*Evaluation and Learning*

# Financing Forest-Related Enterprises: Learning from the Forest Investment Program and Other Initiatives

## QUICK FACTS

RELEVANT CIF PROGRAM:
FOREST INVESTMENT PROGRAM

EVALUATION FIRM:
IIED/LTS INTERNATIONAL

COUNTRIES COVERED:
VISITS TO GHANA AND LAO PDR; EXAMPLES FROM OTHER COUNTRIES (INCLUDING BURKINA FASO, MEXICO, ETHIOPIA, INDONESIA, PERU, AND UGANDA) COVERED REMOTELY

METHODS USED:
CASE STUDY VISITS, LITERATURE REVIEW, PORTFOLIO ANALYSIS, INTERACTIVE LEARNING WORKSHOPS

## OBJECTIVE

*The objective of this study is to learn lessons from the experience of the Forest Investment Program (FIP) and other initiatives in supporting investment in forest-related enterprises. The study identifies key barriers and risks that impact leveraging private finance and examines how to overcome these challenges to increase the viability and scale of private-sector investments, with an emphasis on small and medium-scale enterprises.*

## Context

The Forest Investment Program (FIP), launched in 2009, was set up to provide and leverage additional funding to address drivers of deforestation and forest degradation. FIP works primarily through multilateral development banks (MDBs) to put in place enabling investments, with aspirations towards piloting replicable models of REDD+ asset investment that will attract new and additional sources of finance.

This learning review covers four learning areas: the FIP theory of change and design, early results for forward-looking learning, overcoming barriers and risks, and lessons learned on scaling-up and transformative change.

## Key Findings

Following country priorities identified in their Investment Plans, FIP has made investments in forest governance and strengthening the enabling environment, as well as investments in micro-scale activities that, if sustainable beyond project completion, would benefit households and communities in the long-term. However, the study finds there is an "enterprise support gap", with relatively few FIP investments explicitly targeted to small- and medium-scale enterprises that, cumulatively, could have a significant positive impact on deforestation and forest degradation. Financing for the larger scale investments that the MDBs are better placed to enact has also been a challenge.

# KEY FINDINGS continued

In analyzing the composition of the FIP investment portfolio (US$627 million across 54 projects as of June 2017), the review finds it is comprised of approximately 53 percent providing financial support to micro-scale income-generating activities, 41 percent to enabling investments (policy and capacity), and only 3 percent in asset investment finance and 3 percent to business incubation. While some support to small and medium enterprises is being provided, a more concerted effort to finance well-directed enabling investments that would build a pipeline of investible businesses could yield important benefits. There are good examples to build on from within the FIP portfolio, with exceptional (yet patchy) support to small- and medium-scale forest enterprises in Mexico and Burkina Faso and value chain-specific support to sectors such as cocoa in Ghana.

## ADDRESSING THE GAP

The majority of additional REDD+ funds leveraged for financing forest-related enterprises by FIP has come from MDBs rather than the private sector. Since most of forest and farm production comes from multiple smallholders, and the MDBs generally prefer large scale investments, the study concludes that the MDBs are an inappropriate investment vehicle for the smaller, enabling investments needed to close the enterprise support gap.

**"There is no shortage of small projects with innovative project developers. What there is a shortage of is the US$100 million projects that banks are looking to fund."**

**Findings suggest that a strategy to close the enterprise support gap will require three clearer focus-areas:**

- **Organization—**Aggregation of product from multiple smallholder producers is an essential precursor to market access and enhances the ability to attract asset investment. Investments should not only focus on lead-firm out growers aggregation approaches, but should be complemented with efforts to build multi-tiered organizations of smallholder producers.

- **Business incubation—**Dedicated training in business and financial management and marketing alongside networking with experts is essential if sustainable smallholder enterprises are to grow. Producer organization models (where second tier umbrella cooperatives add value to primary production from their member groups and also provide business incubation services to improve their performance – including finance) seems to have the best long-term potential.

- **De-risking finance—**FIP can help de-risk finance through guarantees that reduce exposure in the event of default; concessional loans; support for leasing, factoring, warehousing and other forms of trade credit; and developing financial and fiscal regulation to raise domestic finance.

The review recommends that FIP engage intermediaries who can undertake these three tasks, especially with regard to the facilitation of better organization/ aggregation of products from multiple smallholder producers.

## FIP Mexico support for forest-related small- and medium-scale enterprises in Ejidos and Communities

FIP's work in Mexico provides a clear example of how an emphasis on organization, business incubation and de-risking finance can yield results and impacts for communities. The project—a US$3 million FIP contribution and an expected co-financing of US$4 million—established a business incubator for community forest enterprises (CFE). The work involved aggregating products, business development support, and tailored financing instruments and credit to de-risk finance—a comprehensive approach that increased the CFEs' ability to manage forests profitably and sustainably. For example, a CFE in San Pedro el Alto was given a US$265,000 loan via local microfinance institution FINDECA for a new sawmill and kilns. This improved management practices and increased the quality and volume of forest products, with higher returns. This investment enabled the project implementing agencies to form new partnerships with local banks and local communities. The combination of grants and concessional loan financing lowered overall risk for the implementing bank and allowed them to work with communities that previously did not have enough credit history to qualify for traditional financing.