Large parts of the global private sector continue to rely on natural resources either as part of companies’ core business or in their supply chains. One such resource is natural forests. The estimated total value of forest products worldwide is approximately $1 trillion per year, and demand is growing as population and income levels rise—particularly in developing countries.

Firewood and charcoal currently represent as much as 90 percent of the total forest harvest in regions such as Africa and South East Asia. Natural forests are the source of 75 percent of these removals, including firewood. As living standards increase, so too do demands for other forestry products such paper, housing, furniture, and packaging. An increasing portion of the demand will have to be met by relying on new plantations on previously deforested or other suitable lands, and by otherwise sustainably managing natural forests.

Protecting or expanding existing forest cover globally is necessary to preserve biodiversity, maintain water quantity and quality, provide a carbon sink, provide goods such as food and medicine, and to protect it as a potential source of future benefits. Shrinking natural forests and huge losses in biodiversity, combined with increased public scrutiny and growing pressure from investors, are therefore driving a change in the way companies view and manage these resources. Market demand for more sustainable forestry and nature-based products is also creating commercial incentives for better forest management.

At the same time, there is growing recognition of the rights of communities that live in forests. Many governments have enacted reforms in recent years around concessions for commercial use of national forests. This is creating opportunities for communities to own the forests that they have traditionally lived in and to engage in sustainable business partnerships with the private sector.

For companies, this can mean a more efficient and reliable supply of wood or other resources, as well as the potential for added value, such as processing before the product reaches them. For communities, this can mean an opportunity to develop skills, create more local employment, earn a higher premium for processed products, and channel higher returns into benefits such as education and infrastructure. Communities can also enjoy more secure land rights through formalized contracts and greater access to international markets as a result of international industry certifications.

IFC’s Role

The International Finance Corporation (IFC), the World Bank Group’s private sector arm, is committed to good corporate governance as well as social and environmental sustainability in all its investments. IFC encourages its clients to operate in an environmentally and socially responsible fashion. In the forest products sector—where IFC’s investments have averaged $250 million per year over the last four years—this is demonstrated through the adoption, by clients, of environmental and social management systems, the use of independent certification to attest to sustainable forest management, and the application of sustainability throughout the supply chain.

Relying on certification schemes and industry voluntary codes of conduct are just some of the ways that companies can ensure that their products are sourced sustainably, and thereby gain greater market and consumer confidence.

Proactive approaches to the governance of natural resources—such as collaboration with governments and other stakeholders, fair compensation to stakeholders for loss of traditional access to resources, and conflict resolution relating to distribution and shared use of resources—can also significantly reduce reputational and business risks and
increase the long-term positive impacts of private sector development.

New Standards for Private Sector Investment

In February 2006, IFC adopted a new set of performance standards on social and environmental sustainability, which provide clear requirements for client companies when IFC undertakes a new project or finances an existing enterprise. They include a new standard that replaces IFC's previous policies on natural habitats and forests, and establishes a more integrated approach to sustainable natural resource management.

The new standard on Biodiversity Conservation and Sustainable Natural Resource Management applies to projects in all habitats, whether or not those habitats have been previously disturbed and whether or not they are legally protected. Among other things, it requires companies seeking IFC investment to assess potential impacts on the various habitats and communities concerned, avoid or minimize negative impacts, and enhance positive ones. Overall, clients are to manage natural resources in a way that allows them to meet the reasonably foreseeable needs of future generations, and safeguarding the life-supporting capacity of air, water, and soil ecosystems.

When developing appropriate certification and management systems, the standard therefore emphasizes engagement with relevant stakeholders, such as local communities, indigenous peoples, and civil society organizations representing consumer, producer, and conservation interests.

Promoting Change in the Marketplace

IFC’s standards for private sector investment are some of the highest in the world and provide a global benchmark. They have been adopted by commercial banks as the basis for the Equator Principles, which now cover more than 80 percent of global project finance. The Principles provide a significant incentive for emerging market companies to improve the way they manage risk and identify opportunities.

IFC also increasingly provides technical assistance to improve the capacity of the private sector and of communities to develop innovative and more sustainable models for governance of shared natural resources. The following examples show various approaches that have sought to combine commercial viability with the interests of people and protection of the environment.

Creating Sustainable Wood Supply Chains in Indonesia

In Indonesia, home of one of the planet’s richest ecosystems, forest area the size of 300 football fields is estimated to be cut down every hour—70 percent or more of it illegally. Sustainable wood is responsibly sourced timber that can be traced back to a forest that has been verified as well managed or is part of an ongoing certification process. A Sustainable Wood Program, managed by IFC through its Program for Eastern Indonesia Small and Medium Enterprise Assistance (PENSA) is linking saw mills, furniture manufacturers, and buyers to help them gain business advantage from using responsibly sourced timber. Through training and technical assistance, the program is providing market opportunities to producers who use sustainable wood, and providing on-the-ground support to international buyers who want to procure materials responsibly in Indonesia. The program enables forest product buyers to track where their timber comes from and shows how better inventory management can improve manufacturing margins. Assistance in improving production processes further increases wood recovery and reduces waste.

In May 2006, IFC-PENSA successfully assisted the first Acacia plantation in Indonesia to gain membership in WWF’s Global Forest and Trade Network (GFTN). The 50,000 hectare plantation is owned by PT Inhutani II, a Kalamantan-based, state-owned enterprise. The GFTN endorses responsible forestry enterprises and links them with international buyers seeking sustainable timber products. This recognition is a major milestone for plantation forestry in Indonesia and shows international confidence in the Indonesian market to deliver sustainable wood products. IFC has also been assisting small- and medium-sized furniture manufacturers to capitalize upon this opportunity, by training them to dry Acacia timber prop-
Improving International Market Access via Better Forestry in Nicaragua

Nicaragua’s wood sector has great potential to contribute to the economic and social development of the country. Demand for wood products is high due to a global boom in the housing and construction market, which in turn has attracted the interest of international investors. International demand for products made with environmentally certified wood has also grown. Over 78 percent of Nicaragua is covered by forests. Annual exports total $11.6 million, of which 99 percent is raw timber. These conditions provide interesting opportunities for local firms to engage in higher, value-added activities, while addressing global consumer concerns about deforestation and the environment.

IFC’s Project Development Facility in Latin America and the Caribbean designed a pilot project drawing on the World Bank’s Program on Forests (PROFOR), a multi-donor partnership, as well as on the increasing international interest in the sector. Analysis showed that timber resources in Nicaragua are owned by local communities, and local firms in the sector are almost exclusively small businesses. The project helps link local suppliers with international buyers, potentially making the wood sector an important pillar of the Nicaraguan economy.

In February 2004, the facility began a small and medium enterprise (SME) supplier project, linking Exchange, a high-end furniture designer to approximately ten SME outsourcing companies. In March 2005, the facility partnered with the World Wildlife Fund (WWF) in a complementary pilot project to provide technical assistance to five carpentry businesses and two forest communities. The pilot promoted environmentally sound lumber harvesting and provided market information on certified lumber. It also worked with local firms to target high-end international markets sourcing certified wood.

Sales to international buyers quickly exceeded targets. The SMEs increased their exports by $59,000. The project showed that forest communities can benefit from selling sawn lumber, which commands a much higher price than raw timber. Prices rose by a factor of 12 and forest communities reported increased sales by $120,000. Moreover, the project contributed to the certification of 4,662 hectares of a community forest under the Forest Stewardship Council (FSC) certification system – the largest NGO providing environmental and social certificates for responsible forestry management. This represents a 27 percent increase in total certified forest in Nicaragua.

The facility plans to expand the pilot to include more forest communities and small businesses. It will provide training in firm-level business management and production techniques, and sustainable forestry management advice by creating a Forest Management Company that will offer technical assistance to forest communities. It will also explore the possibility of setting up a capital fund to provide local firms and communities with working capital.

The strength of the pilot results has encouraged replication of the model in other countries. WWF is now supporting a similar project in Panama. The facility is using the experience to develop projects in Bolivia and Peru, and the IFC PEP Africa Facility is also using the model to develop in other countries.

Identifying Barriers to Sustainable Community-Based Forestry in Africa

In 2004, IFC’s Social Responsibility Practice Area commissioned two feasibility studies to examine opportunities and constraints in Gabon and Ghana for the development of a community-level, sustainable forestry sector. The studies revealed several key challenges. They found that the difficulty of securing tenure and resource rights was a significant disincentive to businesses wishing to acquire concessions or logging permits. Moreover, as concessions or permits are often of short-term tenure, they don’t provide a good basis for the medium- and long-term planning and management needed for good forest management, including achieving formal certification.

In Gabon, community forestry enterprises were found to be ill-equipped to comply with the requirements of a recently introduced forest law, particularly with regard to preparing and implementing a forest management plan. In Ghana, constraints were linked to the process and legal basis of concessions’ allocation. Many suppliers also lacked adequate financing needed for bidding and competing for the concessions.

Capacity constraints presented challenges in both countries. These included lack of sufficient understanding and demand for sustainable logging, and lack of knowledge regarding regeneration capacity of the forest and its biodiversity status. The study also highlighted the importance of being able to demonstrate to other parties (buyers and investors) that forestry practices are sustainable, equitable, and transparent.

Companies seeking to operate sustainably in these markets can address some of these issues through effective sourcing and purchasing policies, by providing training and capacity building for suppliers, and by encouraging best practice by harvesting companies.

For more information on IFC’s sustainability initiatives, visit www.ifc.org/sustainability

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SHARING THE BENEFITS

THE FUTURE OF FOREST MANAGEMENT AND THE ROLE OF THE PRIVATE SECTOR

There is no doubt that environmental change, investor pressure, and a new attitude by many companies is changing private sector approaches to the management of natural resources. This is evidenced by two clear trends: more proactive assessment of risks and identification of new business opportunities through the diversification of ecosystem services.

Where companies used to respond in a reactive, ad hoc manner to risks when their operations utilize or impact natural resources, they are gradually taking a more rigorous approach to risk assessment, preparing corporate strategies and taking steps to manage impacts responsibly. In so doing, they are protecting their license to operate and continued access to resources.

A case in point is Forest Trends’ Business and Biodiversity Offset Program, in which leading mining, oil and gas, and construction companies are undertaking voluntary biodiversity offsets to ensure their new infrastructure projects bring about “no net loss” of biodiversity. This strengthens their relationships with regulators and communities—which are increasingly financially material—and helps them access capital.

Banks and asset management companies are also playing an important role in the process. Loan conditions, such as the IFC’s Performance Standard 6, require biodiversity offsets for capital projects in certain circumstances and are part of the revised Equator Principles, which are based on IFC standards and used by leading commercial banks to assess risk in their investments. To find out if engaging with companies on this issue works, Insight Investment, a London asset manager, teamed up with Fauna and Flora International in 2003 to compare quality of management on biodiversity in 36 mining, oil and gas, and utility companies. Insight then engaged with the companies to encourage them to improve their performance. When the team repeated the “Biodiversity benchmark” in 2005, the scores in each sector had improved substantially.

At the same time, the private sector is becoming more imaginative in identifying new business opportunities through better governance of natural resources. In the forestry sector, investors and companies are starting to see ecosystem services as valuable commodities. A “multiple-asset approach” to forestry has been developed by Forest Trends’ Business Development Facility with funding from the International Finance Corporation. It helps forest operators move from a single-asset approach, where cut timber is seen as the only real value of forests, to a business model that diversifies revenue streams for companies and communities by capitalizing on non-timber products and services that generate higher real returns on the forest asset.

This diversified approach benefits the business as well as local communities. Companies can increase their profits and improve their relationships with stakeholders. Communities gain new opportunities to participate in the value chain for forestry products. The success of initial ventures in this area is helping to set new standards for sustainable forest management, particularly in developing economies.

A partnership with Forest Trends and the International Finance Corporation this year led to a successful diversification of operations by Precious Woods, a pioneer in sustainable forestry operating in the Amazon. In June 2005, the company acquired an 80 percent stake in a local renewable energy biomass plant, to which it has started supplying waste woods from its forest operations. Energy sales from the renewable energy plant as well as sales of carbon credits under the Kyoto Protocol—resulting from the plant’s switch from diesel to biomass, the reduction of stockpiled waste wood, and avoiding transportation of diesel into the Amazon—will provide Precious Woods with additional revenue of $10 million in 2006. It will also secure a reliable source of electricity to a nearby town of 70,000 inhabitants. The project is expected to offset more than 1.4 million tons of CO₂ over a ten-year period. It shows that alternative revenue streams from forest ecosystems can benefit local communities and the environment and make good business sense.

This article was written by Michael Jenkins, president of Forest Trends, and Kerry ten Kate, director of the Business and Biodiversity Offset Program at Forest Trends. Forest Trends is a Washington, DC, non-profit group that supports initiatives such as company-community forestry partnerships, independent forest certification, and increasing investor awareness of the benefits of an integrated approach to governance and natural resource management. For more information, visit www.forest-trends.org.