Mardivar companies; and the Cururú community with the Cimal IMR company. This process of facilitation has led to mutual benefits, since the companies need to increase their supply volumes with quality raw material for external markets, and the indigenous communities obtain access to fair forest trade through these alliances, and are therefore recognised for their sound forest management. These alliances are also being reinforced by the facilitation of public and transparent bidding processes, enabling the community forest companies to access fair prices, and taking social aspects into consideration (WWF-Bolivia, 2007).

In Indonesia, the Tropical Forest Trust has facilitated support from a local partner-NGO, Jaringan Untuk Hutan, to help the community forest cooperative Koperasi Hutan Jaya Lestari organise its 46 villages members into a productive group, attract finance and technical support and sell teak to such companies as B&Q and M&S in the UK (Barr, 2007; IIED, 2007).

In Guatemala, the Rainforest Alliance together with USAID and a number of other donors have been supporting communities of the Maya Biosphere Reserve in the Peten to access finance, receive training in business administration, forest management and processing and gain access to preferential international markets – including both lesser known species of timber and commercially valuable timbers. For example, the community of Uuxactún now has the technical capacity and market knowledge to produce special cuts of mahogany for the Gibson Guitar Company. Community members have used part of the profits to finance teachers in their under-financed school and provide bursaries for older students to do computer training in the nearest city (Rainforest Alliance, 2007). Facilitation of the establishment of the Forest Services Community Enterprise has greatly enhanced the product lines that can be produced and the market options and prices that can be obtained (Macqueen *et al.*, 2007).

In Papua New Guinea, ICCO, together with the DOEN Foundation, NZAID, WWF-Pacific and the EU have been financing the Forest Management and Product Certification Service (FORCERT) to catalyse the organisation of community forest producers in seven provinces – linked to Central Marketing Units and ultimately to the Woodage Company in Australia. FORCERT has helped the PNG Microfinance Initiative to launch a loan facility for its members. It has also helped to broker technical service provision for them – including expertise on certification. Finally, it has helped to link community forest producers to potentially lucrative overseas markets (Dam, 2006; Macqueen *et al.*, 2007).

4.2 Building institutional homes for the facilitation of market system development

Despite such commercial successes, an emphasis on the *environmental sustainability* of forest management has often dominated concerns over *economic viability* or *social acceptability* in small and medium forest enterprise support activities and public forest services. The result is that there is often a **lack of institutional competence to do with facilitating enterprise development**, a situation both unfortunate and counterproductive in terms of sustainable forest management.

But as the emphasis on small and medium forest enterprise grows there is an increasing number of NGOs who wish to see both sustainable and viable enterprises flourish. At the same time, there are numerous private sector business associations who have enterprise support firmly on their agenda.

The need for neutral facilitation in market system development rules out business associations as the primary institutional home of this approach. However, in cases where business associations really represent the wider SMFE target group, they may be well placed to play the role of facilitator.

Whether the institutional home of such facilitation should reside in the government or NGO sector or business associations will depend on the country context. That being said, early engagement and much needed **learning from experts in the existing business associations** is clearly desirable, even if facilitation is not run through those business associations. Especially in weak economic contexts, the lack of institutional capacity in

enterprise development is best addressed through greater connectedness – both in-country and with the multiple international programmes that are often beyond the forest sector, as described below.

4.3 Optimising links with support services in agriculture and other sectors

In recent multi-country programmes which specialise in market system development approaches in the agricultural or manufacturing sectors, there are national partners whose experience could be invaluable in building capacity in the forest sector. But there is often a **lack of awareness of in-country expertise beyond the forest sector**.

For example, The USAID funded SEEP Practitioner Learning Program has country partners in India, Kenya, Paraguay, Peru, Sierra Leone and Tajikistan – all engaged in both FS and BDS facilitation (Villeda and Hansel, 2005). The Emerging Markets Group is active in more than 60 countries worldwide. The ILO Boosting Employment through Small Enterprise Development (SEED) programmes have run in more than 90 countries across the globe with resident master trainers still active in many countries for key programme such as Start and Improve Your Business. In other words, rather than reinventing the wheel for the forest sector, it may be best to tap into existing national institutions who are linked to existing market system development programmes.

In this context it is worth noting that a **multi-sectoral advisory** committee made up of members of existing SME support agencies (including FS and BDS providers) could usefully help any national facilitator in the forest sector.

4.4 Monitoring against broader indicators of progress

For many engaged in support to small and medium forest enterprises, enterprise growth and associated rises in income are merely intermediary objectives on the road to poverty reduction. Recent reviews emphasise the fact that there are still insufficient efforts being made to accurately measure the impact of small enterprise development activities on poverty (Vandenberg, 2006). The **lack of indicators on broader aspects of poverty** reduces the likelihood that they will routinely be assessed in monitoring and assessment procedures.

The preceding chapter (section 3.4) introduced the need to look at monitoring through different perspectives that involve various stakeholder groups. Making sure that each of these sets of actors is well versed in a set of broad indicators of poverty would do much to avoid perennial problems (such as elite capture of wealth by minority groups within communities and sub-sectors). Some form of initial discussion over what different groups aspire to, and how indicators could be developed to monitor progress, would be a useful starting point (see Macqueen, 2005).



Practical training in sawdoctoring in Guyana

Recommendations for better links to markets, service providers and processes

Processes are needed for small and medium forest enterprises that facilitate support especially in weak economic contexts. A core focus needs to be to connect such enterprises to each other, to markets, FS and BDS service providers and policy processes, such as those linked to nfps. This is the central idea of the 'Forest Connect' alliance. There are two primary audiences for the recommendations below – first, external SMFE support agencies and second, national facilitators for market system development in relevant SMFE sub-sectors.

5.1 Ten best practice steps for support to SMFEs

Market system development works best when targeted towards market sub-sectors that have potential to grow. For external support agencies or existing national facilitators, the first recommendation (where such information does not already exist) is to **conduct a diagnostic of the SMFE sub-sectors to assess those with actual or potential growth prospects**. Where national facilitators do not exist, a collaborative approach to this diagnostic can be the basis for developing a national host for facilitation of better market system development for relevant SMFE sub-sectors.

A key element of market system development is the presence of a driver of change or national facilitator. In the context of support for SMFEs, therefore, a second recommendation for external SMFE support agencies is to **identify, establish or support facilitators of market system development, preferable within neutral institutions, that have an autonomous mandate to pursue broad improvements to relevant forest sub-sectors**.

A facilitator would be expected to have familiarity with the main sub-sector value chains – from producer to final market, the main FS and BDS providers for those sub-sectors, the capacity and activities of other existing support programmes both within and outside those sub-sectors, and the main elements of the policy environment that enable or constrain current activities. But an important shift in recent advice, and therefore a third recommendation for external SMFE support agencies and national facilitators, is to **restrict the aim of SMFE support to facilitating links between forest producers, FS and BDS providers, support programmes and policy processes, not the direct provision of services or direct attempts at policy advocacy**.

To make facilitation of enterprise support possible, it has been found necessary to identify entry points. The best way of doing this is by in-depth consultation around a particular value chain using a range of tools broadly referred to as value chain analysis. A fourth recommendation for national facilitators is therefore to **augment existing information on a sub-sector by conducting participatory value chain analyses with important stakeholder groups**. Particular focus on FS, BDS and BE constraints will help to identify priority areas for action.

A desired outcome of market system development is upgrading. Experience shows that upgrading tends to happen when there is strong market pull or demand for a new or better product or technology – rather than when there is supply push from producers' service providers. And a key factor in generating demand pull is increasing the visibility of market opportunities, and the capacity of producer groups and service providers. In terms of SMFE support therefore, a fifth recommendation for external support agencies and national facilitators is to **develop an information service that draws greater attention to what forest product markets want, what SMFE producers can supply and what service providers can offer.**

Where lack of FS blocks upgrading, value chain analysis may help to identify exactly what the issue is. Strategic alliances can often overcome such constraints. For example, lead firms in value chains, sales agencies etc can act as intermediaries between formal banks or microfinance institutions and small producer groups lower down the supply chain to improve the reach of FS provision. Risk can be countered by supplying FS through the supply chain (where future production can be used as collateral), by introducing BDS to new loan recipients, by ensuring that savings schemes precede and accompany credit schemes, or by vetting and assuring loan applications etc. A sixth recommendation, for national facilitators, is therefore to **explore strategic links between FS providers, value chain intermediaries and SMFE support programmes in order to facilitate better service provision.**

Where lack of BDS blocks upgrading, experience suggests that better organisation of and information about small enterprises and their needs can often lead to the emergence of solutions. Where no training or advisory services exist, it may be possible to facilitate the introduction of training materials or consultancy expertise, initially from elsewhere but which then becomes embedded in local BDS providers through a train-the-trainers approach. Where services do exist it may be possible to stimulate demand for them either by improving information flows or by developing a voucher system (if resources permit). A seventh recommendation, for national facilitators, is to **use knowledge about BDS needs to stimulate demand for existing services and or catalyse the supply of non-existing services.**

Where policies and laws discriminate against small enterprises – or there are other constraints in the BE – facilitators in different sectors have shown the effectiveness of a range of options to help SMFEs get a better deal. Helping SMFEs to organise into representative associations or umbrella organisations that have a stronger voice in nfps and national policy processes has proven to be very useful. Where there is resistance to change, the development of indicators of how easy it is to do business in a country has also proven useful. Benchmarking of this sort can act to convince decision makers that change is necessary. Once there is a desire for change, various forms of regulatory impact assessment can help to identify what policies, tax regimes or incentive structures need to change, be eliminated or be introduced. An eighth recommendation of this report, for national facilitators, is to **strengthen the capacity of SMFEs to organise, analyse their BE constraints and demand greater representation in decision making.**



Finding markets for tree seedlings produced by community entrepreneurs in Malawi

Indicators of progress have a very important bearing on what outcomes are prioritised by both external SMFE support agencies or national facilitators. It has proven useful to differentiate these indicators – separating out short-term and long-term impacts by looking at progress from a number of perspectives. A ninth recommendation for both external SMFE support agencies and national facilitators is to **develop from the outset a set of progress indicators that encompass (i) internal project indicators (ii) SMFE client satisfaction indicators (iii) evidence indicators based around baselines established in initial diagnostic and value chain analysis work and (iv) uptake network indicators that measure progress against plans for spreading successful tactics.** In developing the specific content of these indicators it is worth looking at broader elements of progress than income alone, such as for (i) social

security (ii) employment conditions and opportunities (iii) the functioning of supportive social networks (iv) environmental sustainability and (v) cultural identity. It is also important to make sure that distributional impacts are assessed.

The institutional structures that often exist in the forest sector are often geared less towards the economic viability or social acceptability of forest management and more towards environmental sustainability. This prevalent emphasis, and the consequent gap in terms of business know-how in many forest institutions, can be addressed by developing modular guidance. The tenth and final recommendation of this report for external support agencies is to **develop a toolkit that both provides a rationale for a specific SMFE approach and the wherewithal to set it in place.**

5.2 Future priorities to improve guidance through an action learning ‘toolkit’

Any tool is only as good as its implementation. Recent experiences from the forest ‘Power Tools’ process (Vermeulen, 2005) has shed considerable light on what does and does not work for such tools. For example, Vermeulen (pers. com.) notes that:

- ◆ tools almost never get used by people reading about them in a book or on a website and then learning and applying them alone. Tools get spread through verbal presentations, demonstrations and practice. It is therefore recommended that the tool is **rolled out through action research** – testing and revising the tool as it is developed
- ◆ loose sets of practical ideas in general work better than holistic, cohesive approaches. E.g. Participatory Learning and Action: A Trainer’s Guide (Pretty *et al.*, 1995) is a basket of tools that can be picked up easily and used together in different ways – nothing is too intimidating or boringly complicated. FAO’s MA&D tool (Lecup and Nichol森, 2000) is a good example of a tool that both provides practitioners **with a big-picture framework but also a basket of smaller methods and exercises** that can be extracted and adapted
- ◆ **clear layouts and signposting** matter as much as content. The MA&D tool, for example, makes selective use possible by breaking down the whole process into five booklets, each a different rainbow colour
- ◆ the only way to write a tool is through **a committed iterative process of testing and rewriting** – that looks both at (a) the tools itself and (b) how well the tool is explained in the text and diagrams. Doing it and then writing it up later (or worse, writing it up and then expecting it will get done) rarely lead to replicable tools
- ◆ any future **updates or necessary support mechanisms must be built** in from the start. If the tool cannot operate without future updates or central support – then these issues need to be carefully discussed from the outset
- ◆ experienced development professionals can have no idea at all about real basics of facilitation – such as making sure there are enough chairs in the room and enough cards to

write on before a meeting starts. It is not too patronising to insist on **including the real basics of facilitation** in detail in a toolkit

- ◆ people like examples, preferably **with real-life examples backed up by a good, interesting story**. By working in several countries that share the difficulties of a relatively weak economic context it will be possible to build an album of interesting examples
- ◆ it is pointless to get too hung up about ‘transferability’ and relevance to other countries. If the tool has been genuinely developed through practice and is proven to be useful, **replication can be allowed to take care of itself**. Experience shows that people are very quick at picking out what is relevant to their own context
- ◆ people do tend to follow toolkit instructions to the final letter. So this side of things needs a lot of work – extremely **clear, unambiguous instructions for each step** or stage. Everything that is written will be read closely and taken literally. Avoiding qualifiers, asides, comments, critique can help – being as straightforward as possible. It is especially important how any ‘key questions’ are framed within the toolkit

The development of a toolkit in the iterative, action research way described above will require the selection of a number of country partners in which the economic context is weak, but the potential contribution of the forest sector to poverty eradication is strong. A draft framework for such a toolkit based on the two key audiences described above is laid out below to stimulate discussion. Developing it further is part of the plan of the Forest Connect alliance.

AUDIENCE 1. EXTERNAL AGENCIES

Module 1. How to identify institutional host to facilitate market system development?

Module 2. How to introduce the facilitator to market system development?

Module 3. How to help facilitators select and apply value chain analysis tools with different ‘lenses’?

Module 4. How to build international knowledge networks to share findings and revise the tool?

Module 5. How to exit in such a way that support for SMFEs is sustainable?

AUDIENCE 2. NATIONAL FACILITATORS

Module 6. How to develop framework indicators and a process for monitoring progress?

Module 7. How to use sub-sector knowledge to strengthen inter-firm organisation?

Module 8. How to analyse FS and BDS needs and facilitate better service provision?

Module 9. How to identify BE bottlenecks and strategies to overcome them?

Module 10. How to set up national communication platforms linked to international knowledge networks?

In summary, there is much that can be learned from studying existing examples of successful small enterprise interventions. But ensuring that this learning percolates into existing forest sector programmes and approaches still requires much work.



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Useful websites with academic information on support to small and medium enterprises

The International Institute for Environment and Development (IIED) Small and Medium Forest Enterprise pages

http://www.iied.org/NR/forestry/projects/sm_med_enterprise.html

<http://www.iied.org/NR/forestry/projects/associations.html>

<http://www.iied.org/NR/forestry/projects/forestconnect.html>

<http://www.iied.org/NR/forestry/projects/fairtradetimber.html>

The United Nations Food and Agriculture Organisation (FAO) Small and Medium Forest Enterprise pages and FAO Agribusiness service

<http://www.fao.org/forestry/site/25491/en> http://www.fao.org/ag/ags/index_en.html

The Donor Committee for Enterprise Development

<http://www.businessenvironment.org/dyn/be/BEsearch.home> <http://www.sedonors.org/>

USAID's Microenterprise Learning Information and Knowledge Sharing (MicroLINKS)

http://www.microlinks.org/ev_en.php?ID=1_201&ID2=DO_ROOT

The GTZ Competency based Economies through Formation of Enterprise (CEFE) programme

<http://www.cefe.net/>

International Labour Organisation's (ILO) boosting employment through small enterprise development (SEED)

http://www.ilo.org/dyn/empent/empent.portal?p_prog=S

The ILO International Training Centre inter-agency seminar on business development services

<http://learning.itcilo.org/entdev/BDSSeminar/pub/home.aspx?l=Eng&IdSezione=0>

The Small Enterprise Education and Promotion (SEEP) Network

<http://www.seepnetwork.org/>

The BDS Forum – an independent guide to business development services

<http://www.bds-forum.net/bds-reader/start.html>

The Rural Finance Learning Centre

<http://www.ruralfinance.org>

The World Bank's (WB) small and medium enterprise pages

<http://rru.worldbank.org/Themes/SmallMediumEnterprises/>

The International Finance Corporation (IFC) small and medium enterprise pages

<http://www.ifc.org/sme>

The Inter-American Development Bank's (IADB) micro, small and medium enterprise pages

http://www.iadb.org/sds/MIC/index_mic_e.htm

The Organisation for Economic Cooperation and Development (OECD) pages on small and medium enterprises

http://www.oecd.org/department/0,2688,en_2649_34197_1_1_1_1_1,00.html

Enterprise Development Impact Assessment Information Service (EDIAIS)

<http://www.enterprise-impact.org.uk/index.shtml>

United Nations Industrial Development Organisation (UNIDO) private sector development website

<http://www.unido.org/doc/18233>

The Swiss Agency for Development and Cooperation (SDC) small enterprise development website

<http://www.intercoop.ch/sed/main/>

The Global Value Chains Initiative

<http://www.globalvaluechains.org/>

Useful websites that guide small and medium forest enterprises wishing to export to developed countries

(Source: DIPP, 2007)

Denmark

DIPP (Danish Import Promotion Programme) provides information on the Danish import market and some key trends for different product markets – plus a good links page from which this information is drawn.

<http://www.dipp.eu/en/linksen.aspx>

Canada

TFOC (The Trade Facilitation Office Canada) operates as a non-governmental, not-for-profit organisation, and is the primary provider of information on the Canadian import market and a source of training for exporting and for investment attraction for developing and transition economy countries.

www.tfoc.ca

Germany

GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit GmbH). GTZ is the German governmental organisation for international cooperation with worldwide operations. GTZ offers technical assistance and information on business development and international trade.

www.gtz.de

Italy

ICE (Italian Institute for Foreign Trade). ICE is the public agency in Italy entrusted with promoting trade, business opportunities and industrial cooperation between Italian and foreign companies.

www.italtrade.net

Japan

The Import Promotion Department of JETRO (The Japan External Trade Organisation).

www.jetro.go.jp

The Netherlands

CBI (The Centre for the Promotion of Imports from developing countries). The mission of CBI is to contribute to the economic independence of developing countries. To fulfil this mission, CBI aims at strengthening the competitiveness of companies in those countries on international markets, primarily the West-European market, by improving conditions in enterprises and business support organisations.

www.cbi.nl

Norway

Norad (The Norwegian Agency for Development Cooperation) has signed an agreement with **HSH** (The Confederation of Norwegian Commercial and Service Enterprises) for cooperation on trade promotion services.

www.hsh-org.no

www.norad.no

Sweden

SIDA (The Swedish International Development Agency) has signed an agreement with **Swedish Chambers of Commerce and Industry** for cooperation on trade promotion services. The objective is to increase and upgrade business contacts between Swedish companies and exporters in Africa, Asia and Latin America.

www.cci.se/trade

www.chambertrade.com

Switzerland

SIPPO (The Swiss Import Promotion Organisation) promotes imports from emerging markets and markets in transition and operates under the patronage of the State Secretariat for Economic Affairs (SECO).

www.sippo.ch

Other trade support organisations

ITC (International Trade Centre) is the technical cooperation agency of the United Nations Conference on Trade and Development (UNCTAD) and the World Trade Organisation (WTO) for operational, enterprise-oriented aspects of trade development. ITC provides technical assistance and market information on various product groups, country information, including directories of trade promotion organisations, ITC publications and projects.

www.intracen.org

Expanding Exports Helpdesk – Advice for Developing Countries Exporting to the EU

The Expanding Exports Helpdesk is an online resource, provided by **the European Commission**, to facilitate access for developing countries to markets within the European Union. The Expanding Exports Helpdesk provides relevant information required by developing country exporters interested in supplying the EU market.

<http://export-help.cec.eu.int>

Small and medium forestry enterprises for poverty reduction and sustainability

Most international attention in forestry has been given to improving the conditions for large-scale or micro-scale forestry, and much less to the 'messy middle' – which produces a high proportion of forest products and involves huge numbers of people. Ways need to be found by which small and medium forestry enterprises (SMFEs) can better contribute to sustainability and reducing poverty. IIED, with partners in Africa, Asia, Latin America and the Caribbean have been investigating these issues. Country diagnostics show that the SMFE sector is of major significance for livelihoods – the net effect of myriad small players represents a substantial part of local economies. Yet, these are largely invisible economies, and policy and programme developments almost completely ignore the SMFE sector. Raising the sector's visibility such that its impacts can be better assessed, and then going on to explore how the positive links to sustainability, livelihoods and poverty-reduction can be enhanced, is a major challenge to which this initiative seeks to rise. Reports in the *Small and medium forestry enterprises* series available from IIED on request, and downloadable from www.iied.org, include:

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- No. 4 Small and medium forest enterprise in China. 2003. Sun and Chen.
- No. 5 Small and medium forest enterprise in Guyana. 2003. Thomas *et al.*
- No. 6 Small and medium forest enterprise in India. 2003. Saigal and Bose.
- No. 7 Small and medium forest enterprise in South Africa. 2004. Lewis *et al.*
- No. 8 Small and medium forest enterprise in Uganda. 2004. Auren and Krassowska.
- No. 9 Small-scale timber production in South Africa: What role in reducing poverty? 2005. Howard *et al.*
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- No. 11 Small-scale enterprise and sustainable development – key issues and policy opportunities to improve impact. 2005. Macqueen.
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- No. 15 Forest-based associations as drivers for sustainable development in Uganda. 2006. Kazoora *et al.*
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Series editor: Duncan Macqueen

Small and medium forest enterprises (SMFEs) are the norm in many developing countries. They generally make up 80-90% of enterprises and more than 50% of forest-related jobs. SMFEs have potential to reduce poverty and manage forests sustainably – especially when they work together in associations. But they often need support to deliver on this potential.

Small enterprise support structures and associated guidance are widespread across many sectors. But more is needed to connect SMFEs with these support structures. Opportunities also need creating to allow guidance (that is often extra-sectoral) to percolate into and transform forest sector support initiatives.

This report is a step along that road – reviewing the growing consensus on best practice in small enterprise support, both within and outside the forest sector. It describes how a framework known as ‘market system development’ unites attempts to: strengthen enterprise associations, facilitate better provision of financial and business development services, and improve the business environment. It concludes with specific recommendations for support to SMFEs.



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