Opportunities and constraints for investing in forests and trees in landscapes

Background Paper for the *Investment Forum on Mobilizing Private Investment in Trees and Landscape Restoration in Africa*

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Abstract

Investment in land and forestry simply to raise yields for fibre, food and fuel, perhaps by achieving economies of scale, is a narrow objective that, more often than not, does not account for the long term ecological, economic and social consequences of land use change. Forests and landscapes, particularly in Africa, can satisfy the needs of investors that are seeking an attractive rate of return combined with sustainable and socially responsible impact. There is great investment potential in releasing the latent energy of the small and medium sized enterprise sector. Local enterprises can manage (and restore) landscapes in a manner which better reflects the need for achieving social, environmental and economic objectives. These landscapes are populated by people who have certain rights over the land and the resources it provides. 'Climate-smart' investment needs to account for the role local people play in the landscape, particularly if the drivers of deforestation are to be tackled.

However, there are constraints to investing in such enterprises, such as low capacity, unclear tenure and weak institutions. These constraints can be overcome if 'soft' investment - from donors, multilaterals and governments - precedes 'hard' investment in order to improve the enabling environment and reduce transaction costs. For instance, through supporting institutional reform and financing intermediaries that are often so crucial in helping SMEs overcome their isolation from markets, investors and political influence.

Building a partnership between different types of investors, intermediaries and SMEs takes trust, patience and transparency. Certain steps are needed in the process to ensure a clear understanding of goals, and the means by which issues such as benefit sharing and quality improvement can be handled in a business-like manner. To realize investment opportunities into 'trees and landscapes', appropriate investments need to be made into people and enterprises that have a value proposition and the wherewithal to carry out their plan. This vision of 'climate-smart' investing is optimistic about the opportunity to restore forests and landscapes whilst also stimulating grassroots economic and social development.

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Abbreviations

BDSP	Business Development Service Provider
CDM	Clean Development Mechanism
CSR	Corporate Social Responsibility
DFID	UK Department for International Development (UK Aid)
EITI	Extractive Industries Transparency Initiative
FLEGT	Forest Law Enforcement, Governance and Trade
FPIC	Free, Prior and Informed Consent
FSC	Forest Stewardship Council
GACF	Global Alliance of Community Forestry
GFP	Growing Forest Partnerships
IAITPTF	International Alliance of Indigenous and Tribal Peoples of Tropical Forests
IFFA	International Family Forest Alliance
NTFP	Non-timber Forest Product
REDD	Reduced Emissions from Deforestation and Forest Degradation
REIT	Real Estate Investment Trust
SFM	Sustainable Forest Management
SME	Small and Medium Enterprises
SOE	State-owned Enterprise
SRI	Socially Responsible Investing
TFD	The Forests Dialogue
TIMO	Timberland Investment Management Organization
VPA	Voluntary Partnership Agreement

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1 Introduction

Economic development in rural parts of the developing world is constrained by many factors, not least of which is the failure to encourage the emergence of a vibrant small and medium sized enterprise (SME) sector. Activity in the forestry sector, within any given landscape, is dominated at the top end by very large businesses engaged in extraction of resources or using economies of scale to manage large estates, and at the other end a vast morass of informal enterprises attempt to eke out a livelihood in often unpromising conditions. The SME sector is often informal, poorly organised and unsupported and yet Africa in particular is a continent bursting with entrepreneurial spirit. This problem is known as the 'missing middle' and it goes some way to explain why land use in Africa is inefficient and so many people remain in poverty.

Yet these same people are living in proximity to potential wealth. It has been estimated that there are more than one billion hectares of lost or degraded forest lands worldwide which offer opportunities for restoration as forests, woodlots or agroforestry (GPFLR, 2010). In most cases local people, who have some form of formal or informal property rights, manage this land. This paper discusses how scaling up and ensuring effective local control of forest and agroforestry enterprises[1] holds the key to achieving landscape restoration and realizing investment opportunities, at the scale required to mitigate climate change and boost food production. Not only will this help to fill the 'missing middle' found in so many less developed economies, it will ensure that land management is equitable and sustainable.

Furthermore, investment in this sector need not be a niche activity, or a low-return sector confined to NGOs and donors. In the right conditions, investment in forest and agroforestry enterprises can yield attractive returns, representing a substantial investment opportunity that may satisfy social, environmental and economic objectives, for instance through:

i) Restoring forest landscapes *and* intensifying agriculture to meet the need for 70% more food by 2050 and trebling biomass energy by 2050 in ways that are socially and politically acceptable

ii) Protecting ecosystem services at both a local level and for global goods through mitigating and adapting to climate change

iii) Building viable local economies and off-farm employment, thus improving livelihood prospects for hundreds of millions of people.

This paper[2] considers the opportunities for investing in forests and trees in landscapes with a focus on how including local people in the ownership and management of small and medium sized enterprises is not only the right thing to do, it is the most likely precondition for satisfying

[1] *'Local control' means formally or informally, owned, managed or used by forest dependent people such as smallholders, local communities and indigenous peoples, as opposed to those managed by large companies or the state.*

[2] *Through the Growing Forest Partnerships initiative, in conjunction with The Forests Dialogue, investors in the forestry sector, forest rights-holders and other stakeholders have been working together to explore the opportunities and constraints for improving investment into locally controlled forests, and how investment can be directed to realise the opportunities provided for substantial economic, environmental and social returns. This has been through a series of field dialogues in Kenya, Panama, Nepal and Macedonia plus interactive dialogues specifically targeted at obtaining investors' input into the dialogue stream.*

sustainable investment criteria. These enterprises are within an economic sector that encompasses natural forests, plantations, woodlots, agroforestry, shade crops and the wide range of non-timber forest products and eco-system services that landscapes with trees can provide. They could be stand-alone enterprises or one of the various types of outgrower schemes or joint ventures that can now be found producing many estate crops.

A typology of different types of investors is presented, discussing how they can interact to improve the conditions for investment in locally-owned enterprises engaged in the management or restoration of forests and landscapes. The paper discusses the main constraints to such investments, and then proposes an improved approach to preparing, negotiating and implementing successful partnerships, with specific roles and responsibilities for each stakeholder.

2 Unlocking investment potential

Directing investment into trees and landscape restoration

Landscapes are complex systems, ecologically, economically and socially. Within these systems governments, who still control almost three quarters of forests (White and Martin, 2002), often see forests as strategic assets, yet these assets are allowed to diminish. While there has been some devolution of control over (often degraded) forests to local communities (White et al., 2007) poorly managed government control has still left large areas of marginal land, with overlapping legal title, confusing regulations and unpromising conditions for investment. Growing populations and global economic development are increasing the pressure on land, leading some to conclude that the only solution must be large-scale investments in plantations or food estates, which has led to a trend for so-called 'land grabs'. There is a growing debate about the costs and benefits of this trend. For instance, The World Bank (2009) has in the past commented with approval about land grabs, noting that *'while some small-scale agricultural enterprises (e.g. for labour intensive crops) can raise value added on small production units, most modern agricultural enterprises must pursue scale economies to justify increased investment and a higher cost structure.'* But a more recent report has documented deficiencies with the large scale approach, finding that *'…many investments…failed to live up to expectations and, instead of generating sustainable benefits, contributed to asset loss and left local people worse off than they would have been without the investment'* (Deininger and Byerlee 2011).

It appears that a top-down approach to forest management has failed in most places to deliver either good forest management or a decent living for local people, and applying a similar approach to broader landscape management is unlikely to be much more inspiring. This may be because raising yields for fibre, food or fuel is a narrow objective that fails to account for the long term ecological balance of the land (e.g. carbon, watersheds, and soil quality), the social realities on the ground and the importance of stimulating off-farm employment in order to bring about structural changes in the economy. Put simply, poor people are not hungry because of a shortage of food, but because they are denied access to the resources that would enable them to earn a decent livelihood by which they can purchase food (Sen, 1981). The solution is therefore an alternative investment route that is based on a broader understanding of complex forests and landscapes, and does not involve large-scale estates or 'land grabs'.

REDD Benefits to local communities

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

The company's flagship REDD project in Rukinga, Kenya protects over 500,000 acres of forest and brings benefits from direct carbon financing to Kenyan communities whilst securing a corridor between the Tsavo National Parks. Wildlife Works is actively developing a portfolio of additional REDD projects in Africa with an aim to; protect 5 million hectares of native forest, capture 25M tones of CO2 annually, create thousands of sustainable jobs for rural Africans and secure enduring markets for their products.

Recently they announced an agreement with BNP Paribas Corporate & Investment Banking and its commodity derivatives business in which BNP Paribas will provide up to U$50 million in finance to combat deforestation and climate change. The bank's carbon finance business and Wildlife Works will develop a portfolio of large scale REDD carbon projects in Africa. BNP Paribas will have the option to purchase avoided emission credits created from the portfolio with the right to purchase 1.25 million tones of credits over the next five years.

The project received validations under the Climate Community and Biodiversity Alliance standards and is designed to bring substantial benefits to local communities, while protecting forests and biodiversity.

Sources; http://www.wildlifeworks.com; http://www.ecosystemmarketplace.com/pages/dynamic/article.page.php?page_id=7717&section=news_articles&eod=1

Granting greater control to those who appreciate the multiple services provided by trees and forest landscapes is a means to satisfy multiple objectives for investment in trees and landscape restoration. The chances of reaching an outcome with acceptable trade-offs between those services are, therefore, increased. Investors who are interested in economic, social and environmental sustainability might wish to pursue an investment strategy built around strengthening local control.

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

Economic: In developing and developed countries, SMEs, such as those found across different landscapes, can be the engine of economic development. For example, Mayers (2006a) estimates that in many countries, 80–90% of forestry enterprises are SMEs comprising over 50% of all forest-sector employment and over US$ 130 billion/year of gross value-added wide. Unlike the vertically integrated industrial model of forest resource management that has been the dominant paradigm for so many years, small-scale industry has specific micro-economic characteristics that generate a 'multiplier effect' in rural economies because wealth is accrued locally, resource rights are secured as enterprises develop, social capital is enhanced and local environmental accountability is strengthened (Macqueen, 2008). This translates into entrepreneurial skills, higher incomes, higher local consumption and improved terms of trade. The DFID-funded Livelihoods and Forestry Programme program in Nepal (LFP, 2009) indicates this effect to be approximately 10:1, but some studies calculate this multiplier effect to be as high as 20:1 (GEF).

Social: Local economic development, where it involves the active participation of local people, has obvious social benefits. Specialising in small enterprises (e.g. timber processing) allows households to make a smooth transition from subsistence living to the market economy. Time gained through buying food in the market instead of hunting or gathering can be spent participating in local institutions. Surplus income is often invested in health and education, improving the welfare of the next generation through better nutrition and broader horizons for fulfilment. Communities with a mosaic of locally-owned businesses tend to have more self-confidence, political influence and autonomy.

Environmental: It is a common generalisation that forest dwelling people are naturally disposed to be careful stewards of the environment, and where they do collude in the degradation of forests they do so for understandable economic reasons (the 'poverty causes deforestation' argument). Conversely, where forest dwelling people receive financial benefits from the forest, they have a strong incentive to keep the forest standing (Carter et al. 2007). This may not be entirely accurate for all people in all places (just as generalisations about large corporations may overlook the better examples), but widespread evidence from around the world demonstrates that private property holders, including those with communally-held property rights, can and do protect public goods if the appropriate incentive structure is in place. In fact, rural communities own, or administrate under license, at least one quarter of forests in developing countries; and they invest $2.6 billion in conservation, exceeding state funding and all forms of international conservation expenditure combined (Scherr, et al., 2004).

Macro versus micro investments

It is easy to see why investors and governments often perceive greater value in macro investments that involve few transactions costs – as long as areas of land can be found that are empty or underutilised. But, as noted above, perceptions that such areas exist are highly questionable in most contexts. For instance, in South Africa large plantations were, and remain, the preferred option for timber companies. But initially land shortages and latterly land reform have forced companies to negotiate with multiple smallholdings through outsourcing agreements. It is an open question as to whether the reduction in scale efficiency brought about the new approach has a significant impact on profitability, and to what extent the benefits of improving the social and economic conditions of smallholders outweighs any such costs.

What is clear from recent research is that investments in SMEs have some advantages from a sustainable investment perspective.[1] Recent research suggests that industrial scale commercial forestry has at best avoided exacerbating poverty, but evidence that it has actually reduced poverty is scarce (Mayers, 2006b). Small and medium forest enterprises offer better prospects for rural development, especially when organised in groups or associations that have strong social and environmental aims (Macqueen, 2007a).

SMEs operate in any one of a number of different value chains (e.g. wood-fuel and charcoal, industrial roundwood, primary or secondary processed products, NTFPs and service delivery) and occupy a range of upstream to downstream positions within those chains. Many SMEs are restricted to upstream positions in agricultural crops, timber or NTFP production and harvesting. In some countries major agricultural or forest industries (notably South Africa, but also countries such as Brazil and Indonesia) operate well-established outsourcing schemes that involve such SMEs (Desmond and Race, 2002). In more exceptional circumstances, well-organised SMEs have taken on downstream processing and retailing activities too. For example, in Mexico, the communities of Ixtlan de Juarez, Santiago Textitlan and Pueblos Mancomunados in Oaxaca State all have forest

[1] Sustainable investing, also known as 'socially & environmentally responsible investing', accounts for the three dimensions of social, environmental and economic returns, sometimes abbreviated as 'people, planet, profit'.

harvesting activities, sawmills and furniture factories and at the end of 2007 jointly opened a furniture shop in Oaxaca city. In addition the communities are investing in ecotourism projects to add value to their forest activities (Suarez and Trujillo, 2008).

In general, the more advanced downstream processing activities tend to emerge only once SMEs achieve some form of collective organisation and scale. While there are many umbrella membership organisations covering different forest industry sub-sectors, the more useful forms of collective organisation involve producer groups or associations that actually do business together. For example, in Papua New Guinea, 29 community producer group members supply timber to seven coastal Central Marketing Unit members with certification and marketing services provided by the jointly owned umbrella body FORCERT. Each member is an independent company, but their joint producer group structure helps to achieve scale efficiencies, add value to the raw material and increase their collective bargaining power (Dam, 2006).

Investor and Investment types

Investments in forest and trees in landscapes can be made in a variety of ways and by a variety of actors. They can be grouped under the titles of 'soft' or 'hard' investment depending upon the expectations of return on investment. For instance, investments made by donors and non-governmental organizations to improve governance or secure forest rights through tenure reform could be said to be 'soft' investments, as their expected outcomes are not measured in cash terms. On the other hand, investments in creating new forest resources, managing landscapes or forests, building production and processing facilities and other infrastructure are 'hard' investments as the anticipated outcome is a tangible return on the original investment. In many cases 'soft' investment is required to pave the way for more commercial investment to follow.

For the purposes of this paper, investors can be divided into three 'ideal types' of Value Investors, Social Investors and Conservation Investors, defined by goals, pre-conceptions and expected return on investment. Broadly speaking, the different types are defined as follows:

Value Investors are seeking a real return on capital, and they do not expect to lose the real value of their investment over the medium to long term. Some may be more aggressive in pursuing this objective than others - for instance requiring a superior rate of return - while others will be satisfied with a 'better than cash' return. This represents a continuum of value investors with the more aggressive seeking strong economic returns whilst less aggressive value investors may seek social and broader environmental returns to their original investment. A combination of these hard investments across a landscape is necessary due to the nature of investments in forest and trees and the trade-offs required for sustainable landscapes.

Social Investors are investing as a means to an end, pursuing goals that are separate from the requirement to earn a return on their money. As soft investors they may expect no real return, or accept risks that are not usually justified by the rates of return on offer. Typically they are promoting development in some way, or acting as a pioneer investor in the hope of attracting mainstream capital. Social investors are attempting to change the circumstances of poor people through their investments, and recognise that markets often fail to deliver outcomes that are either efficient or equitable. Often these fall into the soft investment category but more increasingly these can be part of an actual social venture fund portfolio from commercial banks.

Conservation Investors are using their capital to protect or restore a specific landscape, habitat or species. As with social investors they are less interested in earning a real return on their capital.

They may view environmental degradation as an example of the market's failure to set appropriate prices on ecosystem services, and thus they use their capital to correct this distortion. However in some sectors they may feel there is no place for the market in the natural world. They are usually regarded as soft investors, but may be less interested in paving the way for hard investment.

Examples of these types of investors, and the investment models they are likely to deploy, are presented in Annex 1.

There is now a wide potential universe of value investors: equity funds, Timberland Investment Management Organisations (TIMO), Real Estate Investment Trusts (REIT), carbon funds, pension funds, Sovereign Wealth Funds etc., many of whom are becoming adept at reconciling sustainable investment goals with attractive returns. Investors are beginning to understand the reinforcing loop between local livelihoods and long-term forest asset quality, which is important for 'climate-smart' investments that hold their value over the longer term.

The openness and fluidity of international capital markets can be a crucible for innovation, which may lead to the emergence of models that resolve some of the issues facing sustainable forest management.

The range of potential investments at landscape level is vast with variations between forest type (natural forest, planted forest, etc.), the type of asset in question (e.g. wood, non-timber forest products, ecosystem services, intellectual property, capital), and the varying local rights platform (security of tenure, sub-national variations in legal regime, etc.). Consideration should also be given to the investment mechanism, and the value proposition, for both investor and rights-holder.

Real Estate Investment Trusts

In many cases the state grants timber concessions but does not have the capacity or inclination to oversee them properly to ensure long term forest quality. The state thus loses both ongoing revenue and long term asset value. Using Real Estate Investment Trusts as an investment model could not only ensure sustainable forest management (SFM), but also improve the terms for local rights-holders.

As the International Family Forests Alliance puts it: 'SFM needs a long-term commitment, and such a commitment needs tenure rights'. Investors see this as: a long term investment needs long term asset quality, which in turn requires all stakeholders to have a stake in that quality, requiring a separation between the investor, regulator and manager. The solution could be an improved concession model in which the local rights-holders agree to encapsulate their rights in an existing legal instrument (such as a timber production concession), without forgoing their pre-existing claim.

The concession is then held by the REIT, which in turn appoints the community as manager, probably in partnership with an experienced timberland manager who co-invests in the project. The REIT has a long-term financial interest in the asset quality, whilst the community has its existing interest and the co-manager needs to apply professional SFM methods to avoid cessation of the contract. All parties can agree terms on extraction rates (probably based on an existing certification model). The state regulator becomes effectively redundant, as disputes would be handled through a civil legal process. Such a model could form part of a sub-national or project level REDD or CDM project.

Investment opportunities exist throughout the supply chain of products coming from landscapes from different management practices such as sustainable forest management, and restoration, including reforestation / afforestation of degraded lands, agribusiness tree crops, out grower schemes and plantations.

People, Planet and Profit

Many investors now recognize that achieving resilient returns over the long term will only be possible if their assets deliver a balance of social, ecological and economic benefits. #

Understanding how to deliver these benefits through investment in trees and landscape restoration is essential in the context of climate change mitigation projects, rising food prices and social unrest.

Numerous REDD strategies and readiness plans have identified what must be solved at the forest agriculture interface to avoid deforestation, but the various climate change funding organizations show little sign of knowing how to marshal the soft and hard investments to make that happen. Similarly, a report submitted by the Special Rapporteur on the right to food to the UN Human Rights Council now recognizes that continuing to invest in industrial agriculture is unlikely to address the challenge of global food security. Advanced in its place is a paradigm of 'agroecology' in which investment in biodiverse and biomass rich agro-forest production systems is held out as the key to food security in an ever more variable climate.

But how can soft and hard investment bring that about? If multilateral institutional funding can be channelled correctly, it could provide the 'soft' investment that paves the way for attractive 'hard' investments in forests and trees in landscapes. More than 100 southern civil society organisations and indigenous people's groups from 38 countries have called for such an alternative approach (Accra Caucus, 2010) arguing that soft investment should be channelled not to augment the economic value of standing forests (versus the ever increasing demand for, and therefore value of, agricultural alternatives) but instead, channelling towards securing the (often fragile) commercial rights to land and resources that are held by local right-holders, building their business organisations and capacity to attract investments that respect the multiple benefits that landscapes provide at local, national and international levels.

Both rights-holder groups and 'hard' investors are thus in agreement that a 'climate smart' approach to investment would find ways to unlock the economic value of the landscape and the talents of the people that dwell there, forming genuine businesses that contribute to development and human welfare. This approach acknowledges the role that trade and enterprise plays in development, diminishing the drivers of deforestation and enhancing the returns to rising productivity and innovation.

3 Constraints to investment

Competing goals of investors and rights-holders

Different actors (notably investors and forest rights-holders) have quite different cultural and professional outlooks that involve divergent ways of using key linguistic terms. Different meanings held by rights-holder groups and investors of common words and unfamiliarity with the professional or cultural language of the 'other side' hinders understanding at times and challenges joint progress. For example, 'investment' is understood by investors as a primarily financial term involving capital transactions, whereas, forest rights-holders understand 'investment' to mean something much broader, the active allocation of resources (including rights, organisation and capacity alongside capital) to enhance forestry assets not only in the present but also for future benefits (Elson, 2010). Such differences in language are rooted in different perspectives about the objectives of investing in forested landscapes.

The ultimate ends of investing in trees and landscapes might be summarised as follows:

For the investor: Acceptable returns on capital (be they economic, environmental or social returns – depending on the type of investor) invested in viable entities often over relatively short time frames with acceptably low transaction costs – where stability, liquidity and measurable risk are pre-conditions.

For the rights-holder: Strengthening of local control (autonomy) over land, resources and enterprises such that their more holistic social, environmental and economic aspirations can be furthered on their own terms.

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

Tenure and use rights

Lack of clarity about land ownership is the prime concern of investors (McKinsey, 2008). Investors with experience in timberlands may expect a form of unqualified land ownership, such as 'fee-simple' or freehold. As this is less common in emerging markets, the Global Environment Fund (2009) suggests that 'investors must be comfortable negotiating long-term leases or concessions.' However, the danger with this approach is that the ownership of so much forest around the world (especially in the tropics) is contested. Exactly the same problem applies to agricultural land (Cotula et al., 2009).

Where investors look beyond the tenure on offer from the local government, they may find a tangled nest of issues awaits them, with competing claims to both the land and the standing assets from local rights-holders. Investors may be neither willing nor equipped to deal with these issues. Even in the event that local rights-holders do have recognisable legal rights, such as smallholders, it may not be clear how these 'rights' can be monetized or securitized if they are not assignable, and it is most unlikely that Indigenous People and communities can officially grant natural forest leases to investors.

Effectiveness in establishing clear tenure and commercial use rights depends to a large extent on the quality of governance (Mayers, 2011). Unfortunately, weak governance is often found in both formal statutory land administrations as well as in informal and customary tenure arrangements. It flourishes because the law is often complex, inconsistent or obsolete; people who work in land agencies lack motivation and are poorly paid; decision-making processes are not transparent and civil society is weak.

Poor governance of tenure and commercial use rights discourages social stability, investment, widespread economic growth, and sustainable use of the environment.

Social organisation into viable business entities

Investment cannot easily proceed without viable business entities in which to invest. One of the key constraints facing investment in trees and landscape restoration is that much of the commercial activity involves informal, unregistered enterprises. Informality (not necessarily illegality) is pervasive in most developing country forested landscapes (Kosak, 2007).

The high transaction costs associated with engaging with multiple actors spread across landscapes has often led to a focus on collective action. The rationale is that overcoming social structural difficulties – creating the trust and organisational structures necessary for collective action – can help reduce transaction costs and so help to foster investment. To date, much of this focus has been directed at the level of the firm (the 'first tier' of social organisation). For example, considerable emphasis has been placed on formalising share-based or stakeholder-based associations and cooperatives (Macqueen et al. 2006) or else developing new partnerships, debt, grant and equity based relationships with private sector investors of different types (Elson, 2010).

Social organization is often a secondary consideration to economic and environmental goals when dealing with community forest enterprises (de Marsh, 2011). Yet at the enterprise level, social organisation is required to define and staff appropriate business roles, undertake basic business registration, management and record keeping in order to manage income and costs effectively (and inspire investor confidence should expansion be desired). At the regional or national level social organisation is crucial to link forest enterprises better to each other (in business groups or federations), to markets, to financial and business service providers and to policy and decision-makers (Macqueen 2007b). Where viable business entities do not exist this proves a major constraint.

A further constraint to developing viable business entities is isolation. Multiple country studies show how SMEs and their associations are often isolated in four main areas:

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

Business capacity

Competitive business skills among forest rights-holders are essential to break into or create new markets, ensure profitability and attract investment for managing the forest resource sustainably. They are rarely ubiquitous across forest landscapes in developing countries. Indeed *ad hoc* alliances such as Forest Connect[1] have been established to facilitate support for small forest enterprises precisely because business capacity development is so unsupported in forest and tree enterprises across landscapes (e.g. Macqueen, 2008)

Experience suggests that there are a number of areas that require attention in helping entrepreneurial forest rights-holders to understand (Macqueen et al. 2009):

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

One of the key areas that requires support is in helping forest rights-holder groups to prepare or negotiate adequate investment proposals. This involves both preparing the proposal (e.g. developing the initial concept or business idea, conducting an impact study, formalising an organisational and institutional structure, preparing a feasibility study, getting agreement internally, and writing the concept note or business proposal) and negotiating the deal with an investor (e.g. disclosure of objectives, matching the investor to the concept, designing the deal with debt/equity financing, revenue sharing, time scale, involvement of third parties, conducting due diligence to identify gaps, making improvements, re-negotiating and signing a heads of terms agreement) (Elson, 2011).

[1] *http://forestconnect.ning.com/*

Market constraints

Policies & rules

Not all markets are free. For different reasons, governments might restrict investment options relating to forest landscapes. For example, in Mozambique only Mozambican nationals can take advantage of the annual Simple License arrangement to exploit timber – whereas both national and international investors can pursue longer term concessions. In other countries such as Ghana, strict requirements for legality linked to the Voluntary Partnership Agreement (VPA) with the EU Forest Law Enforcement Governance and Trade (FLEGT) action plan restricts what timber species can be harvested and exported and how. Alternatively many governments restrict investments in particular landscape contexts for environmental reasons, for example agriculture on sloping lands due to watershed and erosion concerns, or plantations on peatlands in Indonesia due to carbon emission fears. National forest policies and regulations, notably those on cutting of indigenous trees, also provide adverse incentives and limitations for investment in such species in landscapes (Ruf, 2011).

Overcome regulatory barriers to realize investment potential

To date the development of the ***baobab*** *sector has been relatively fast and shows strong potential for further growth especially given the significant resource base within Africa. The sector is currently being fuelled primarily through the sale of baobab powder - with the production and sale of baobab oil viewed largely as a by-product. Following the successful approval gained by PhytoTrade Africa on behalf of its members for the sale of baobab powder into the EU under its Novel Foods regulation, the next step is to bring baobab powder to the attention of the buying public as a new and therefore unfamiliar ingredient. This should emphasise its many beneficial qualities but also convey its role in improving livelihoods and sustaining biodiversity.*

Further investment is needed in the overall sector and while the resources of the enterprises in the sector remain modest this is an area for which donor support will continue to be needed. Regulatory barriers remain in much of the world - although PhytoTrade has been successful in gaining entry for baobab powder to the United States of America under the Generally Regarded as Safe (GRAS) regulations and also into Canada. For baobab powder other major markets need to be addressed - for example the Far East and South America. Within those markets for which the regulatory barriers have been addressed there remains a strong need to highlight baobab and its benefits and to build a strong and lasting distribution network into key markets. As the sector continues to grow there will be a need to ensure that other countries in which baobab occurs in quantity are enabled to join the business generated.

Within the individual enterprise level, emphasis from the outset on domestic and regional markets is an important key to establishing viable business whilst the export markets are developing. Opportunities clearly exist within these countries for investment in baobab processing. Production of around 150 tonnes of baobab powder annually, for example, would involve around 1,000 people. This would entail an investment of between US$150-200,000 covering factory and machinery together with investment in harvesting groups, training, certification, transport to factory etc. excluding working capital investment.

Source; adapted from PhytoTrade personal correspondence

Market inefficiency

Even where markets are relatively unconstrained by policies and rules, they may operate inefficiently because of a number of factors. Poor market information systems can constrain the ability to meet demand with supply. For many agriculture and forest products, lack of market information may be compounded by inadequate grading or product quality control. For example, in Honduras when Greenwood[1] were attempting to supply Taylor guitars with Mahogany guitar necks, a major effort went into building capacity for quality control before the first orders were delivered. Attempting to invest in community forestry timber operations has frequently collapsed through the inability to meet quality expectations on time (Kwisthout, undated).

[1] *http://www.greenwoodglobal.org/*

Competition

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

Seasonality

For NTFP investments especially, seasonality of supply may mean that there is a glut during the harvesting period that depresses prices. In such circumstances finding alternative markets or ways of storing products so as to be able to sell off-season are possible solutions.

4 Improving investment streams into forest landscapes

A first step towards overcoming the challenge of mobilizing investment in trees and landscape restoration is to recognize that investment is attracted by a value proposition, not merely an empty landscape. Forests and landscapes are inhabited by people who have some form of rights over the land, of varying degrees of formality. Investors are increasingly aware of the need to apply some form of Free, Prior and Informed Consent (FPIC) process in order to acknowledge some respect for these pre-existing rights - although the practicalities of how these rights are respected has received less attention (Colchester et al. 2011). The output of such a deal is usually some form of compensation for lost revenue, rather than a shared enterprise. This trend may be even more likely in REDD deals, where communities are being paid to avoid deforestation.

However, 'respect' for local rights needs to arise from something other than mere proximity to natural resources. The danger in advocating principles that rely on emphasizing the inherent worth of rights holders (such as Indigenous Peoples) is that they risk overlooking the real value of the deal, which is vested in the business plan rather than just the resources. A focus on resources and rights, whilst important, diminishes the importance of labour, skills, markets, capital and institutions.

Investment in forestry and agribusiness usually follows a pattern of 'capital seeking natural resources', for which some labour is required, which may often be migrant labour (**Figure 1**).

Figure 1 - The resource-led system

In this rendering, undeveloped land is 'empty' and has no value, and any informal customary rights over the land are subordinate to the wider national interest. Indeed, such rights are pre-modern, inscrutable and an impediment to development. There is also an assumption that because forests are often sparsely populated, the land must be unclaimed wilderness. It seems corporations and conservation NGOs alike often share this assumption. It is this view of an extensive, virtually limitless expanse of land, unfettered by formal boundaries and seemingly devoid of people, which informs the approach to land use and natural resource extraction.

In contrast to the resource-led approach, a rights-based system places rights at the heart of the process, as rights-holders seek investors and partnerships in order to manage the sustainable use of natural resource assets they command (see **Figure 2**). This approach recognizes the autonomy of the local people and their rights to determine the destiny of their land and participate in the income from its effective management.

Figure 2 - Rights-based system

A genuine business partnership between investors and local rights-holders is both a manifestation of the rights-based approach and the means by which it can be sustained. Because unless investment is forthcoming, economic development stagnates and there is a chance that local and national governments propose the default 'resource-led' system as the solution to releasing value from forests and landscapes.

Road map to implementing a deal

Building an investment partnership with rural enterprises, in either forests or agribusiness, is in some ways no different from mainstream investment. The process of discovery, relationship building, negotiation and implementation will be familiar to investors and bankers from any sector. However, as previous sections of this paper have argued, there are some specific challenges to investing in trees and landscape restoration. At each stage the local counterparts will need advice, mentoring and capacity building - which may be supplied by an intermediary or soft investor. The process may not be strictly linear, but is an iterative one, which at certain points may require some specific intervention. For instance, a feasibility stage should test the business concept and the community's capacity to deliver it, before the investor is involved. Gaps identified at this stage need to be addressed, either by improving the value proposition or by upgrading capacity and organisational strength. Later in the process, the investor will follow a due diligence process, and this could also identify further gaps requiring attention. At this point roles can be assigned to third parties such as NGOs and soft investors, and budgets allocated.

There are a number of ingredients to a successful deal, which are discussed below.

Preparation Phase

a) Identification of an organisational entity with whom a deal can be made based on appropriate local representation

Identifying an appropriate body with clear decision-making power is widely perceived as a difficult proposition, especially whilst respecting the need for wide participation. However, it seems that the answer to this lies in the process: only the community itself can define the composition and structure of the entity (usually with help from a third party – funded by 'soft' investment). When the investor comes on the scene, this body should be fully formed and present itself as a coherent entity that in some way the investor can recognise. It is not reasonable (or desirable) to expect the investor to be making judgments about inclusion, gender and the opaque politics of disparate communities that may be culturally and spatially specific. The preparation phase requires that a process satisfying community norms and general principles of community development are followed (e.g. from the FPIC guidelines), and that the investor is satisfied such a process was followed – it is unlikely they will require the details.

Developing viable local business entities in Mozambique

As part of the Forest Connect alliance, the Centro Terra Viva (CTV) have been working with communities to develop investible entities in bamboo and integrated coconut fibre utilisation. For both product lines, CTV helped communities to constitute and legally register commercial associations. They then identified experts to provide training on the integral use of bamboo and coconut fibre (from plantation, management and harvesting to product processing, design and commercialisation). In order to scale-up commercial activities they negotiated with a 'soft' donor, the Government of Mozambique small enterprise authority IPEME, to establish a demonstration centre on Bamboo. They also financed farmer association exchange visits and participation in trade fairs where they could build their experience both in product design and marketing. As the formality of farmer associations has increased, it has been possible to explore with local companies options for investment and retail.

The impact of the interventions so far has been formalised producer groups producing more diversity of products on the market (vases, tables etc) which have been sold at higher values to increase family income.

However, it is important that the proposed organisation is a formal legal entity that can trade and enter into commercial relationships (it may not actually be set up yet – the costs of formality can be considerable and may require the investor's financial and legal clout to execute). In most countries it is unlikely that a community group or cooperative would satisfy these criteria. The ownership of the new entity will need to be discussed, and the terms under which shareholders can withdraw their investment. For instance, a separate limited company may have shares owned by a cooperative or directly by community members, in each case suggesting a different form of relationship between the company and local people.

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

It is perhaps here the issue of sequencing between ‘soft’ and ‘hard’ investment is most clearly seen. Preparing the community (‘soft’ investment) means helping them articulate what they wish to achieve, how they are going to organise themselves into an investible business organisation, who can speak on their behalf, who has veto, are women excluded etc. These issues should ideally all be dealt with in the preparation phase before the investor is on the scene. Once the ‘hard’ investor arrives, the community needs to confirm that an appropriate process was followed and that this entity is one that can make enforceable deals. Otherwise, the investor would face a future risk of disagreements over the terms of an agreed deal and ‘submarine’ claims over land and resources. There may be a case for the principle to include a statement that the ‘investor has evidence that the constitution and ownership of the company is a proper reflection of the will of the broader community’, but it is hard to see how this could be ascertained by an investor in practice.

It thus makes sense to widen the definition of this principle to include the process of participation to design the enterprise, and how the Articles of Association can be used to define rules and procedures to balance the rights of shareholders with the need for company officers to make effective business decisions that are in the long term interests of the company and all its shareholders, such as replacing a non-performing executive.

It may also be worth pointing out that such a structure should be careful not to discriminate between different classes of shareholders if that means diminishing the autonomy of the local rights-holders. (e.g. voting and non-voting shares, preferred stock etc.)

b) Common understanding of forest tenure, rights and obligations and a commitment to strengthen local control through the investment process

Where there is no clear legal tenure, it could be said that the land is not ‘locally controlled’, and thus investment in local forest or landscape enterprises is not yet possible. It could be argued that tenure is the fundamental necessary condition for investment. Yet rights holders have argued that one of the key reasons for getting involved with an investor is that it may lead to clarification of tenure, indeed this could be seen as an outcome that is actually more important than direct financial rewards. How would this happen in practice? Perhaps an investor has more weight with the national or local government? Not all such deals end happily. The palm oil estates in Indonesia endow each of the outgrowers with a two hectare plot of land, but in many cases this is perceived to be less valuable than then previous situation of communal access to a very large area of forest. So formal tenure may be a retrograde step from the status quo.

As part of the process of securing long-term tenure security, rights-holders may need to be prepared in to work with governments to encapsulate their rights into an existing legal framework (for instance a concession or lease) that permits fair use of the resource, even if this does not in the short-term advance their ultimate goal of freehold tenure (Elson, 2010). This implies some compromise may be required by the local rights-holders in order to allow investment to proceed, but with the stated long term goal of obtaining more permanent formal tenure in future. There is consensus amongst rights-holder groups that recognising and securing land tenure and user rights is a precondition for sustainable forest and land management. Rights are thus a precondition for rural development, as tenure is an asset, and releases value that is locked up in land and forests. However, governments often need to be convinced that there is no ‘loss’ to the state by transferring state forest land to local people, and this misconception stands in the way of tenure reform in many countries.

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

Rights-holders may hold various interpretations of how 'tenure' maps onto their usually quite sophisticated understanding of multiple overlapping layers of state-defined and customary-practice ownership, management and use rights. Tenure may be tied up with issues of self determination or intra-community politics, and can often have a complicated legacy.

For *investors* tenure is generally understood as a legal right that creates an asset that can be assigned, for instance to become an asset on the balance sheet, or as collateral for a loan. The investor needs to identify how rights to land and standing timber are held by the company.

Governments in most cases understand tenure as a strategic tool to confer the benefits of land use on different interest groups while retaining the freehold and receiving rent in return.

These formulations are not necessarily incompatible, but they do need clarification. There is some tension: rights claimed by communities may be ignored by government, and whilst they have local recognition this may not be sufficiently robust for investors. Conversely, leases granted by government without local consent are not consistent with FPIC principles and thus do not constitute sustainable investment (and thus carry significant risks for the investor). Therefore, all three parties need to be in a position to negotiate these rights.

Securing tenure rights requires a range of governance tactics are premised on a number of legal ingredients the sum of which give necessary security for a forest or landscape enterprise (RRI, 2009):

- Duration – sufficient to provide an incentive for communities to invest both in the forest, and in businesses that might sustainably use it.
- Assurance – clearly prescribed, avoiding any ambiguity or distinction between 'subsistence' and 'commercial' use or between 'land' and 'forest' rights – guaranteeing returns from any investment.
- Robustness – easily defensible in a court of law and so prescribed and disseminated that they permeate the day-to-day practice of forest officers, transport police, customs and the judiciary.
- Exclusivity – no overlap between the commercial forest rights of communities and those of external investors or government agencies.
- Simplicity – free of excessive bureaucratic steps, lengthy documents, costly registration procedures in far-distant offices etc.

c) Investment in capacity building

Improved capacity should be an expected outcome of investments, as people generally 'learn by doing', and provides enhanced opportunities for future investment. However, some degree of capacity is required in the earlier stages in order to:

- Organise the rights-holders into a coherent entity with professional business roles
- Secure the necessary formal commercial access rights and operating permits
- Identify the business opportunity / value proposition
- Understand the nature of the deal and any relinquishment of control proposed
- Negotiate the best outcome – based on all parties agendas
- Start up the business on a solid footing

Capacity building is relevant to all parties: investors can learn more about certain landscapes and local conditions. Governments can learn more about what works for promoting enterprise. NGOs refine their community development skills. Capacity building is thus an integral part of the process, with each step calling for different skills and intervention from third parties.

The guiding principle is to respect inherent skills, whilst acknowledging the potential for improvement. All parties should commit to bring optimism, enthusiasm and willingness to learn. Investors acknowledge that investment will be required in capacity building, and also that all new enterprises have the right to make mistakes – so long as they learn from them quickly.

Building a Partnership

Partnership supporting the "People, Planet, Profit" concept

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

Novella is an international public-private partnership with a wide range of actors. Unilever has carried the largest investment and buys the harvest in pre-processed crude oil for refining in Rotterdam and has received a food clearance for Allanblackia oil in spreads from the European Food Safety Authority, which is the entry ticket into the food market. The opportunity of having such a key market player as Unilever in the partnership is critical to encourage increased supply of Allanblackia seeds.

ICRAF is leading the scientific work on the domestication of Allanblackia to boost harvest levels into commercial viability. The National Forestry Research Institutes in Ghana and Tanzania are supporting this work by coordinating field activities and linking to other government departments. Technoserve provides business advice and access to both markets and capital to business people in developing countries. Whilst IUCN works to facilitate the integration of forest landscape restoration principles in the different models for increased production of Allanblackia, they are also supporting the development of a market differentiation system for the Allanblackia oil in collaboration with the Union for Ethical Biotrade.

Novel International is the African partnership member and consists of the companies developing the supply chain in the main 3 countries of focus at present; Ghana, Tanzania and Nigeria. In 2008 Unilever took a step back from the management of the national level supply chain and it was handed over to three local companies in Africa (Novel Ghana, Novel Tanzania and Novel Nigeria). The reasoning behind this decision is to strengthen decision-making, ownership and implementation at a national level and support the vision of Allanblackia being a product from Africa for the benefit of Africans. This highlights the position of Unilever as an organisation that wants to facilitate the development of the supply chain (rather than own it), which as other buyers enter the market will improve the opportunity for a sustainable supply chain.

a) Trust and transparency are the foundations to a successful partnership

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

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

However, transparency is just one element of the process of trust building. In modern investment relationships, the process of trust is embodied in institutions and signified by the strength of social capital. For instance, the sanctions for misconduct by directors is severe in many jurisdictions, usually ensuring some adherence to fiduciary responsibilities. This is buttressed by systems that monitor performance, such as independent auditing of accounts. Assets lodged as security of a loan can be relied upon to be available for alienation in the event of default. In forest investment, with long time frames and remote locations, trust plays an important role in satisfying investors that future returns can be realised. However, local institutions may be weak or non-existent, and judicial systems dysfunctional. Therefore some outsourcing of trust may be necessary, for instance by encouraging certification schemes such as FSC, setting up auditing systems and the long-term involvement of intermediaries.

b) All parties explain their vision for the deal, and proceed towards agreed goals.

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

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

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

These are the issues that should be explored further to reveal potential differences in values and vision, e.g.:

- Does an enhanced forest landscape require a diverse forest (so monoculture crops are not appropriate)?
- What is the endgame of afforestation in terms of utility and amenity value (will the future forest provide more than just timber)?

- Do the requirements for financial discipline that underpin profitability preclude early dividends to a social fund?

This is a process of mutual learning, and is the first step in determining if this partnership is viable and sustainable. It does not mean that either side needs to compromise their values, but rather that goals need to be clarified so there can be no later misunderstanding.

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

Some major social, environmental and economic transformation is likely to be the eventual outcome of the deal (e.g. moving from a subsistence to market economy). Indeed, if a locally-controlled enterprise is successful it is hard to see how it could not be transformative in some way. How do rights holders prepare for this transformation and take measures to ameliorate the disordered effects of progress such as inequality, maladaptation and loss of cultural homogeneity? (Cowen & Shenton, 1996).

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

Negotiation

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

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

There are certain guidelines for good negotiation:

- Straight and fair dealing
- Share information and data (transparency)
- Disclosure of other parties involved
- All parties have capacity to say 'no' as well as 'yes'
- The deal on the table can be compared to alternative deals (e.g. its benefits are expressed as financial returns, or as money equivalent rather than as intangible or hard to measure benefits)
- Risks should be aligned with rewards

A good negotiation process should reveal what each party has to offer and what they expect out of the deal. However, it may be difficult for rights-holders to reject 'easy money', for instance:

- REDD funds that are finding a home but come with little oversight
- Subsidy from local government in the form of cash or equipment
- NGOs experimenting with private sector projects to please donors, but with no real understanding of long-term private sector development.

Perhaps rights-holders need to be examining the proposed deals to test them for potential to be transformative. Deals that perpetuate the status quo (such as REDD cash transfers conditional on not exploiting the forest) should be rejected in favor of genuine investment. The principle behind this may be that the deal aims to build something with sustainable value.

Working together

a) An agreed arbitration process mediated by a third party

As observed above, partnerships of any sort are built on trust, openness and the perceived fairness of how each party's contributions are rewarded. However, matters may still arise that require resolution, and this may involve third parties. A pre-defined negotiation process can identify agreed routes for arbitration and conflict resolution that are most appropriate to the context. Such a mechanism is a standard clause in mainstream investment, but where there are disparities of power, resources and access to information, a more innovative approach is required.

In any business, if the shareholders are deadlocked (for instance where the investor and entrepreneurs each hold 50% of the equity) then exercising a straight vote may not resolve anything. For this reason it is sometimes appropriate for a third party to hold a 'golden share' which does not have much face value or right to dividends, but can be used as a casting vote. It can also be used to ensure certain businesses stay loyal to a set of founding principles. NGOs and other soft investors could in some circumstance fulfil this role for investors and rights-holders.

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

The contract can improve resilience and lower risk by introducing trusted third parties, for instance:
- Escrow accounts for capital drawdown and revenue collection
- Arbitration services and foreign jurisdictions
- Crop verification and asset protection
- Performance certification (e.g. FSC)
- Financial auditing by professional accountants
- Insurance to cover political, economic or physical risks

b) Fiduciary responsibility towards the enterprise without favouring any one group of stakeholders

In order to protect the interests of all parties, it must be understood that the business is a discrete legal entity and the embodiment of the agreed rights and obligations of all parties. The company's interests cannot be made subordinate to any one group of stakeholders and the benefits should be distributed according to the agreed formula. As benefit sharing is often a cause of disputes in forestry and landscape deals (especially in cases of power imbalance and non-transparency), it is not sufficient for parties to sign up to a vague principle of 'fair distribution of benefits', as this fails to crystallise the terms and conditions of how - and when - the business will be capable of paying dividends.

There is a sense that the benefit being 'shared' in not always cash. It could be anything valued by the either party, but to evaluate if benefit sharing is fair it probably needs a cash proxy value of some sort. Sometimes the project is designed to generate revenue to cover cost of infrastructure and local services. For instance the RuKinga plan in Kenya calls for: 'Government involvement to ensure funds used for infrastructure and health' (Barrow et al., 2010). But this acts as a form of super-tax that displaces state expenditure, and may not necessarily generate additional benefits. It often seems the case that NGOs and governments conspire to persuade community enterprises to spend their profit (and often the balance sheet too) on local services that should more properly be provided by the state. Investors may fear that this practice has the perverse effect of penalising success, to the detriment of all parties (except, of course, the local government).

Timely and equitable benefit sharing is important for sustainability, and perceptions of inequality will lead to disputes requiring arbitration. This will be particularly the case if projects are either way below or way above profit target. The costs of failure should not fall unduly on the local people, but on the other hand it is also important that equity investors have confidence that they will be allowed to participate in unusually high profits without having renegotiated terms thrust upon them in the name of 'fairness'.

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

The principle should be that all parties understand what they are putting into the deal, and what they can expect to take out in any given set of circumstances. Such a deal can accommodate what to do with profits that exceed expectations, but can also formulate deals that allow for cash to be kept in the business if a dividend distribution is considered imprudent.

This requires all parties to consider the business to be a separate entity that stands apart from its directors and shareholders, and as such is almost another party in negotiations. In some jurisdictions a company is in fact a legal person. This is the fallback position when negotiating benefit sharing: any act that compromises the sustainability of the business cannot be permitted, even if all parties agree to it. This is where a 'golden share' can be useful, to ensure that such a set of circumstances is unlikely to arise.

Roles and Responsibilities for improving investment conditions

a) Governments

It is common to call for 'good governance' to improve the investment climate in forestry and landscapes. Good governance creates the circumstances for good institutions, which in turn improves the enabling environment for business, so this is primarily a government responsibility, but is a process of change that unfolds over time and involves many different actors. For instance, the Extractive Industries Transparency Initiative[1] is an example of how foreign investors have acknowledged they have a part to play in supporting efforts to improve governance, and not undermine institutions. (e.g. *EITI Principle No.9:* 'We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business'.)

Good governance, institutional quality, democracy, accountability and transparency all contribute to an improved enabling environment for business. For instance, good quality social institutions and legal frameworks start with rights as something to be protected and nurtured. The better the institutions, the lower the transaction costs, the more attractive for investors. Commercially oriented parties, within the context of decent institutions, will make better deals than if governments are left alone with investors to strike deals out of the public eye, as many of the so-called 'land grab' deals have demonstrated (von Braun & Meinzen-Dick, 2009).

Many of the pre-conditions for successful investment in trees and landscape restoration, such as clear tenure and property rights, flow from an improved institutional context. It is perhaps fanciful to expect governments to reform tenure in isolation, without considering the broader institutional issues, such as the role of forests as a strategic asset in the political economy of the country.

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

In some respects the government is a 'soft' investor, and is both creating the institutional conditions for investment as well as committing funds to tenure reform and spatial planning, which can be significant items of expenditure. For instance, Papua Province in Indonesia has been assisted by donors to formulate the provincial spatial plan for the next twenty years, covering thirty million

[1] *http://www.eiti.org*

hectares of forest, with special attention given to ‘putting people back in the plan’. Donors that give sectoral support direct to government budgets may need to ensure that resources are focused on improving the institutions rather than attempting to intervene directly in local forestry.

In summary, the institutional conditions can be made more suitable for investment through improving the enabling environment for business, for instance as measured by the World Bank ‘Doing Business’ Review (World Bank / IFC, 2010), including:

- Clear tenure and usage rights for defined periods, reflecting local customary rights
- Enforceable contracts and terms of payment
- Foreign Direct Investment rules allow foreign investors to own equity stakes in local companies, and that do not place forestry on the negative list
- Level playing field (e.g. forest governance excludes illegal logging, SOEs do not have monopolies or control licensing)
- Many players, open markets and competition
- Fiscal rules that encourage investment in SFM
- Systems for monitoring corruption (e.g. ‘Publish What You Pay’ schemes)

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b) Intermediaries and brokers

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

However, these intermediaries may not always be competent to supply these services, or they may run out of funds. Some intermediaries are themselves soft investors, but may be pursuing a goal that is at odds with what local communities wish to achieve, for instance purely social or conservation objectives. Clusters and associations can assist rights-holders in vetting appropriate intermediaries. Soft investors, particularly donors interested in stimulating rural enterprises, should ensure service providers (e.g. Business Development Service Providers) have secure funding to enable them to extend services to SMEs over the medium term.

Farm Africa as an intermediary in the development of wild coffee exports from Ethiopia

Coffee has its origins in the mountains of Ethiopia, but local rights-holders have not captured the full value of this product which helps to maintain a substantial belt of rainforest in the Bale Mountain region. As part of the Forest Connect alliance to support small forest enterprises, an intermediary (Farm Africa) set out to improve coffee quality and thereby increase price, establish a functional value chain between community producers, emergent Forest Cooperatives, the newly privatised Oromia Forest and Wildlife Enterprise (OFWE) and international markets and develop a speciality brand (Balewild).

Their intervention consisted of several overlapping activities. They organised capacity building for coffee farmers (training in quality improvements and providing coffee technology support). They brokered a business partnership between the newly established Forest Cooperatives and OFWE. They encouraged OFWE to pay a premium price for coffee farmers (conditional on quality improvements). Finally they made the link between OFWE and an Italian coffee importer (Sandalj trading spa.)

The impact two years into the programme has been increased revenue generation for both Forest Cooperatives and OFWE. This has translated into real livelihood improvements for coffee farmers. In addition, coffee farmers have become aware of the value of coffee quality improvement. Both business partners have come to appreciate the mutual value in a strong business partnership with market linkages to overseas markets. The intermediary, Farm Africa is working towards strengthening both the capacity of OFWE to identify overseas markets, and local Forest Cooperative to federate and strengthen their supply base to OFWE – within a carefully planned exit strategy.

c) Investors

A constructive partnership between hard and soft types of investment in trees and landscape restoration is essential because of the inherent mismatch between the scale of potential investment, and the professionalism required to secure them, and the scale and capacity at which SMEs operate. Since hard investors understandably look for investible value propositions, and are unlikely to shoulder the transaction costs of developing investment preparedness among actors in forested landscapes – it is incumbent upon soft investors to step in.

It is clear that soft investors need to precede hard investors to ensure that the preparatory work is done in order to enhance the likelihood of a successful negotiation and implementation. For instance by providing financial support for:

- Any necessary process of mapping, campaigning for, delimiting and registering commercial forest rights
- The facilitated organisation of business entities – and associations and federations between entities
- Institutional hubs that facilitate market system development and small enterprise support

They should also be prepared to hold the 'golden share' and arbitrate between investor and rights holders (and perhaps also government).

Hard investors, on the other hand, should

- Be prepared to negotiate some terms directly with government (e.g. tenure), but with a mandate agreed with rights-holders.
- Be prepared to act as a business mentor
- Ensure all materials and communication are understandable to the all stakeholders (e.g. through training, translation and dissemination)

Investors are usually already convinced by the role of SMEs in the economy at large, and pragmatic about the risks of investing in that sector. Scale becomes less of a problem if the obstacles to aggregating projects can be overcome, and investors can use portfolio approaches to mitigate risks. The investment proposition is that value can be released through enabling communities to obtain command over their forest resources, manage themselves as a viable enterprise and establish linkages further down the value chain. For instance:

- There may be opportunities to make strategic and complementary investments across the value chain to overcome bottlenecks and fill gaps. Broader market presence means the ability to form vertical linkages (e.g. access to specialist markets etc.).
- Capacity building and training costs can be factored into initial investment, without reducing the IRR significantly, perhaps by less than 1%. Also, agencies that provide organisational development (e.g. Business Development Service Providers) may themselves be investment opportunities.
- Certain investors can apply their experience in venture capital to the forest sector, enabling innovative or fragile businesses to be incubated until they reach viability and scale.

- More equitable and productive Company / Community partnerships can have strategic value to the investor that goes beyond the usual Corporate Social Responsibility goals. This will require codes of practice and performance agreements to apportion responsibilities and benefits fairly between all parties.

d) Rights-holders

Institutional quality does not begin and end with national governments. Local organisations also need to consider how they can improve in order to enhance the conditions for investment. Well-governed local institutions (community groups, tribes, clans etc.) are more likely to be amenable to capacity building and also to honour the terms of the deal.

Rights-holders should therefore:

- Undertake the necessary steps to map out, campaign for, delimit and register commercial rights
- Establish legally competent entity that is empowered by community to enter into a contract
- Push for training in business and basic bookkeeping and bring experience of natural resource use into the learning process
- Ensure local institutions (e.g. customary law) are legible to outsiders where relevant

Most crucially, rights-holders must acknowledge that economic development will bring about transformation in their circumstances, which may be largely desirable but may also be accompanied by some social upheaval. They need to make plans to ameliorate any negative effects of this process.

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Annex 1: Investor types

Ideal Type	Model	Example
Value investors	Debt, Bonds and Securities	Banks (domestic and international) Pension funds Sovereign Wealth Funds
	Equity in commercial enterprises	Foundations and endowment funds Equity funds (retail or private) Socially Responsible Investors (SRI) Venture Capital For Sustainability (VC4S) Sovereign Wealth Funds High net worth individuals (HNWI) Local Entrepreneurs Returning émigrés
	Co-investment	Multilateral Investment Institutions (e.g. IFC, Global Environment Facility)
	Carbon REDD+	Multilateral Financial Institutions (e.g. World Bank Forest Carbon Partnership Facility - FCPF) Carbon offset funds and brokers Socially Responsible Investors (SRI) High net worth individuals (HNWI) Hedge funds
	Direct ownership of forests	Real Estate Investment Trusts (REITs) Timber Investment Management Organizations (TIMOs) Carbon offset funds and brokers High net worth individuals (HNWI)
	Insurance and derivatives	Hedge funds Specialist insurers (e.g. GuarantCo, ForestRe) Multilateral Financial Institutions (e.g. MIGA)
Social investors	Soft loans, microcredit	NGOs, bilateral and multilateral Donors Philanthropists
	Grants	NGOs, bilateral and multilateral Donors Philanthropists
	Equity in commercial enterprises	Foundations and endowment funds Socially Responsible Investors (SRI) High net worth individuals (HNWI) NGOs, bilateral and multilateral Donors
	Carbon REDD+	Multilateral Financial Institutions (e.g. World Bank Forest Investment Programmed- FIP) Socially Responsible Investors (SRI) High net worth individuals (HNWI)
Conservation	Grants	Conservation NGOs, bilateral and multilateral donors

Ideal Type	**Model**	**Example**
investors	Equity in commercial enterprises	Foundations and endowment funds Socially Responsible Investors (SRI) Philanthropists NGOs, bilateral and multilateral Donors
	Conservation Trust Funds	Foundations and endowment funds
	Carbon REDD+	Socially Responsible Investors (SRI) Philanthropists NGOs, bilateral and multilateral Donors