The Forests Dialogue

Writeshop on Investing in Locally Controlled Forestry 5-6 April, 2011 | London, United Kingdom Background Paper

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1) Introduction

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

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

They assert (with some substantive evidence to back it up) that locally controlled forestry leads to responsible, long term sustainable forest management, including protection of biodiversity, improved livelihoods, multiple forest products and services, local enterprises and benefits to society. Investing in locally controlled forestry (ILCF) is a distinctive investment process that respects and strengthens locally controlled forestry as defined above.

Exactly what ILCF means in practice has been the subject of six dialogues hosted by The Forest Dialogue (TFD) and co-chaired by investors and G3 members. Broad discussions have identified and embraced both 'hard' commercial investment and 'soft' investments in clarifying rights, strengthening organizations, and building business capacity. Improving understanding on how to do ILCF was perceived to be a priority by dialogue participants on account of:

a) The comparative success of locally controlled forestry in conserving forests, mitigating and adapting to climate change and reducing poverty compared with state or corporate alternatives
b) The rather dismal track record of investment in locally controlled forestry to date compared to those alternatives
c) The real difficulties of turning this around that requires better cooperation between 'hard' and 'soft' investors and the forest 'rights holders' themselves.

Clarifying how to invest in locally controlled forestry – and indeed in locally controlled agricultural and forest landscapes more broadly - could not come at a more opportune time. 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? An investment support guide on ILCF could usefully inform both initiatives.

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In what follows this paper tries to draw out from the ILCF dialogues how participants see a constructive partnership between soft and hard investment in support of locally controlled forestry. By 'hard' investment we mean direct financial investment in creating new forest resources, managing forests, building production and processing facilities and other infrastructure, principally by financial investors (banks and forest or agricultural companies), but also governmental organizations, small and medium forest enterprises and resource owners and rights-holders. By 'soft' investment we mean development funding that prepares the ground for 'hard' investment, for example by improving governance, securing commercial forest rights, strengthening enterprise organizations, developing human resources and business capacity building. Such development funding has traditionally come from government donors and NGOs, but this could now be complemented by multilateral institutional funding for REDD+, or by new initiatives to establish food security based on agroecology.

Background to this document

This paper has been prepared for The Forests Dialogue's (TFD) writeshop to be held in London on 5-6th April 2011 as part of the dialogue initiative on Investing in Locally Controlled Forestry (ILCF). In this undertaking the TFD is working in collaboration with the Growing Forest Partnerships. The writeshop will build on the outputs of the London 2010 dialogue in order to develop an 'investment support guide' for investing in locally controlled forestry.

The main objective of last year's London dialogue (2010) was to find common ground between forest rights-holders and investors in order to improve the prospects of attracting productive investment into the locally controlled forestry sector. The dialogue attempted to unpack the issues that concern all forestry stakeholders and identify the pre-conditions, obstacles and opportunities that define locally controlled forestry.

Previous dialogues in Panama, Nepal and Macedonia concluded that the three major themes that should be explored in the subsequent dialogues are: partnerships, markets, and government's role. Further, these dialogues recognized that Locally Controlled Forestry involves three groups of rights holders, namely: indigenous peoples, community forestry groups, and forestland smallholders—who own or manage a significant part of the world's forest resources.

The London dialogue agreed that there should be a set of principles or guidelines for ILCF projects that would be useful to both investors and rights holders. Such a set of guidelines could eventually be developed into a code of conduct. The guidelines would have two principal functions:

- To provide an operational basis for ILCF projects that would aid both investors and land-owners in pursuing their interests and / or defending their rights throughout the process

- Enable project developers to gain the support of investors and local leaders and their communities by allowing both to present to their constituencies the set of principles / guidelines to which the other side has agreed.

In December 2010 a field dialogue was held in Kenya to build on the outcomes of the London dialogue. Through a series of 4 field trips in Kenya during a 2 day period, followed by two days of discussions, the attendees investigated the 'value propositions' for locally controlled forestry. They also discussed the relevance and utility of two products of the London Dialogue, namely the Principles (code of conduct) of ILCF, and the Steps in Exploring and implementing a Deal.

This background paper will unpack and analyse the draft principles and process model, summarising feedback from the Kenya dialogue as well as interviews with various people involved in the ILCF dialogues to date[2]. The purpose of the paper is to tentatively propose a revised draft of the principles and process model, and make suggestions for how they may be incorporated into an 'investment support guide'. This paper is thus a foundation for further discussion at the London meeting, and although in parts it may appear to be provocative, it is not in any way intended to be prescriptive.

[2] Approximately 17 people were involved in telephone interviews in March, plus another 8 in face-to-face discussions. However, in most cases I have not identified the origin of specific contributions.

2) Progress to date

Participants at the London dialogue in 2010 recognized that an ILCF set of guidelines might draw from other codes of practice already developed for various related purposes. These include those developed in the mining and water sectors (e.g. EITI), the Sustainable Forest Finance Toolkit developed by PricewaterhouseCoopers and the World Business Council for Sustainable Development, principles developed by the OECD, the FAO-CIFOR-IIED company-community forestry partnership guidelines, forest certification standards, and the Equator Principles. Another set of guidelines considered important were those arising out of current discussions on Free, Prior, and Informed Consent (FPIC).

As a starting point, key elements for inclusion in such a set of principles/guidelines were identified, and are reproduced here in their original order, which did not intend to imply any hierarchy or sequence of events:

1. An agreed long-term “end game”(common vision of the investment)
2. Identification of an organizational entity with whom a deal can be made based on appropriate local representation
3. Clear property and tenure rights, with the central or local government having a key role in defining and conferring rights
4. Definition of the roles of other development actors, e.g. ‘soft investors’
5. Requirements for governance and transparency
6. Investment in capacity building (including organization of rights holders, business planning)
7. Identification of entry and exit strategies
8. Appropriate and agreed arbitration and conflict resolution mechanisms
9. Commercialization of the resource respecting multiple benefits and cultural aspects
10. Benefit sharing
11. Effective safeguards

Participants also acknowledged that it was important that all parties to an ILCF project understand how the others prepare and execute a potential forestry project. To this end, participants developed a skeletal model of the steps in the development and execution of a business deal, noting who might be responsible for each step:

Steps in exploring a deal

Step	Whose role? (investors, community, others)
Idea origination/concept/ often from strategic needs assessment	Either; both, government
Pre-feasibility study	Either; both; broker/project developer
Community preparedness	Soft investors; other strategic partners
Deal development: exchange of information, development of business plan/case	Either; both
Letter of intent: arranging terms, i.e. who will get what, arranging who will do what, arranging timeline, lay out due diligence; binding	Perhaps investors on large project, community on small projects; both
Approval	Both

Steps in implementing a deal

Step	Whose role?
Community management capacity building	Soft investors; other strategic partners
Establishment phase – project activities developed and further finance released on preconditions being met	Both
Sharing of revenues through project activities	Both
Monitoring and evaluation	Both
Exit, when applicable: dilute outside investors’ holdings; determine when enterprise shuts down	Both

Before analyzing these principles and guidelines in any detail, it is worth examining the rationale of developing an 'investment support guide' and enumerating the benefits that it may bring.

Who is the code of practice[3] aimed at and how will it benefit them?

Hard Investors[4] will appreciate the support guide because it will:

- Help them understand the sector and organise their approach to negotiating and finalising a deal.
- Ensure that proposals from rights holders are developed in an understandable format (template), so due diligence process is easier and transaction costs fall.
- Process is self-selecting – groups that are not yet ready for investment will get stalled in process and need intervention from 'soft' investors.
- Help instil good management practices – all parties are aiming to build a high quality business.

Rights-Holders will find the guide useful because it will enable them to:

- Help them to weigh up the financial benefits of investment and any socio-political, environmental or economic trade offs
- Make appropriate preparations for attracting desirable investment
- Focus on the deal at hand
- Be confident that they are attracting the 'right sort' of investor

Some interviewees have pointed out that the investment support guide could also benefit soft investors such as governments and NGOs who are seeking ways to support LCF:

Benefits for Governments:

- Guide policy reforms that install the pre-conditions for investment (secure commercial forest rights, formally registered institutional organisations, and human and business capacity development)
- Provide a focus for improving the business enabling environment (BEE) and developing extension support and financial and business development services
- Provide a framework that adequately addresses environmental sustainability, poverty reduction and social justice
- Direct and harmonise REDD+ and other agricultural and forest landscape projects towards a common vision for long term sustainability

Benefits for NGOs and donors

- Make projects more focussed and goal-oriented to ensure resources are directed accordingly
- Clarify best practice against which to hold investments accountable
- Direct advocacy and policy development work to most appropriate areas (e.g. BEE)

Potential pitfalls

There is a danger that the code of practice becomes too prescriptive becoming a series of rigid hurdles that investors need to jump. This should be avoided so the guide makes the process easier, not harder. It should also avoid clashes with existing sets of principles (e.g. FSC).

Organisations with experience in this field warn that 'Principles and Criteria' are very hard to draft and agree. For instance FSC takes years just to make small changes to its Principles and PWC consulted in detail with over 70 organisations to develop the Forest Finance Toolkit.[5] Perhaps the ILCF should lean towards 'guides' and 'models', rather than lists of 'principles' that may take on the air of moral imperatives.

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[3] The formal name is provisionally 'investment support guide', but in this paper it is also referred to as code of practice, or best practice guide. An appropriate title can be decided at the London meeting.
[4] For an explanation of the typology of investors as 'hard' or 'soft' see the 2010 London Background Paper. Note that 'soft' indicates that the investor is more flexible in judging a return on investment in non-cash terms – it is not to be interpreted as meaning unfocused, weak or a 'soft touch'.
[5] http://www.pwc.co.uk/pdf/forest_finance_toolkit.pdf

For instance, their may not be a need to duplicate what is already in the FPIC principles. FPIC is different because it needs to be applied in cases where people have very few (if any) formal property rights but whose livelihood and quality of life will be affected by a development. In the ILCF system (outlined below), FPIC should not really be an issue as by definition the people are already in the stance of consent.

The ILCF System

Although certain rights-holders may be in a better position to decline investment than many other communities (who may need to rely on the FPIC process to safeguard their interests), there is a feeling that a code of practice would help creditors and investors gain 'respect' for the people they are investing in. But respect 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, an ILCF 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 is a rights-based approach that recognises the autonomy of the local people and their rights to determine the destiny of their land and participate in the income from any exploitation.

Figure 2 - Rights-based ILCF system

The investment support guide should explain that ILCF is both a manifestation of the rights-based approach and the means by which it can be sustained. Where investment is not forthcoming, economic development stagnates and there is a chance that local and national governments propose the default 'resource-led' system as the solution.

Well designed investment in locally controlled forestry, guided by the principles arising from the TFD dialogue stream and founded on the 'rights-based ILCF system', will have benefits for all stakeholders, as shown the in the table below.

Government	Investors	NGOs & Rights Holders

Government	Investors	NGOs & Rights Holders
• Improved capital stock • Wider and deeper fiscal space • Jobs and growth • Well directed REDD and other forest and agricultural landscape project finance • Achieved Emissions targets	• Good risk-adjusted rate of return for uncorrelated assets • Lower transaction costs • A clear process to minimise confusion and maximise opportunities • No problem getting timely data • Triple bottom line	• Empowerment and autonomy • Rural development on their own terms • Poverty reduction • Asset formation (and improved asset diversity: cash, shares, housing etc.)

3) Analysis of the 'Principles'

The feedback from the Kenya meeting on principles suggested at the London Dialogue shows how difficult it is to present a set of eleven 'principles' and expect them to have saliency and relevance for all stakeholders. It seems some of the principles are actually steps in a process, or are pre-conditions for success. Such issues need to be clarified at the next dialogue.

Some of the issues call for attention by investors, some by government, but it is not clear who is responsible for what. The approach I have used therefore is to examine the generic steps in an investment process, and from that glean the common principles that could act as preface for best practice guidance on how those steps might be pursued and who is responsible for what. Any common principles should be clear and pithy, and should convey the spirit of the whole ILCF dialogue process. They should indicate what ILCF is attempting to achieve (e.g. forming partnerships between rights holders and investors that not only deliver viable investments but also strengthen locally controlled forestry in the process)

I have analysed the principles with the following questions in mind:

- How are these points understood?
- Has their meaning remained constant through the dialogues or changed over time?
- Are they sufficiently direct and positive?
- How can 'lessons learned' from the dialogues help to refine the principles and best practice guidance?
- How do they compare to other principles (e.g. FSC, RSPO, PEFC, EITI etc.)?
    - What are common themes, wordings etc.
    - What was the process behind these principles, and to what extent to they meet their objectives? What are the pitfalls of developing prescriptive guidelines?
- Who will be using the principles and best practice guidance?(e.g. process model)
- Are they aimed at international investors only, or also applicable to domestic investors?
- Can the process model be sufficiently flexible and non-linear to make it applicable in the messy real world, where very rarely are we working from a tabula rasa and a straight line from A to B?

Some of the analysis deals with semantics, which may be seem pedantic, but how people react to certain words and phrases reveals how they think about the issues. Also, the ILCF dialogue has already identified areas where investors and rights holders use the 'same words but with different meanings', so clarity is essential. This may only be achieved through unpacking the phrases and understanding where they come from and what purpose they intend to serve. For instance, the Kenya dialogue called for 'Creating equity through benefit sharing as requisite' (in the co-chair's presentation). On first reading, thinking as an investor, I took 'equity' to mean shares in the company, and assumed this referred to a practice of deferring dividends in order to boost the value of shareholder equity. However on second glance I see that it means that 'benefit sharing' (profit distribution) in some way creates 'equity' (fairness). I can see how benefit sharing should be <u>based on</u> principles of equity (what you take out should reflect what you put in), but I am not sure how it can <u>create</u> equity. These differences matter, as an investor may suspect that the other parties of the deal may view future benefit sharing as an opportunity to redistribute surplus profits in a manner that is considered 'fair' in some abstract sense, rather than actually reflecting the original deal that was agreed. This is also a good example of where unpacking the process (how are benefits shared in practice?) can help inform the formulation of guiding principles.

In each case, I have given a selection of feedback, a cross-reference to other principles where appropriate, some brief analysis and on some cases a note of issues that need to be discussed further.

Analysis of Draft 'Principles'

1	**An agreed long-term "end game"(common vision of the investment)**
Feedback	Selected Feedback from Kenya dialogue: 'Objectives can be long term but visions are aspirational.' 'Long term is not clear' 'Delete 'end game' as it has wrong connotations and is contrary to idea of sustainability' Also, it was felt that in the context of different cultures, educational levels and power differences, the notion of a 'common vision' was problematic.
Examples	*RSPO Principle 3*: Commitment to long-term economic and financial viability *FSC Principle 1:* Compliance with laws and FSC Principles
Analysis	

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, ILCF is 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)?
- Do the requirements for financial discipline that underpin profitability preclude early dividends to a social fund? Etc.

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, Mads Asprem at Green Resources (in the London 2010 dialogue) rejected the notion espoused in the background paper that value investors just accept the status quo, stating that as investors they 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 I would argue that in this case 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. from subsistence to market economy). Indeed, if a LCF 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 its 'disordered effects' (e.g. inequality, maladaptation, loss of cultural homogeneity)?

The Kenya dialogue warned that "partner objectives often shape conservation and commercial activities of communities and therefore such partners have to be responsible." This means that investors should be careful in imposing their values and goals on local rights holders. But it seems inevitable that some values are going to be transmitted in the process of developing a successful business, and this may not be a wholly undesirable outcome. Perhaps what is needed is a means by which the values can be revealed and discussed openly, acknowledging that goals may change, and it is more important that visions are compatible than identical.

The principle could therefore be amended to: All parties explain their vision for the deal, and proceed towards agreed goals.

2	**Identification of an organizational entity with whom a deal can be made based on appropriate local representation**
Feedback	"Ensuring everyone is represented may require involving more than one organization…", but "...multiple groups may bring in different interests and may even have conflicting interests." "Identifying right partners should mean that there is good representation, equity, transparency, accountability, democratic process and overcomes community divisions. If not done right there will not be sustainability, effectiveness and equity." "It is better to have the agreements between formal organizations (legal entities) as opposed to individuals or "ill-defined" entities" "While inclusion may be necessary it is also clear to get agreement about the 'chain of command': need to get clear whose voice is necessary for things to be agreed."
Examples	n/a
Analysis	

The discussion in Kenya seemed to identify the difficulty of finding an appropriate body with decision-making power, whilst also 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 entity should be fully formed and present itself as a coherent entity that in some way the investor can recognise. It is not reasonable (or desirable) to expect the investor to be making judgements about inclusion, gender and the opaque politics of disparate communities that may be culturally and spatially specific.

The preparation process 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.

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 more collective community 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.)

3	**Clear property and tenure rights, with the central or local government having a key role in defining and conferring rights**
Feedback	'Not always necessary to get the Government to confer the right: it is possible to have investor and community agree on rights without legal endorsement', but on the other hand, 'well defined rights give confidence to the investor.' 'Rights imply responsibilities and so having rights clear means it is clear who has responsibilities.' 'Rights conferred by government (e.g. to companies) may conflict with rights of communities.(e.g. customary rights)' 'rights issues are complex but bottom line is that they need to be clear to ensure sustainability and profitability' Also some debate about the interaction of property rights and human rights, and that 'Communal/ collective rights also need to be taken into account'
Examples	*FSC Principle 2*. Demonstrated and uncontested, clearly defined, long–term land tenure and use rights *FSC Principle 3*. Recognition and respect of indigenous peoples' rights
Analysis	

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

The London background paper (2010) noted that 'rights-holders may need to work with governments to encapsulate their rights into a legible legal framework that permits fair use of the resource, even if this does not in the short-term advance their ultimate goal of freehold tenure.' 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 LCF groups that 'recognizing and securing land tenure and user rights of forests are central to sustainable forest management.' Rights are a precondition for rural development. Tenure is an asset, and releases value that is locked up in land and forests. There is no 'loss' to the state by transferring state forest land to local people.

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.

The principle could therefore be: 'Common understanding forest tenure, rights and obligations and a commitment to strengthen local control through the investment process'

4	**Definition of the roles of other development actors, e.g. 'soft investors'**
Feedback	Other development actors 'catalyze communities', 'bring cross-sector expertise' and can act as 'checks and balances' (for instance in resolving disagreements). But 'sometimes wrong knowledge is transferred', 'Many actors can bring confusion and complexity', and the project may be '…stuck in "planning" stage and never into "execution" stage.' There may also be no exit strategy, and the NGO and community become co-dependent.
Examples	n/a
Analysis	

This is a step in the process rather than a principle. The process needs a stage in which gaps and needs are identified and then different actors are allocated appropriate roles. Lack of capital and access to markets requires a 'hard' investor, but 'lack of clear tenure' calls for government involvement (perhaps facilitated by a third party, maybe the hard investor in some cases).

5	**Requirements for governance and transparency**
Feedback	'Codes of conduct agreed by all parties' 'bring accountability' and 'reduce corruption'. 'Good governance can promote security for empowerment and investment' But we need 'to define better governance, and it's relation with transparency'. The 'Systems might not align with traditional community government affecting governance.'

Examples	*EITI No.5:* 'We underline the importance of transparency by governments and companies in the extractive industries and the need to enhance public financial management and accountability.' *EITI No.6*: We recognise that achievement of greater transparency must be set in the context of respect for contracts and laws. *EITI No.7:* We recognise the enhanced environment for domestic and foreign direct investment that financial transparency may bring. *EITI No.9:* We are committed to encouraging high standards of transparency and accountability in public life, government operations and in business. *RSPO No.1*: Principle 1: Commitment to transparency FSC Principle 8: Monitoring and assessment: Monitoring shall be conducted -- appropriate to the scale and intensity of forest management -- to assess the condition of the forest, yields of forest products, chain of custody, management activities and their social and environmental impacts.
Analysis	

This principle is vague and divided into two rather distinct elements. I assume the terms to mean 'good governance' and 'maximum transparency', but the former is subjective and is more properly regarded as a process of improving governance, often driven by opening up markets and investment. Transparency is not always possible where confidential commercial details are involved.

Of whom is the good governance and transparency being expected? Good governance creates the circumstances for good institutions, which in turn improves the enabling environment for business, so this is a government responsibility. But we should also require good governance by local groups themselves. Transparency can relate to the process of negotiating a deal (have all agendas been revealed?) but 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.

This item could be split as the following pre-conditions and principles:

a) Enabling environment for business (including good governance, institutional quality, democracy, accountability and transparency). 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 context of decent institutions, will make better deals than if you leave governments alone with investors.

b) Well-governed local institutions (community groups, tribes, clans etc.) are more likely to be amenable to capacity building and honour the terms of the deal.

c) Principle of transparency at 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 (see below) 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.

6	**Investment in capacity building (including organization of rights holders, business planning)**
Feedback	'Allow communities to make informed decisions', which 'Can help to keep focus' and promote 'smooth running of business' by building 'business and commercial skills', which will benefit all parties in the deal. However, 'Capacity needs are unclear', and 'if capacity building processes are not widespread, many capable people lose out.'

Examples	*FSC Principle 4.* Maintenance or enhancement of long-term social and economic well-being of forest workers and local communities and respect of worker's rights in compliance with International Labour Organisation (ILO) conventions *RSPO Principle 6*: Responsible consideration of employees and of individuals and communities affected by growers and mills *RSPO Principle 4*: Use of appropriate best practices by growers and millers
Analysis	

Improved capacity is an expected outcome of ILCF, as people generally 'learn by doing'. However, some degree of capacity is required in order to:

- Organise the rights holders into a coherent entity
- Secure the necessary permits and access rights
- Identify the business opportunity
- Understand the deal being offered
- Negotiate the best outcome
- Start up the business on a solid footing

Capacity building goes both ways: 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 could be: respect of inherent skills, and potential for improvement. All parties 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.

7	**Identification of entry and exit strategies**
Feedback	'Clarity on minimum expectations from all parties and criteria for entry and exit points; (a) time-bound & funding (soft investors); and (b) profitability (hard investors)' 'Define sustainability positions of the project by the exit point – what will be the community status at the end of the project and ensure a process is in place to meet this.' 'Provides a framework to define the costs and returns of both investors and local control parties.'
Examples	n/a
Analysis	

Defining an exit point for the investment is an integral part of the business plan and most unlikely to be overlooked by 'hard' investors. On the other hand, 'soft' investors may have unclear timescales, determined by budgets and projects rather than the needs of the local enterprise.

Furthermore, the soft investors usually need to be involved with the enterprise before the hard investor is brought in, and may have ongoing responsibilities in terms of capacity building and arbitration. Therefore it is not only identification of entry and exit points that is needed, but also harmonising of intervention timetables between all parties.

This seems to be a process issue rather than a 'principle'.

8	**Appropriate and agreed arbitration and conflict resolution mechanisms**

Feedback	'Agreements (MoU) should provide mechanisms for conflict resolution', but '…there usually is a large imbalance of power'. 'Trust building is a foundation to mitigate conflicts; this can be enhanced through: (a) a strong flow of information and participatory decision-making; and (b) regular meetings / discussions to reduce fracture lines.' Amend to read: 'management and resolution of conflict'
Examples	Café Direct uses a 'golden share' held by independent organisations to act as a casting vote in the case of a dispute where the company's founding mission may be compromised.
Analysis	

Partnerships of any sort are built on trust, openness and the perceived fairness of how each party's contributions are rewarded. This issue is therefore connected to the principle of transparency and capacity building. However, matters may still arise that require resolution, and this may involve third parties.

The 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, so perhaps we should be considering what is particular about ILCF that may require a different approach.

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

This issue needs to be tackled as part of the process, so as to ensure differences are resolved before they become intractable, and perhaps there are two principles arising from this:

a) 'An agreed arbitration process mediated by a third party'
b) 'Checks and balances to ensure decision making is in the best interest of the business and all its stakeholders'

9	**Commercialization of the resource respecting multiple benefits and cultural aspects**
Feedback	'This aspect is a key concept of local control', that 'may help risk reduction for both investors and the local group.' However, 'multiple-use may reduce investment opportunities as it may make management / investment for a single resource over complicated and represents a significant management challenge.'

Examples	*FSC Principle 6*. Reduction of environmental impact of logging activities and maintenance of the ecological functions and integrity of the forest
Analysis	

It is not quite clear to me what this principle means. On one level it seems to be saying that commercialization of any one resource (e.g. plantation wood) must take into account the fact that forests in the local context are expected to perform multiple functions, so a monoculture may not be appropriate. This could reduce financial returns. On the other hand, it may mean that investment should be directed into as many productive areas as possible, for instance NTFPs and eco-tourism.

In plantation businesses, local people may expect to be able to intercrop with annual crops in the early years, and perhaps also with permanent shade crops (coffee, cocoa etc.). They may expect some tolerance from the investor that the land is being used in such a manner. It is unlikely that the investor would expect to share in the income from such activities, but if they reduced the yield of the main crop then this would need to be taken into account in the negotiation phase.

It would probably not be advisable to mandate that investors are compelled to invest in multiple uses. Any investment should be judged on its own value proposition. Similarly, it would not make sense for investors to have a single-minded focus on one crop (for instance oil palm) while seeking to exclude any diversification, as this imposes risk on the local enterprise through over-exposure to one commodity.

The principle should attempt to embody the benefits of diversification, by suggesting that investment in LCF taps into local wisdom and culture, allowing for more innovative, profitable and sustainable approaches to land use (because if it did not, why would we be promoting it?). The process should thus require a holistic analysis of the potential of the landscape as well as the people who inhabit it (which is consistent with the ‘new paradigm’ discussed above).

10	**Benefit sharing**
Feedback	‘Perceived inequalities on benefit sharing is not sustainable (sometimes communities decide to step out of a project because they feel inequities)’ Elite capture (directors get most of the money) Communities may be in it for something other than cash, e.g. clarity of tenure. In Nepal the rules of the game changed: when a project started being very successful the government wanted to get more contributions from the communities
Examples	*FSC Principle 5*. Equitable use and sharing of benefits derived from the forest
Analysis	

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 (e.g. the RuKinga plan in Kenya calls for: ‘Government involvement to ensure funds used for infrastructure and health’). 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. Although this clause may seem to be aimed at investors, 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 ‘equity’.

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 fall-back 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.

Thus the principle could be revised to state 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. For instance: 'Fiduciary responsibility towards the enterprise without favouring any one group of stakeholders'

11	**Effective safeguards**
Feedback	Kenya dialogue participants were not sure about this principle. It could 'raise confidence within all parties involved' and 'Guard against overexploitation of resources, political interference and corruption'. However, 'the often lengthy process often involved in the establishment of effective safeguards mechanisms can put off the investment deal.'
Examples	n/a
Analysis	

It seems to be more effective to build safeguards into the whole process, as a means to buttress the edifice of trust and understanding and mutual benefit that needs to be assembled. Safeguards are inherent in the notions of transparency, knowledge sharing, negotiation and conflict resolution. Specific safeguards may be appropriate in certain circumstances, such as the 'golden share' or other checks and balances. However, it is probably not necessary to have a specific principle dealing with safeguards.

12	**Respect of all parties in participation in outside networks (Encourage communities to participate to broader/outside networks) embracing movement of knowledge, and freedom of expression**
Feedback	This is an additional Principle proposed by Kenya dialogue
Examples	n/a
Analysis	

I am not sure if this is necessary as a separate principle as allowing partners to participate in networks is most unlikely to be contentious for the investor. On the contrary, most investors will be keen to encourage diffusion of innovation and clustering as proven methods to improve productivity.

Furthermore, 'freedom of expression' is not necessarily in the gift of the investor (it probably arises from the political and cultural context), but the principles of transparency and knowledge sharing strongly imply the right to 'exit, loyalty and voice' as Hirschman[6] put it. There seems to a thread running through ILCF that investment may develop social capital as well as physical capital. One aspect of this is to help remote communities overcome the disadvantages of isolation, but the unspoken corollary of this is that they may also escape from certain cultural constraints as well. Put more objectively, it could be said that

[6] Hirschman, A.O. (1970) *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and States*, Cambridge MA, Harvard University Press.

while rights holders develop social capital and business acumen, investors develop a sharper sense of the value of sustainability, diversity and unconventional forms of ownership. This is a desirable outcome, to be sure, but I am not sure how it can be expressed as a guiding principle, except perhaps within the notion of 'mutual learning and the value of partnerships'.

4) Analysis of the Process

The principles listed above arise out of the process, and as discussed some of the principles may be more properly described as steps in the process, or even preconditions, rather than actual principles.

General observations from the Kenya meeting and other stakeholders regarding the process guide (The 'steps in exploring / implementing a deal' drafted in London) included the following remarks:

- 'Community preparedness should not be a row in the table (so only takes place at a discrete time) but should be a column in this table, so that community preparedness issues are addressed at all stages of the deal and implementation' (Arabuko Sukoko case study)
- 'Investors can be top-down'. The best value proposition may not be what is in the best interests of the community at this time.
- The presence (or prospect) of investors can induce clarification of tenure, or policy reform.
- The process is not linear. There are some feedback loops, where for instance tenure needs to be clarified or business plans refined.
- 'Is it possible to develop pre-feasibility studies for small scale production? However it is quite necessary before large soft or hard investments.'
- 'It takes a long time to build trust. But, no matter how long it takes, it's a vital pre- condition for investments.'
- There may already by a business of some sort – we should not assume that every deal is brand new. So the process model should be flexible enough to 'embrace transition and processes improvement'

The missing elements of the principles and the process model seem to be the aspect of negotiation, and the role of government and how capacity building can be integrated with pilot projects.

<u>Negotiation (building a partnership)</u>

At the London dialogue it was suggested that negotiation starts by asking the right questions of the other party. 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?"

Sometimes groups want something more from an investment relationship than just access to cash. For instance, they may be looking for security of tenure etc., 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 that may be reformulated as 'principles':

- 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 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 for keeping away from 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.

Role of Government

A Nicaragua delegate at World Forest Week[7] suggested that institutions (e.g. government) should 'supervise' deals between investors and communities. This is likely to lead to inflexible application of the code of practice, or interference in the objectives and modalities of the deal. It is unlikely that good market-based deals would emerge from such a process.

But what role can governments play, and to what extent can the investment support guide help them follow certain principles? For instance, 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).

The key role for government is to improve institutions and thus the business enabling environment. This is likely to be more valuable than direct intervention in markets, facilitating deals between investors and communities or attempting to set up clearing houses and marketing boards. However, it is also the least glamorous aspect of development, often shunned by donors as too time-consuming, exhausting and - ironically - not expensive enough.
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 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.

The non-linear process model

The Kenya dialogue noted that 'there was some clear learning from this process. While going through such a step wise process (which by its nature tends to be linear) masks the fact that most such processes tend not to be linear. Different steps may be carried out at different times, and projects may not start at the beginning. In addition the reality is that many projects are already being implemented to varying degrees for varying periods of time. In addition some new steps were suggested:

i. Community preparedness is needed at all stages of the deal, and should be inserted as a third column to give it the importance deserved; and
ii. An additional row on institutional governance and partnership development was suggested which would give emphasis to the importance of institutions in project and deal development and implementation.'

The process is an iterative one, and should account for the fact that at certain points some specific intervention may be required. 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 and 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.

[7] FAO World Forest Week / COFO, Rome, October 2010

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

5) Re-designing the 'investment support guide'

Based on the discussion above, a revised draft for the principles / guidelines can be sketched out. The principles are designed to be universal, applying to all parties in the deal, and this is a shorter list than the original draft. In addition, a framework of ‘roles and preconditions’ suggests specific issues that each party should address in order to enhance the success of the deal. Finally, the process model is an expansion of the ‘steps in exploring / implementing a deal’ drafted in London.

Please note that this draft is not complete, but is merely to provide the basis for further discussion. Some have been bracketed, to emphasise that these are provisional and require further discussion.

Principles

No.	Principle
1	Transparent and honest sharing of information at all times
2	Common understanding of forest tenure, rights and obligations and a commitment to strengthen local control through the investment process
3	Commitment to developing [and respecting] workable organisational structures with clear roles and representational mandates [that accommodate traditional community processes of authority and decision making]
4	Reciprocity, mutual learning and building social capital. [Respect for each party’s skills and knowledge and capacity to contribute to the success of the deal]
5	All parties explain their vision for the deal, and proceed towards agreed goals
6	Checks and balances to ensure decision making is in the best interests of the locally controlled forestry [business] and all its stakeholders
7	An agreed arbitration process mediated by trusted third parties
8	Fiduciary responsibility towards the enterprise without favouring any one group of stakeholders

Pre-conditions

Step	Roles			
	Rights holders	**Hard investors**	**Soft Investors**	**Government**
Secure commercial forest tenure and rights against agreed management responsibilities	Undertake the necessary steps to map out, campaign for, delimit and register commercial rights	Be prepared to negotiate some terms directly with government (e.g. tenure), but with a mandate agreed with rights holders.	Provide financial support to any necessary process of mapping, campaigning for, delimiting and registering commercial forest rights	Develop and enforce policies that give full commercial control over forests to communities
Establish organised business groups that are formally registered	Establish legally competent entity that is empowered by community to enter into a contract		Provide financial support for the facilitated organisation of business entities – and associations and federations between entities	Ensure all policies and regulations regarding legal business forms and registration procedures are as simple and accessible to right-holders as possible
Develop local capacity to run successful businesses	Push for training in business and basic bookkeeping and bring experience of natural resource use into the learning process	Be prepared to act as a business mentor	Provide financial support to institutional hubs that facilitate market system development and small enterprise support	Levy taxes and supply public business development and financial services as demanded by citizens.
Ensure adequate communication between right holders and investors	Ensure local institutions (e.g. customary law) are legible to outsiders where relevant	Ensure all materials and communication are understandable to the all stakeholders (e.g. through training, translation and dissemination)	Be prepared to hold 'golden share' and arbitrate between investor and rights holders (and perhaps also government	Allow rights holders and investors to agree how benefits will be shared in a manner that best suits the company.
Respect different values and embrace change	Acknowledge likelihood of transformation (e.g. social change) and make plans to ameliorate any negative effects	Do not impose values on rights-holders, instead seek common goals	Do not impose values on rights-holders, instead seek common goals	Define / clarify tenure, rights and obligations

Process

Step	Roles	Notes
Preparation		
Initial concept development / business idea	Concept may arise from: Rights-holders – based on specific local knowledge Investors - who have relevant market insight NGOs – Arising out of a project Government – e.g. based on an economic development policy	Some concepts arise out of the needs of the local community, or the chosen government policy, but fail to take into account market demand. Where investors are involved at an early stage, they can help to ensure that concepts are focussed and relevant to the market. However, the chosen business idea must be 'owned' by the rights holders, and cannot be imposed from outside.
Impact study	Rights-holders, assisted by soft investors (NGOs, government)	The concept needs to pass an informal and rapid Environmental impact assessment as well as a Community impact assessment (livelihoods, cohesion, culture).
Organisational & Institutional development	Rights-holders, assisted by soft investors (NGOs, government) Government defines legal framework and costs of registration, permits etc.	Form the management team, identify and organise stakeholders. Agree on type of business (formal entity) Assess relationship with other institutions Determine access rights to natural resources (formal and informal)
Feasibility study	Rights-holders, assisted by soft investors (NGOs, government). Informal input from hard investors at this point could save time later on.	Assesses the suitability of the concept (environmentally, socially), and the capacity of the local enterprise to execute it. Determine the nature of market demand for the product
Community agreement	Rights-holders	The new business requires a 'social license to operate'.
Output: Concept note / draft business proposal	Rights-holders, assisted by soft investors (NGOs, government).	Summarises the value proposition: Activity, resources, market. Estimate of capital required Evidence of environmental / social suitability Evidence of access rights and legal status of permits, leases etc. Identification of collateral (if applicable)
Negotiation		
Deal development	Rights-holders and hard investors, facilitated by other parties if appropriate (NGOs, government)	Starts with disclosure of objectives: matching the investor to the concept. Design the deal: debt/equity, revenue sharing, time scale, involvement of third parties
Due diligence to identify gaps	Hard investors, perhaps with funding from soft investors	Review: Track record, supporting organisations, concept note, strength of value proposition, veracity of market claims, risks and assumptions, legal basis for activity (entity, tenure and access to natural resources).
Make improvements	Rights-holders, assisted by soft investors (NGOs, government). May require policy improvements by government, or better execution of existing policy. Hard investors may be able to influence policy.	Address areas of weakness and determine if these are internal or external (structural). Internal weaknesses require a time-bound project for improvement (e.g. capacity building of management). Structural constraints may require lobbying of government to improve the enabling environment for business.

Step	Roles	Notes
Re-negotiate	Rights-holders and hard investors, facilitated by other parties if appropriate (NGOs, government)	
Output: Heads of terms	All parties	Includes letters of intent from third parties confirming their role in the deal, agreed actions and commitments of funding. E.g. NGOs agree to cover costs of capacity building, government agrees to supply infrastructure and issue permits.
Agreement		
Output: Contract	All parties	Communities need to approve the deal. Investors need to obtain final sign-off.
Operation		
Establish business	Enterprise and investors, facilitated by other parties as agreed in contract	Training of staff, mentoring of management. Procurement of capital equipment, planting activities, inventory and forest management plans etc. Commence pilot projects, marketing campaigns etc.
Monitoring	Enterprise and investors	Monitor performance (using agreed criteria) & audit financial statements to ensure transparency and accountability.
Feedback & improvement	Enterprise and investors, facilitated by other parties as agreed in contract	Use data from monitoring as constructive feedback to improve performance (Are we doing things right?) If necessary, revisit business plan to change approach to value proposition (Are we doing the right things?) The business needs to be evaluated on its own terms with reference to the agreed business plan, not against other external criteria (e.g. contributions to social fund or infrastructure not relevant)
Managing change	Enterprise and investors, facilitated by other parties as agreed in contract	Changes may be required to strategy, or to staff. Managers may need to be replaced and teams reorganised. The business needs to be able to make these changes without interference by either local communities or government.
Dealing with disputes		
Arbitration	Enterprise and investors, facilitated by other parties as agreed in contract, for instance nominated arbitration service or jurisdiction	Re-negotiation of terms is as likely to arise from unexpected success as it is from failure. In the event of failure the investor / creditor is left with most of the liability, but in the event of great success there may be a feeling that the investor is taking out too much, even if their share is in line with the original agreement. Dispute resolution will not be necessary if all parties have discussed such eventualities in advance.
Benefit sharing and exit		
Distribute profits	Enterprise and investors	Business is a separate legal entity from both rights holders and investors. Dividends can only be paid when all other liabilities have been accounted for.
Exit	Enterprise and investors	Eventually the investors will be seeking an exit, either through the closure of the enterprise, the repayment of loans or the sale of shares.

6) Conclusion

This paper has attempted to analyse the draft investment support guide in the context of feedback from a number of sources, particularly the notes from the Kenya dialogue. Inevitably the author's own prejudices have also crept into the analysis. The next step is to break these principles and processes down further at the London meeting in April so as to produce more polished version of the guide that can be taken into the field and tested further.

In order to assist with this process, it would be helpful if each participant could bring notes from a real case study they have been involved with (as either an investor, intermediary or rights holder), or where detailed notes are available (for instance from a previous TFD dialogue). These cases can then be used to test the framework and avoid the temptation to dwell in the realm of abstractions. It is likely that some of these deals may still be in the early stages, but they could still be useful for cross-checking that our process model is not overlooking any important steps.

Matrix for investment case studies

Investment issues	Notes
Process and progress of the deal	Did it follow the flow in the process model, or was it a very different path?
Current status	Did it get stuck at some point in process? What were the obstacles?
Key goal of the investors	Both hard and soft investors
Key goal of the community	Was the goal widely shared and understood?
Role of intermediaries	Was their role positive or negative? How could it be improved?
Role of government	Was their role positive or negative? How could it be improved?
How did the investment strengthen locally controlled forestry (rights, organisation, business capacity)	Were there discernable improvements to the way local people benefited from and were responsible for forest resources