Unlocking barriers to financing sustainable forest-related SMEs
Lessons from Mozambique and Guatemala

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Cover photo: Workers at the FEDECOVERA nursery in Verapaces operate compost packing machinery, Guatemala. © Juan José Ochaeta/FEDECOVERA.
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This publication is dedicated to Eileen Higgins, who very sadly passed away as it neared completion. Eileen worked on IIED's Forest Team publications for many years, first as an IIED employee then as a freelance designer. Her professionalism, dedication, creativity, efficiency and good humour will be remembered with fondness and appreciation by all those in IIED who worked with her. Part of her legacy is visible in the Team's extensive library of publications, the majority of which were designed by Eileen over the past twenty years, and which stand as a testament to her skill for producing design to a consistently high standard.
Acronyms and abbreviations

ACOF  Agro Comercial Olinda Fondo
AMAZA  Associação de Madeireiros de Zambézia (Zambezia Loggers’ Association)
AMOMA  Associação Moçambicana de Operadores de Madeira (Mozambican Association of Timber Operators)
APAMAZ  Associação Provincial de Agro-Pecuária e Madeira da Zambézia (Agriculture and Timber Association of Zambezia)
BAU  Balcão de Atendimento Único (Single Service Desk) (Mozambique)
BCI  Banco Comercial e de Investimentos (Mozambique)
CEPAGRI  Centro de Pesquisas Meteorológicas e Climáticas Aplicadas à Agricultura (Agriculture Promotion Centre) (Mozambique)
CONAP  Consejo Nacional de Áreas Protegidas (National Council for Protected Areas) (Guatemala)
CPI  Centro de Promoção de Investimentos (Investment Promotion Centre) (Mozambique)
DPA  Direção Provincial de Agricultura (Provincial Directorate of Agriculture) (Mozambique)
FAO  Food and Agriculture Organization of the United Nations
FCID  Catalytic Fund for Innovation and Development (Mozambique)
FDA  Fundo de Desenvolvimento Agrário (Agricultural Development Fund) (Mozambique)
FDD  Fundo de Desenvolvimento Distrital (District Development Fund) (Mozambique)
FFF  Forest and Farm Facility
FIP  Forest Investment Program
FSC  Forest Stewardship Council
FONGZA  Forum of Zambezia NGOs
GDP  Gross domestic product
ha  hectare(s)
IFC  International Finance Corporation
IPEME  Instituto para a Promoção das Pequenas e Médias Empresas (Institute for Promotion of Small and Medium Enterprises) (Mozambique)
ISL  Industrias Sotomane Limitada
MBIM  Millennium Banco Internacional de Moçambique
MINECO  Ministerio de Economía (Ministry of Economy) (Guatemala)
MITADER  Ministério da Terra, Ambiente e Desenvolvimento Rural (Ministry of Land, Environment and Rural Development) (Mozambique)
MZM  Mozambican meticul
NGO  Non-Governmental Organization
PINFOR  Forest Incentives Programme (Programa de Incentivos Forestales) (Guatemala)
PINPEP  Programa de Incentivos para Pequeños Poseedores de Tierras de Vocations Forestal o Agroforestal (Forest Incentives Programme for Small Forestry and Agroforestry Landholders) (Guatemala)
PROMER  Rural Markets Promotion Programme (Mozambique)
PROMIPYME  Centros de Promoción de la Micro, Pequeña y Mediana Empresa (Promotional Units of the Micro, Small and Medium Enterprises) (Guatemala)
PRSP  Poverty Reduction Strategy Paper (Mozambique)
PRSP II  Private Sector Recovery Program II
REDD+  Reducing Emissions from Deforestation and Forest Degradation, plus the role of conservation, sustainable management of forests, and the enhancement of forest carbon stocks
RFN  Registro Forestal Nacional (National Forestry Register) (Guatemala)
SDAE  Servicios Distritais das Actividades Económicas (District Economic Activity Services) (Mozambique)
SEINEF  Electronic Information System on Forest Enterprises
SIFGUA  Sistema de Información Forestal de Guatemala (Guatemala Forest Information System)
SMEs  small and medium-sized enterprises
USAID  United States Agency for International Development
US$  United States dollar(s)
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acronyms and abbreviations</td>
<td>2</td>
</tr>
<tr>
<td><strong>Executive summary</strong></td>
<td>5</td>
</tr>
<tr>
<td>Mozambique</td>
<td>5</td>
</tr>
<tr>
<td>Guatemala</td>
<td>6</td>
</tr>
<tr>
<td>Conclusion</td>
<td>7</td>
</tr>
<tr>
<td><strong>1 Financing sustainable small and medium-sized forest enterprises</strong></td>
<td>9</td>
</tr>
<tr>
<td>Financing sustainable businesses in forest landscapes</td>
<td>9</td>
</tr>
<tr>
<td>Constraints to, and opportunities for, financing SMEs</td>
<td>13</td>
</tr>
<tr>
<td><strong>2 Research methodology</strong></td>
<td>16</td>
</tr>
<tr>
<td><strong>3 Findings in Mozambique</strong></td>
<td>18</td>
</tr>
<tr>
<td>Country context</td>
<td>18</td>
</tr>
<tr>
<td>Forests, and drivers of deforestation</td>
<td>18</td>
</tr>
<tr>
<td>SMEs</td>
<td>19</td>
</tr>
<tr>
<td>Zambezia province</td>
<td>20</td>
</tr>
<tr>
<td>Public policies on forestry and agricultural SMEs</td>
<td>21</td>
</tr>
<tr>
<td>Options for forestry and agricultural SMEs</td>
<td>23</td>
</tr>
<tr>
<td>Public financing</td>
<td>23</td>
</tr>
<tr>
<td>Private financing</td>
<td>25</td>
</tr>
<tr>
<td>Challenges and opportunities for financing sustainable SMEs</td>
<td>29</td>
</tr>
<tr>
<td>Key challenges</td>
<td>29</td>
</tr>
<tr>
<td>Key opportunities</td>
<td>32</td>
</tr>
<tr>
<td>Country context</td>
<td>37</td>
</tr>
<tr>
<td><strong>4 Findings in Guatemala</strong></td>
<td>37</td>
</tr>
<tr>
<td>Case study regions: Petén and Verapaces</td>
<td>38</td>
</tr>
<tr>
<td>SMEs in Guatemala</td>
<td>39</td>
</tr>
<tr>
<td>National information systems and registration of SMEs</td>
<td>40</td>
</tr>
</tbody>
</table>
Public policies on forestry and agricultural SMEs 42
  The forest incentives programmes 42
  Mapping SME needs 43
  Capacity building to support business development 46
Financing opportunities for forestry and agricultural SMEs 48
  Public financing 48
  Private financing 51
Challenges and opportunities for financing sustainable SMEs 57
  Increasing understanding and communication 57
  The challenge of balancing public and private-sector expectations 57
  Low priority of forestry 58
  Cooperatives – a better fit? 58
  Risk 59

5 Discussion and conclusion 59
  Interest rates 60
  Scale 60
  Rate of return 61
  Repayment and grace periods 62
  Social and environmental impacts 62
  Capacity 63
  Recommendations 64
References 65
Annex 1: research questions 70
Annex 2: research interviewees 72
Executive summary

This paper presents research aimed at understanding the barriers to sustainable small- and medium-sized enterprises (SMEs) in forest landscapes in accessing finance by examining the financial situation in forest landscapes in two countries — Mozambique and Guatemala. In both countries, subnational regions were examined for existing public and private financing opportunities available to forestry and agricultural SMEs; the requirements and processes of access to finance; and the key barriers and how to address them were identified.

Mozambique

For this research, key interviews and field studies were carried out in miombo forest landscapes in the province of Zambezia.

The Mozambican government has several programmes designed to support SMEs in the forest and agriculture sectors. Most aim to reduce poverty and ensure food security by supporting the development of SMEs, and two recent programmes on REDD+ also have a goal of reducing deforestation and forest degradation.

A range of government institutions exist that could assist SMEs in the forest and agriculture sectors to gain greater access to financing.

Gapi, for example, is a development finance institution founded in 1990. It is a unique and successful public financing mechanism that manages more than US$40 million in funds from international development partners. It operates in over 100 districts in Mozambique and has given out more than US$90 million in loans since its establishment. Its success derives from its transparent, multistakeholder governance structure; its capacity building coupled with the provision of credit; and loan programmes designed to overcome barriers to SMEs in accessing finance.

Another promising institution is the Institute for Promotion of Small and Medium Enterprises (IPEME), which has a mandate to support SMEs. IPEME identifies emerging and existing SMEs, provides training for the development of business plans and financial reporting, and facilitates access to finance by acting as a link between SMEs and banks.
Key challenges facing forestry and agricultural SMEs in Mozambique in accessing finance include: an unfavourable macro political and economic environment featuring political instability, a volatile currency and poor governance; high operational costs, resulting in low rates of return; a high level of business risk; the large investments required to develop value-added businesses; the informality of most SMEs and their poor repayment histories; the lack of high-value fixed assets such as buildings (favoured or required by banks) among SMEs; the short-term, low-value nature of the loans on offer; a lack of information on financing options and capacity-building opportunities; the weak monitoring of environmental and social impacts; and the lack of capacity building for SMEs.

Opportunities for SMEs include the increasing availability of public investment in support for SMEs; diversification to reduce business risk; the creation of cooperatives and associations of SMEs; and emerging success stories among SMEs, which could inspire more entrepreneurship. Two such success stories – Industria Sotomane and Agro-Comercial Olinda Fondo – are described.

Guatemala

Guatemala has two major programmes – and a funding mechanism – in place and enshrined in law designed to enable local forest owners, smallholder farmers and indigenous peoples to participate in forest restoration and management. A well-organised sector of forest owners and community forest users has emerged in this enabling environment, including more than 1,000 community forestry organisations.

The paper examines two regions in Guatemala — Petén and Verapaces — in detail. Petén contains the Maya Biosphere Reserve and is a priority area for the national REDD+ programme. Fourteen forest concessions operate in the reserve’s multiple-use zone, of which 12 are owned by community forestry enterprises. The Verapaces region is characterised by a mosaic landscape of pine plantations, agroforestry, agrotourism and a variety of agricultural crops.

Finance for community forestry concessions in Petén is provided mainly by commercial banks, but international donors and NGOs have also provided significant support. SMEs in the Verapaces region have received much less donor support, and the banking sector offers only limited financial services. Cooperatives play an important role in the region as financial intermediaries — they offer financial services and credit to members and thereby help them overcome the lack of direct access to bank credit.
Guatemala has made advances in creating electronic systems for data collection and information sharing on SMEs and forests, but there is still a lack of information on SMEs, especially very small enterprises. Informality in the forest sector is high, and smallholder forest producers face major barriers in accessing finance.

Two forest incentives programmes – PINFOR and PINPEP, and their successors – demonstrate the government's strong, long-term commitment to the forest sector. The funding they provide enables forest producers to implement initial income-generating activities that can be used to leverage additional private-sector investment and to access credit from commercial banks. The government is also scaling up its efforts to strengthen business capacities and increase opportunities for forest SMEs. Nevertheless, efforts to address the credit-risk concerns of commercial banks by providing guarantee funds have made only slow progress.

In addition to government programmes, other financing options for forestry and agricultural SMEs in Guatemala include commercial banks, REDD+ and cooperatives. The role of FEDECOVERA, a cooperative representing 25,000 Mayan families, is described.

Challenges for SMEs in Guatemala in accessing finance include increasing understanding and communication between commercial banks, government and SMEs; balancing the expectations of the public and private sectors on the role of publicly funded programmes; and the low priority given to forestry in banks, especially their rural branches. Cooperatives, on the other hand, loom as important actors in reducing the cost of credit for SMEs and better tailoring services to needs.

**Conclusion**

Innovation is needed among both private-sector and public investors to address SME financing needs in eight key areas: 1) managing risks; 2) interest rates; 3) rates of return; 4) grace periods for repayment; 5) repayment periods; 6) the scale of investment; 7) social and environmental impacts; and 8) capacity. National governments, international donors and financing institutions should:

- Create innovative definitions and approaches to collateral and explore ways of guaranteeing credit to help create new mechanisms for granting access to finance for SMEs.
- Develop key principles and criteria for identifying appropriate institutions and models for channelling finance through intermediaries with mandates or specific motivations for enabling SME access to finance.
Establish agreements with global aggregators that have strong partnerships with regional and national aggregators of forest and farm producer organisations to facilitate the delivery of climate and development finance to decentralised levels.

Design terms and conditions that consider environmental and social impacts for financing in a collaborative process involving financial institutions, intermediaries and service providers.

Invest in national and regional networks of qualified service providers to develop business incubation processes to build the capacity of SMEs and help feed them into higher-value chains.
1
Financing sustainable small and medium-sized forest enterprises

Financing sustainable businesses in forest landscapes

Formal and informal small and medium-sized enterprises (SMEs) are key producers of forest and agricultural products for domestic and international markets; they are also crucial for broad-based economic development through job creation and tax revenue. SMEs have a potentially large multiplier effect in addressing the drivers of deforestation and forest degradation and thus in mitigating and adapting to climate change.

SMEs constitute 80–90 per cent of all businesses globally (UNIDO, 2006; Moore and Manring, 2008; IFC, 2011). Formal SMEs contribute 45 per cent of total employment and up to 33 per cent of gross domestic product (GDP), and they create four of every five new positions in emerging economies (World Bank, 2015). The informal sector is also large, increasing significantly the contributions of SMEs to those economic indicators. For example, SMEs in the formal and informal sectors are estimated to contribute more than 50 per cent of GDP and 63 per cent of employment in low-income countries (UNEP, 2007).

1 The definition of ‘small and medium-sized enterprise’ is discussed in Box 1.
SMEs are key players in achieving sustainable land use in forest landscapes. Although the overall impact of SMEs in forest landscapes is not well researched or understood, the crucial role of SMEs in achieving sustainable land uses at scale (Mayers et al., 2016) is indicated by the following:

- 80–90 per cent of all forestry enterprises in many countries are SMEs; and
- 98 per cent of all farms are family farms, representing at least 53 per cent of agricultural land and production. The majority of those family farms engage in commercial agriculture and constitute the majority of SMEs in developing countries (IFC, 2011; Graeub et al., 2015).

Box 1. Key definitions

Small and medium-sized enterprises. Different countries and regions use different definitions of SMEs, based mostly on the number of employees, sales or assets. At the global level, the most widely used definition is: firms with fewer than 250 employees with no lower limits (thus also including micro-sized enterprises).

Forest landscape. A forest landscape is a landscape that is, or once was, dominated by forests and woodlands and which continues to yield forest-related goods and services. Dealing with landscapes with a major forest component requires taking into consideration social, ecological, economic and agricultural factors that influence the forest (InfoResources, 2005).

Family farming. There is no global consensus on the definition of family farming, and countries often use their own definitions. The data shared in this report use the definition of the Food and Agriculture Organization of the United Nations (FAO): “a means of organizing agricultural, forestry, fisheries, pastoral and aquaculture production which is managed and operated by a family and predominantly reliant on family labour, including both women and men. The family and the farm are linked, co-evolve and combine economic, environmental, social and cultural functions”.

Local control. The Forest Connect Alliance defines successful community forest enterprises as entities undertaking commercial exchanges based on sustainably managed forest or tree products or services, overseen by credible representative bodies suited to act as rights-holders and which have legitimacy within self-defining ‘communities’ in terms of people and area, that generate and redistribute profits within those communities (Macqueen, 2013).

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2 Box 1 provides a definition of ‘forest landscape’.
3 Box 1 provides a definition of ‘family farming’.
SMEs operating in forest landscapes depend on forests and their ecosystem services to produce food, fuel and fibre. They are often locally based, with strong motivations to sustain the local resource base, and they are a great source of innovation and entrepreneurship. Collectively, SMEs are a significant — if not the largest — part of the private sector, and they invest labour, time and savings in forest landscapes. With the right pre-conditions (e.g. secure commercial tenure and technical support), locally controlled SMEs\(^4\) have been proven to be an effective business model because their strong linkages with forests, communities and markets improve forest condition and social impact in addition to generating economic returns (Bolin and Macqueen, 2016; Mayer et al., 2016; Macqueen and DeMarsh, 2016). Providing financial incentives for SMEs to adopt sustainable land-use practices, and investing in SMEs that already use land sustainably, will help bring the transformative changes in land uses mandated by the Paris Agreement on climate change and the UN's Sustainable Development Goals (SDGs). Box 2 illustrates how financing sustainable SMEs in forest landscapes can make significant contributions to SDGs.

\(^4\) ‘Local control’ is defined in Box 1
Box 2. The SDGs: ‘leaving no-one behind’ means investing in sustainable SMEs in forest landscapes

**Goal 1. End poverty in all its forms everywhere**
Different countries and regions use different definitions of SMEs, based mostly on the number of employees, sales or assets. At the global level, the most widely used definition is: firms with fewer than 250 employees with no lower limits (thus also including micro-sized enterprises).

**Goal 2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture**
SMEs in forest landscapes that engage in food production have direct impacts on forests. Financing their sustainable agricultural practices can improve production while minimising the negative impacts on forests. Financing SMEs engaged in sustainable forest management can help maintain or restore those forest ecosystem services on which food production depends (e.g. water regulation).

**Goal 5. Achieve gender equality and empower all women and girls**
Women play crucial roles in the use and management of natural resources. Supporting sustainable SMEs in forest landscapes and nurturing entrepreneurship in women can economically empower women and contribute to gender equality.

**Goal 8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all**
SDG 8.3 sets a specific goal for supporting access to finance for SMEs: “Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services”.

**Goal 13. Take urgent action to combat climate change and its impacts**
Forests are essential for climate-change mitigation and adaption. Forests are carbon sinks, and forest landscapes that are managed sustainably by SMEs will help increase the resilience of ecosystems and societies.

**Goal 15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss**
Given the crucial role that SMEs play in forest landscapes, achieving this goal will require the provision of incentives and support for sustainable SMEs.

**Goal 17. Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development**
SMEs have always been a source of entrepreneurship and innovation. They also mobilise substantial amounts of investment in sustainable landscapes through their labour and savings.
The research reported in this paper focuses on SMEs that are producing goods and services derived from trees and forests and agricultural goods and services in forest landscapes. Agriculture was included to increase understanding of how financing SMEs can address this significant global driver of deforestation. SMEs practising sustainable agriculture can help reverse deforestation, minimise negative impacts on forests, and promote positive interactions between agriculture and forests. Moreover, most producers in forest landscapes are involved in both forest and agricultural activities. Increasingly, forests and agriculture are being examined together with a view to developing coherent and effective strategies for sustainable land use (FAO, 2016).

Constraints to, and opportunities for, financing SMEs

Despite their important role in delivering the SDGs, SMEs in developing countries face disproportionate barriers to finance. Many studies point to an ‘SME finance gap’ (IDB, 2016; IFC, 2010). The majority of SMEs cannot meet the requirements set by collateral-based conventional bank lending or generate sufficiently high returns to attract risk investors and venture capitalists, and microfinance alone cannot meet their need for growth (IFC, 2011; Global Forest Trade Network, undated). The scale of SMEs is also a stumbling block. The transaction costs of managing small loans limit the deployment of finance through multilateral banks, while national commercial banks also perceive that this sector is a high investment risk. It is estimated that more than 50 per cent of SMEs globally lack access to finance, and the percentage rises to 70 per cent in emerging markets (World Bank, 2015). The credit gap for formal SMEs — which is particularly large in Africa and Asia — is about US$1.2 trillion; the gap for both formal and informal SMEs is around US$2.6 trillion (World Bank, 2015).

SMEs face particular challenges due to their size, ownership and distance to decision-making power and markets. They produce multiple products, most of which are unknown to conventional markets. The diversity of products means that SMEs often fall between the policy mandates of the ministries of agriculture, forestry, industry and commerce, creating a complex and often costly regulatory environment for such businesses to navigate (Kelly, 2013). SMEs operate in remote environments with highly unreliable infrastructure and utilities (e.g. roads, power and water), and their formal activities are associated with high transaction costs (deMarsh et al., 2014). Associations of SMEs can provide economies of scale and help improve product quality and business management, among other benefits. Such associations, however, face the additional challenge of balancing multiple interests with democratic decision making about employment and the fair distribution of profits. Factors such as these contribute to the perception that SMEs are high-risk, hence limiting their access to capital from formal financial institutions.
Nevertheless, there is increasing global recognition of the importance of SMEs for sustainable development and in shaping the future of forests (UNIDO, 2006; UNEP, 2007; IFC, 2011; Hoare, 2016; FAO, 2016; Mayers, 2016). For example, FAO’s private-sector strategy identifies producer organisations and SMEs as crucial for the development of the agriculture sector (FAO, 2013), and SDG 8.3 encourages the formalisation and growth of SMEs, including through access to financial services.

New financing opportunities are available to support sustainable land use in forest landscapes, some of which are being used or could be used by sustainable SMEs. Development agencies such as the World Bank, national governments, and others are providing targeted finance to support initial investments in the value chains of forest and agricultural products through programmes such as the Forest Investment Program (FIP), the Green Climate Fund and the BioCarbon Fund. REDD+\(^5\) financing is contributing to business readiness for sustainable SMEs in forest landscapes; this is the case, for example, in Mozambique. Bilateral support, especially from Norway and Germany, is helping establish an enabling environment for business models addressing climate change, biodiversity conservation and sustainable development in tropical countries. Public and private forest carbon financing amounted to US$37.5 million in 2015, which made the forest sector the biggest participant, by investment value, in the voluntary carbon market (Ecosystem Market Place, 2016).

\(^5\) REDD+ = reducing emissions from deforestation and forest degradation, plus the role of conservation, sustainable management of forests, and the enhancement of forest carbon stocks.
An increasing number of public and private investors are supporting impact investments that seek to create positive social and environmental impacts beyond financial returns. An estimated US$15.2 billion was committed to this purpose in 2015; at the end of that year, the total size of impact-investing assets was estimated at US$77.4 billion, of which 6 per cent was in the agriculture sector and 2 per cent was for conservation projects (with investments in the two sectors combined totalling US$6.2 billion). Investors indicated that impact investments in agriculture were most likely to increase in 2016 (GIIN, 2016). In 2014, 240 investors pledged US$15 trillion in assets to deforestation-free supply chains, although the actual amount of financial commitments is unclear and discussions are ongoing on how they will be delivered. There is a market opening for deforestation-free commodities, and opportunities are emerging to steer investments along supply chains to build the technical and business capacities of SMEs and to support intermediary organisations (e.g. local non-governmental organisations – NGOs) to do so.

If they are to help fill the gap in SME finance, such emerging financial opportunities must be designed to address existing barriers and risks. If they are not so designed, they could have the perverse effect of perpetuating business as usual and thereby undermining the development of SMEs and their combined potential to achieve sustainable land use at scale. The research presented in this paper goes deep into forest landscapes in Mozambique and Guatemala to shed light on the existing barriers faced by forestry and agricultural SMEs to access finance and to inform the design of both public and private-sector investments intended to promote and support sustainable land use.
Research methodology

The aims of the research presented in this paper are to:

- Understand existing barriers to sustainable forestry and agricultural SMEs in forest landscapes in accessing finance in two case-study countries — Mozambique and Guatemala.
- Make recommendations on SME-friendly financing mechanisms and processes that can contribute to the achievement of the SDGs in the case-study countries and globally.

To achieve the research objectives, the following steps were taken in each case-study country:

- Existing public and private financing opportunities available to forestry and agricultural SMEs in forest landscapes were mapped through desk research.
- The requirements and processes of access (eligibility criteria, application, decision making and monitoring processes) were examined through semi-structured interviews with key investors, SMEs, and other key stakeholders, complemented by desk research.
- The key barriers and how to address them were identified based on information gathered through semi-structured interviews as well as field visits to forest landscapes in which SMEs and investors operate.

The case-study countries were chosen because, in both countries: 1) public and private financing schemes are emerging designed to support SMEs in forest landscapes; 2) active forestry and agricultural SMEs are trying to access finance; and 3) some of those SMEs and investors have established partnerships with IIED or through IIED’s network, which made gathering evidence through semi-structured interviews possible within the limited timeframe and budget of the research project.
Based on an initial literature review, six key factors were identified that affect the willingness of funders to offer finance to SMEs and of SMEs to accept such funding (Figure 1). These factors were used to design the key interview questions and were later reinforced and refined by information gathered in the case-study countries. Annex 1 contains the key interview questions.

Figure 1. Six elements that determine willingness to give or receive financing for small and medium enterprises
Country context

Forests, and drivers of deforestation

Mozambique is one of the world’s poorest countries, with 54 per cent of the population living below the poverty line. Forests, woodlands and other types of vegetation cover approximately 70 per cent of the country. The forest area is 40.1 million hectares (ha) (51 per cent of the total land area), of which 26.9 million ha is classified as production forest and suitable for wood production; the remainder (13.2 million ha) is allocated as protected areas, some of which are under communal management (UT-REDD+, 2016). Despite its rich and diverse forest ecosystems, Mozambique has a high annual rate of deforestation, at 0.21–0.58 per cent per year (estimated based on national forest inventories conducted in 1970–1992 and 1992–2002; UT-REDD+, 2016).

The main causes of deforestation are in the forest, agriculture and energy sectors. In the forest sector, illegal and unsustainable logging leads to the degradation and loss of natural forests. It has been estimated that 93 per cent of all commercial timber harvested in 2013 and 81 per cent (on average) of that logged between 2007 and 2012 was illegal, a potential total loss of US$146 million in unearned public revenue over the period (EIA, 2013). Illegal logging also implies significant losses for local communities, which have a right to receive 20 per cent of concession taxes (UT-REDD+, 2016; Fundo do Ambiente, 2015). The clearance of forests to make way for agriculture is the main cause of deforestation outside the forest sector.
SMEs

SMEs in Mozambique are defined by the number of workers and annual sales volume, with the latter being the decisive factor (Table 1). Moreover, to be an SME, no more than 25 per cent of the entity's shares may be held by a large business or the state (PME Moçambicana, 2014). We do not use the lower limits (as shown in Table 1) in our research; thus, micro-sized enterprises are included as SMEs.

SMEs are important in Mozambique's economy, but the majority of forestry and agricultural SMEs are small and operate in the informal sector. The most recent public data suggests that SMEs in Mozambique represent about 98.1% of all registered companies: Micro businesses account for 79.6 per cent, small businesses for 9.4 per cent and medium businesses for 9.1 per cent, and their combined sales volume accounts for 33.4 per cent of national GDP (Observatorio Internacional, 2016; IPEME, 2015). Most registered SMEs are categorised as predominantly trade (57.44 per cent), followed by hotel industry (20.15 per cent), manufacturing (9.93 per cent), agriculture and forestry (2.17 per cent), transport and communications, civil construction and other activities such as financial services, provision of services, education and health, etc (IPEME, 2015; WIPO, 2017). The official number of SMEs in forestry and agriculture underestimates the collective role of SMEs, however, because informality is widespread — an estimated 90.9 per cent of SMEs in the two sectors are informal (Nhancale et al., 2009).
Table 1. Definition of micro, small and medium-sized businesses, as per the General Regulations on Micro, Small and Medium Enterprises (Decree No. 44/2011 of 21 September)

<table>
<thead>
<tr>
<th>Business category</th>
<th>No. workers</th>
<th>Annual sales volume (MZN)</th>
<th>US$ equivalent in 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro-sized</td>
<td>1–4</td>
<td>Up to 1.2 million</td>
<td>20,000</td>
</tr>
<tr>
<td>Small-sized</td>
<td>5–49</td>
<td>1.2–14.7 million</td>
<td>20,000–245,000</td>
</tr>
<tr>
<td>Medium-sized</td>
<td>50–99</td>
<td>14.7–29.9 million</td>
<td>245,000–498,333</td>
</tr>
</tbody>
</table>

**Zambezia province**

For this research, key interviews and field studies were carried out mainly in miombo forest landscapes in Zambezia. This province was selected because it hosts one of the most important forest landscapes in Mozambique; there is a high deforestation rate due to unsustainable land uses in the forest and agriculture sectors; there are many emerging SMEs; and an increasing number of public and private programmes seek to support SMEs in accessing finance.

Zambezia province is the second-most populous province in Mozambique, with around 3.8 million inhabitants (based on 2007 data), of which 70.5 per cent live below the poverty line (Francisco, 2010; INE, 2007). Zambezia has approximately 4.77 million ha of miombo woodland, which is 47.7 per cent of the province’s total land area (10 million ha). Most forests (4.1 million ha) are classified as production forests, and about 0.67 million ha are classified as protection forests, which are important for soil protection because they include steep slopes, mountain areas, riverbanks and mangroves. Between 1990 and 2002, the province ranked second in terms of forest loss (31,000 ha per year, or 0.71 per cent) (Sito A et al., 2012). The main drivers of deforestation in the province reflect the national situation, as discussed above.

Farming is the most important economic activity in Zambezia, accounting for 65 per cent of provincial GDP, followed by commerce (8.4 per cent), fishing (4.7 per cent) and forestry (4.3 per cent). It is estimated that 89.9 per cent of the active population in the province works in the agriculture sector. There are 4,159 registered SMEs, of which 79 operate in forestry and approximately 337 operate in agriculture. Of the 79 forestry SMEs, 24 are forest concession holders and 55 operate with simple licences (INE, CEMPRE, 2014-2015). Informality is widespread in the province, in line with the situation nationally, and the actual number of SMEs is much higher than the official figure. In Mocuba district (one of 16 districts in the province), for example, the Institute for Promotion of Micro, Small and Medium Enterprises (Instituto para a Promoção das Pequenas e Médias Empresas – IPEME) is supporting 2,800 SMEs, of which 79 operate in forestry or agriculture.
In recent years, the government and donors have identified Zambezia as a strategic location for developing agricultural activities, promoting sustainable land use and building the SME sector.

Public policies on forestry and agricultural SMEs

The Mozambican government has carried out major reforms of its macroeconomic policies, with the main objective of promoting economic development and reducing absolute poverty. In 2007 it adopted the Action Plan for the Reduction of Absolute Poverty 2006–2009 (Plano de Acção para a Redução da Pobreza Absoluta 2006–2009 – PARPA II), which has a strong focus on private-sector development and prioritises the development of SMEs (micro-, small- and medium-sized enterprises). The National Development Strategy for 2015–2035 identified the following strategic actions to support SMEs: improve access to finance; reduce administrative bureaucracy; develop production support infrastructure; and provide training and support for SMEs, including on market issues (Government of Mozambique, 2014).

The government and partners have implemented various funding and investment programmes for SMEs to improve the business environment and increase the number of bankable SMEs. Most of these programmes are active in Zambezia province. The main active public programmes focus on the following areas:

- **Registration for SMEs.** All SMEs are required to register with the Provincial Business Council (Conselho Empresarial Provincial) at the provincial level or the Confederation of Economic Associations (Confederação das Associações Económicas) at the national level. Many SMEs choose not to register, however, because of the high level of bureaucracy and related costs. To encourage, simplify and expedite the registration process, the national government created the Balcão de Atendimento Único (BAU; Single Service Desk or “one-stop shop”) through Decree No. 14/2007, which provides a licensing service for SMEs by issuing “simplified licences” and “permits”:
  - Simplified licences are for businesses (e.g. sales) that do not have a direct impact on the environment and only trade in domestic markets as retailers (as opposed to wholesalers). The cost of a simplified licence is 1,576 MZN (US$26).
  - Permits are for businesses (e.g. chemical products, food products and restaurants) likely to engage in activities that have a direct impact on the environment and trade in domestic or foreign markets. Permits allow businesses to operate as retailers and wholesalers. The cost of a permit is 3,278 MZN (US$54). For businesses with a direct impact on the environment, an additional charge of 1,576 MZN must be paid to cover the cost of inspections.
For micro-sized businesses with sales of no more than MZN 750,000 (US$12,500) per year or with no more than four workers, licensing is carried out at the district or municipal level rather than through the BAU.

- **Mapping the needs of SMEs.** The government has carried out a general survey of the needs of SMEs through the Ministry of Industry and Commerce, the Ministry of Lands, Environment and Rural Development (Ministério da Terra, Ambiente e Desenvolvimento Rural – MITADER) and provincial governments. The provincial government hosts 2–3 meetings per year with SMEs and the central government hosts three meetings per year to explain the government’s development objectives in all areas and to outline its planned and ongoing actions for the development of SMEs.

MITADER summarises the survey findings at the national level and shares them with the Centre for the Promotion of Investment (Centro de Promoção de Investimentos — CPI, which focuses on attracting foreign investment) at the provincial level. The CPI tailors the findings based on its interactions with SMEs in the province and provides targeted support to help meet their financial needs.

- **Provide information on financing opportunities for SMEs.** Through the CPI, the Centre for the Promotion of Agriculture Investment (Centro de Pesquisas Meteorológicas e Climáticas Aplicadas à Agricultura – CEPAGRI) and IPEME, the government seeks to maintain a national register of all types of financing bodies and lenders in the country to facilitate and guide the private sector in accessing finance.

The objective of the CPI is to produce and map information on all existing funding opportunities nationwide. Registration is voluntary, however, and financing entities and lenders are often reluctant to disclose information (as is the case in Zambezia). As a result, the CPI is not always informed of all initiatives, and it maps only those activities of which it is aware. At the provincial level, the CPI maps investment areas, provides advice, acts as a liaison between investors and SMEs, and guides entrepreneurs in relevant investment areas. The CPI is also mandated to produce and provide to SMEs a list of all investment opportunities available in the province.

The CPI focuses on all sectors and all types of businesses; CEPAGRI, on the other hand, focuses on supporting SMEs in the agriculture and forest sectors. CEPAGRI is active in four provinces, including Zambezia, mainly supporting agricultural projects (CEPAGRI, 2015). It also produces leaflets with details of each type of funding opportunity in agriculture and forestry and seeks regular meetings with financial institutions for updates on the products on offer.

The lists of investment opportunities generated by the CPI and CEPAGRI are provided to the District Services of Economic Activities (Serviços Distritais das Actividades Económicas – SDAE), which publishes them in its information bulletins.
Support capacity building for business development and facilitate access to finance. IPEME is a public entity of national scope, created under Decree No. 47/2008, with a mandate to promote and support SMEs and to ensure the implementation and monitoring of the Strategy for the Development of SMEs in Mozambique (Ministério da Industria e Comercio, 2007). IPEME has its headquarters in Maputo and branches in all provinces; in Zambezia the branch is in the district of Mocuba. IPEME identifies emerging and existing SMEs, provides training (usually 1–2 weeks) for the development of business plans and financial reporting, and facilitates access to finance by acting as a link between SMEs and banks. IPEME supports SMEs from all sectors. In 2015 and 2016, the Zambezia branch of IPEME has provided services to 2,800 SMEs, including 42 companies in the agriculture sector and 15 in the forest sector.

CEPAGRI provides free services for SMEs in the agriculture sector for the development of business plans and facilitates negotiations between SMEs and banks to help secure loans. Since 2011, around 50 per cent of the companies supported by CEPAGRI have secured loans from commercial banks, of which about 100 are SMEs. CEPAGRI was able to secure interest rates of 9–12 per cent for those companies.

Options for forestry and agricultural SMEs

Public financing

With the financial support of international donors, the Mozambican government has implemented several programmes to support SMEs in the forest and agriculture sectors (summarised in Annexes 2 and 3). The main ongoing programmes are PRSP II, FinAgro, Landscape, the Agrarian Development Fund (Fundo de Desenvolvimento Agrário – FDA), the District Development Fund (Fundo de Desenvolvimento Distrital – FDD), Gapi, the Rural Markets Promotion Programme (PROMER), the FIP and the Catalytic Fund for Innovation and Development (FCID) (direct funding for various agricultural and market activities). Most of these programmes aim to reduce poverty and ensure food security by supporting the development of SMEs, but recent programmes on REDD+ (i.e. Landscape and FIP) also have a goal of reducing deforestation and forest degradation. Most public investments are provided to SMEs in the agriculture sector.

Gapi, a development finance institution founded in 1990, is a unique and successful public financing mechanism that manages more than US$40 million in funds from international development partners. It operates in over 100 districts in Mozambique and has given out more than US$90 million in loans since its establishment. Sixty-eight per cent of its credit portfolio is in agricultural value chains and the remainder is in construction, fisheries,

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6 This pilot project will be implemented in nine districts in Zambezia province.
transportation, services, and technology and microfinance. Gapi has been more successful than other public financing mechanisms in improving the access of SMEs to finance. Contributing factors to this success are the following:

- **A transparent and multistakeholder governance structure.** Gapi is governed as a joint stock company through a public–private partnership. In 2013, the state owned 30 per cent of Gapi's shares, the private sector owned 55 per cent and civil society owned 15 per cent. All shareholders are Mozambican, and they govern Gapi jointly. The use of a private-sector (rather than governmental) governance structure means a high level of transparency in its operations. The multistakeholder governance structure also ensures that its operations in development finance are solvent in accordance with international and national standards and responsive to key stakeholder needs.

- **Strong targeted capacity building coupled with credit (i.e. loans, equity and guarantees).** Gapi ensures that 30–40 per cent of its funds are used to help build capacity in SMEs. It provides business development training and advice to help transition enterprises to formalisation and improve management capacity. Gapi provides financial education and promotes savings by creating community savings-and-credit organisations. It also supports institutional development, including programmes to build producer organisations that empower SMEs and give them more bargaining power in the market and with policymakers.

Miombo woodlands cover two thirds of forest land in Mozambique – financing the transition of artisanal loggers to forest concessionaires is climate smart and makes business sense. © Isilda Nhantumbo/IIED
A variety of loan programmes to address barriers to SMEs in accessing finance, including

- **Interest rates**: In all its agricultural programmes, Gapi offers loans at an interest rate that is 5 percentage points lower than the central bank base rate.

- **Scale of investment required**: Gapi’s “Youth in Agribusiness” programme offers 50 per cent of the loan value as seed funds to young entrepreneurs able to pay back loans according to their loan agreements.

- **Collateral requirements**: Gapi’s “Agro-guarantee” programme offers to assure 25–75 per cent of loan values for SMEs issued through commercial banks.

- **Repayment period**: most loans are for up to five years, but longer periods have also been offered. For example, past loan programmes in the forest sector offered 5–10-year repayment periods.

- **Grace period**: Loans are often given out with short or no grace periods to encourage a sense of financial responsibility from the start of the loan. But Gapi works closely with SMEs on the ground and can allow loan restructuring to accommodate the genuine needs of SMEs.

The FIP project is still in the pilot phase. It is being implemented in nine districts in Zambezia province – Maganja da Costa, Mocubela, Pebane, Gile, Mulevala, Mocuba, Ile, Gurué and Alto Molócué – and in Cabo Delgado province. The government chose these locations for the pilot phase for two reasons (MITADER, 2016; UT-REDD+, 2016):

1. The nine districts in Zambezia province were selected because of their high agricultural and reforestation potential.

2. Districts in Cabo Delgado province were selected to provide diversity in testing

**Private financing**

Most SMEs in Mozambique use their own capital or money borrowed from family members and friends as the main source of financing for their businesses. In a study by the World Bank and the International Finance Corporation (IFC), companies indicated that around 90 per cent of working capital needs and 64.9 per cent of new investments were funded using their own capital (Ministerio da Industria e Comercio, 2007). Many SMEs also get advances from the buyers of their products to improve their businesses: for example, most of the concession and simple-licence timber operators interviewed obtained cash advances from Chinese buyers; some SMEs can also get cash advances or free seeds, seedlings and equipment via outgrower schemes.
An increasing number of banks in Mozambique offer loans to SMEs. The main objective for commercial banks is to make a profit, and SMEs are viewed as high-risk clients because their capacity for repayment is deemed lower than that of larger companies.

Most commercial banks only offer loans to SMEs in the agriculture sector and view the forest sector as higher risk due to the long repayment period (because trees take longer to mature when planted), the high incidence of illegal logging and wildfire, and a lack of secure markets (mainly for logs). The exception is BCI in Zambezia, which views the forest sector as a promising market with both domestic and export sales potential; moreover, it perceives that public policies are improving to support value adding and job creation. BCI offers only limited credit lines to SMEs in the agriculture sector because of a lack of collateral (land belongs to the state and cannot be used as collateral), thin profit margins because their operations are not mechanised, and the high risk of crop failure in predominantly rain-fed agriculture.

Interest rates offered by commercial banks are set against the base rate (or prime rate) determined by the central bank. In Mozambique’s current macroeconomic climate, the base rate fluctuates hugely: for example, it was 10.75 per cent before March 2016 and 23.25 per cent in November 2016.

Repayment periods and the range of loans offered vary among banks. Usually, the larger the loan, the longer the repayment period, with some banks offering periods as long as six years. All commercial banks require proof of legal registration (including tax identification), a business plan and financial records for the previous three years. All commercial banks require collateral or guarantors for loans. The preferred collateral is insured, unmortgaged buildings.

Most banks do not have social or environmental requirements for loans, but some are beginning to consider environmental impacts as a potential risk factor for SMEs because of the potential for governments to shut down operations for violating regulations. The commercial banks manage all loans themselves, and SMEs therefore must approach them to obtain loans and negotiate terms.

Public investors and government agencies can sometimes help negotiate better interest rates and can act as guarantors for SMEs to reduce the need for collateral. Public investors and government agencies can also provide SMEs with information on the availability of, and requirements for, loans, and support them in accessing such loans. Table 2 summarises the key requirements of some commercial banks in Zambezia province.
Table 2. Key parameters of certain commercial banks in Zambezia province
(Note: data was obtained in 2016)

<table>
<thead>
<tr>
<th>Bank</th>
<th>Activities financed</th>
<th>Interest rate</th>
<th>Repayment period</th>
<th>Required scale</th>
<th>Risk (collateral/insurance)</th>
<th>Required documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Bank of Africa</td>
<td>Agriculture</td>
<td>Variable rate, currently 25%</td>
<td>1–2 years</td>
<td>Minimum MZN 600,000; no maximum</td>
<td>Real estate; property deeds; cash</td>
<td>Yes, but rules may be relaxed on a case-by-case basis</td>
</tr>
<tr>
<td>Standard Bank</td>
<td>Agriculture</td>
<td>Variable rate: prime rate + 2.5% (SMEs may be prime rate + 3.5–4.5%)</td>
<td>Up to 6 years</td>
<td>Under US$200,000; no minimum requirements: e.g. MZN 200,000</td>
<td>Equity/assets; certificate of deposit: e.g. store grain and use that as deposit; down payments based on central bank regulations</td>
<td>Yes</td>
</tr>
<tr>
<td>Barclays Bank</td>
<td>Agriculture</td>
<td>Variable rate: minimum 24.5% at present</td>
<td>9 months–5 years, with the possibility of 1-year extension</td>
<td>N/A</td>
<td>Assets/equity</td>
<td>Yes</td>
</tr>
<tr>
<td>Bank</td>
<td>Activities financed</td>
<td>Interest rate</td>
<td>Repayment period</td>
<td>Required scale</td>
<td>Risk (collateral/insurance)</td>
<td>Required documentation</td>
</tr>
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<td>------------------------</td>
</tr>
<tr>
<td>BCI</td>
<td>Forestry; mechanised agriculture</td>
<td>Variable rate: prime rate + 4%; 18% six months ago; now 27%</td>
<td>6 months–5 years</td>
<td>≤ MZN 3 million for products (maize; beans)</td>
<td>Assets/equity or cash guarantor from public sector; equity insurance (for company); asset and personal insurance (for individuals)</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>≤ MZN 1.325 million for warehouse, etc.</td>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>≤ MZN 12 million (investment from Denmark)</td>
<td></td>
<td>Yes</td>
</tr>
</tbody>
</table>
Challenges and opportunities for financing sustainable SMEs

Key challenges

The macro political and economic context leads to high, volatile interest rates. Ongoing political instability in Mozambique, a volatile currency, a high level of corruption, poor infrastructure, a lack of control over illegal land-use activities, and conflicts over land rights pose high risks for businesses and mean a high base rate for loans set by the central bank. In 2016, the interest rate for loans in the local currency, the rate of inflation and the loan commission rate were 27.5 per cent, 21.96 per cent and 5 per cent, respectively. Some SMEs reported that they will take out loans with an interest rate of 10–15 per cent, but some SMEs in the timber market said they could not pay back a loan at any interest rate because of the poor market. An interest rate of 27.5 per cent is prohibitive for them (CEPAGRI, 2015; MEF, 2016).

The base rate is extremely volatile. All commercial banks give out loans at a variable interest rate, and the rate can change overnight along with the base rate. This poses high risks for businesses seeking to take out loans from banks. A company that took out a variable interest rate loan before March 2016, for example, would have faced a more than doubling of interest repayments by November.

High operational costs result in low rates of return. Transportation costs are high for most SMEs due to the poor road network, the poor condition of existing roads, and a lack of electricity. Land prices are high near roads and electricity supplies.

In the forest sector, the cost of concession licences (including the cost of developing management plans, as required by the forestry law) and low efficiency in processing (or a lack of capacity in processing) reduce the competitiveness of Mozambican timber products in international markets.

Forestry and agricultural businesses are high-risk. In the forest sector, a high level of corruption, particularly in law enforcement, a volatile export market, the high frequency of wildfires, and widespread illegal logging in concession areas mean high risks for timber businesses. Coupled with high operational costs, some timber companies will not consider taking out even low-interest loans because the risk of being unable to repay is high. For example, members of the Mozambican Association of Timber Operators (Associação Mocambicana de Operadores de Madeira – AMOMA) declined a EUR 10 million offer from the French government with a two-year grace period. The risk averseness of businesses also stems from the poor business tradition, limited financial management capacity, a lack of competitiveness, and an expectation of hand-outs or grants.
Most agricultural crops are rainfed in Mozambique, and climate change has increased the variability of rainfall patterns and the frequency of extreme weather events. Most SMEs lack irrigation capacity and are exposed to higher risks as the climate changes.

A high level of investment is required to develop value-added businesses. Transforming SMEs in the forest and agriculture sectors in Mozambique requires investment in new production technologies and mechanisation as well as increased processing capacity and skilled entrepreneurs and workers who can operate and maintain such technologies. The upfront investment required is high. For example, even though FinAgro can offer grants to SMEs for 70 per cent of the investment required to purchase machinery, most SMEs cannot self-fund the remaining 30 per cent and must negotiate with banks for loans; they are subsequently disqualified by FinAgro when they cannot meet the requirements of commercial banks (e.g. collateral, legal documentation and financial records).

The informality of SMEs is incompatible with investor requirements for accessing finance. Most SMEs in Mozambique are informal and therefore lack legal documentation, basic organisational structures, an understanding of sustainable resource management practices, accounting skills to keep financial records, and business plans. All private financing options and most public funding programmes require that SMEs are formalised, but few investors and funders help SMEs in the formalisation process. IPEME, CEPAGRI, Gapi and NGOs such as the National Cooperative Business Association CLUSA and Technoserv are trying to fill this void by developing programmes to support SMEs in establishing robust business structures and management systems and thereby becoming creditworthy.

SMEs have a poor repayment history. SMEs have a generally poor record of loan repayments. For example, district-level SME promotion funds have only a 2–5 per cent repayment rate. CEPAGRI also offered loans to SMEs when it was first established, but the repayment rate was so low that the organisation decided to collaborate with banks and use their own funds to build capacity in SMEs and facilitate access to bank loans. An uncertain market, the lack of support for business capacity building, high operational costs and, in some cases, neglect by SMEs of repayment requirements all contribute to the poor repayment rate.

Because of the poor repayment record, most banks view SMEs as high-risk. Most have stringent collateral rules for SMEs, and some demand higher interest rates to offset the risks (e.g. Standard Bank's loans to SMEs are 1–2 percentage points higher than rates offered to other businesses).

High-value fixed assets (especially buildings) are favoured or required for private financing options. To offset high macroeconomic risks and the perceived high risks related to SMEs, all private financing sources require fixed assets — mostly buildings — as
collateral for loans. Equipment and land are usually not accepted as sufficient. In some cases, banks require collateral worth 3–4 times the amount to be financed. Moreover, national laws do not allow land (which belongs to the state) to be used as collateral.

The majority of SMEs do not own buildings. Those who do so are unwilling to use them as collateral for fear that the banks could confiscate them in the event of default (the risk of which is high given the various risks SMEs face, as discussed above). For example, one SME entrepreneur interviewed declined a 14–18 per cent interest rate offered by Gapi because he didn't want to use his house as collateral.

**Short-term, low-value loans are insufficient to meet the needs of SMEs.** Given the macroeconomic context in the country, most banks offer only short-term, low-value loans. These are insufficient to meet the needs of SMEs, hindering prospects of business growth. For example, even Sotomane (Box 3), a successful enterprise able to meet all bank requirements, failed to obtain a MZN 5 million loan in 2016. The bank only approved MZN 1.5 million, which Sotomane declined because it was insufficient to support its investment plans.

**There is a lack of information on financing options and capacity-building opportunities for SMEs.** SMEs often lack information about the public financing and capacity-building opportunities available to them. CPI, IPEME and CEPAGRI recently started gathering information on financing options. The Forum of Zambezian NGOs (FONGZA) also has a database of NGOs operating in the province that support existing or emerging agricultural SMEs. The database includes the area of operation and the scale of investment in each programme or project they finance each year. But effective communication of this information to SMEs remains a challenge.
The monitoring of social and environmental impacts is weak in both sectors. The social and environmental regulations governing concessions are strong, but implementation, enforcement and monitoring are weak. In comparison, the social and environmental regulations governing agricultural businesses are weak and the impacts of agricultural investments are not well monitored. For example, some agricultural SMEs are expanding onto forest land by paying a one-off fee to communities to move off the land.

With the exception of recent REDD+-related funding opportunities and other programmes funded by the World Bank, most investors do not prioritise funding for those SMEs that can demonstrate positive social and environmental impacts. There is a lack of incentives for SMEs to adopt sustainable practices, and this may put responsible and sustainable SMEs at a disadvantage because of the higher costs involved.

There is a lack of long-term capacity building for SMEs. Developing business know-how, nurturing entrepreneurship and changing the business models of SMEs towards socially and environmentally responsible practices requires continuous capacity building over a long period. Long-term capacity building needs to be supported by local government, locally based NGOs and other service providers who can continuously engage and support SMEs, build trust, monitor progress and tailor services to different stages of SME development.

There is, however, a lack of long-term capacity building for SMEs at the local level. In particular, there is a lack of the comprehensive capacity building needed to change SME business models so they are both profitable and socially and environmentally responsible. In Zambezia, most capacity building provided by government focuses on business development and most civil-society activities focus on social and environmental impacts. Some government-supported SMEs are doing well financially but lack awareness of their environmental impacts, or they do not engage communities equitably. Some NGO-supported SMEs are implementing socially and environmentally responsible practices but lack business know-how to sustain their enterprises. Most concession owners lack technical expertise in reforestation; in many cases they need support to engage communities on their concessions so they can better understand and implement reforestation.

Key opportunities

Increasing public investment to support SMEs. Public investment in SMEs is increasing in Mozambique (mostly through international donors), including capacity building. Moreover, an increasing amount of public financing is being used to help offset investment risks associated with SMEs and to leverage more private financing. For example, the Landscape programme is negotiating memoranda of understanding with banks to allow the funding provided by Landscape to serve as collateral and thus leverage private finance.
Diversified business models to adapt to high risks in the market. Increasingly, SMEs are opting to invest in diversified businesses to adapt to changing markets and reduce their business risk. Many simple-licence holders and some concession owners are investing capital in businesses associated with hotels, agriculture, logistics, construction and car rentals as a way of diversifying, ensuring cash flow and reducing the overall risk of their investments. Investment in agriculture is increasingly favoured by SMEs because of favourable government policies, the greater availability of technical support and low-interest loans, fewer government interventions and a more stable domestic market.

Box 3. Sotomane: a successful SME in the forest sector

History of the business
Industria Sotomane Lda (ISL) was established in 1991 from a simple carpentry workshop operating informally beneath a mango tree with just four workers. Today, the company has 60 permanent staff, supplemented by another 60 or more seasonal workers. In 2015, ISL’s net worth was estimated at around MZN 8 million (comprising MZN 3 million in the carpentry and sawmill business and MZN 5 million in the civil construction business). Its business portfolio includes carpentry, small mills, civil construction (e.g. schools and hospitals), agriculture and hotels.

Means of financing
- ISL relies mostly on its own resources to fund investment. In 2015, for example, about MZN 7.5 million (about 80 per cent of the net profit) was invested in the business to expand processing capacity and develop new businesses.
- ISL has requested loans from commercial banks. In 2005, for example, it obtained a loan of MZN 2.5 million to buy a tractor as part of the FinAgro programme.
- In terms of public financing:
  - FinAgro provided 70 per cent of the funding for the purchase of a tractor in 2005. ISL obtained the other 30 per cent of the purchase price from a bank (as indicated in the previous bullet);
  - ISL obtained a loan of almost MZN 3 million from Gapi in 2007 for the purchase of equipment for the company’s sawmill. The loan, which was to be repaid over five years with a three-month grace period, was at an interest rate of 21 per cent. Gapi loaned the company an additional MZN 0.88 million in 2010 for the sawmill, with the same conditions.
Cooperative and association structures for SMEs. AMOMA is the main association for timber companies in Mozambique, and all its members are medium-sized enterprises. AMOMA has representatives at the national level, and it engages in policy advocacy on behalf of its members. There are two associations in Zambezia: the Zambezia Loggers’ Association (Associação de Madereiros de Zambézia – AMAZA) and the Agriculture and Timber Association of Zambezia (Associação Provincial de Agro-Pecuária e Madeira da Zambézia – APAMAZ). AMAZA represent SMEs in the forest sector, and APAMAZ represents SMEs in agriculture and forest sectors. Twenty-four members of these two associations were beneficiaries of the IIED-led Testing REDD+ project funded by the Norwegian government (Nhantumbo and Mausse, 2016), forming nine new forest concessions that required both business and resource management capacity. The project provided an enabling environment by offering ongoing capacity building on the impacts of climate change, legal and technical requirements and sustainable forest management practices such as zoning, forest inventories, and the design of forest, business and reforestation plans (more than 60,000ha of the 204,000ha of land under the nine concessions combined had been deforested). Primary processing capacity was also provided to promote value adding and to comply with legal requirements for forest concessions. Although capacity development activities can be provided through grants, there is a need to increase the financial robustness of enterprises by developing good credit management systems. The new enterprises still require credit from commercial banks to meet operational costs. This is an important pathway for sustainable SMEs.

**Lessons learned**

- **Diversification has helped ensure cash flow and provided capital to grow business.** Diversification has helped the company ensure cash flow despite fluctuations in markets for timber and timber products. Diversification has also been designed strategically to ensure market access: for example, the clients building hospitals and schools need furniture, which they can purchase directly from ISL. A diversified and sustained cash flow also means that the company can accumulate sufficient savings to invest in growing the business.

- **A clear business plan has helped guide strategic investments and manage risks.** A clear business plan gives the company a vision for the future and enables the manager to execute activities to mitigate risks. For example, the company has always focused on value-added products in the forest sector; to secure a supply of cheap raw materials for its furniture business, therefore, it has invested in concessions and reforestation (using both native and exotic species). This has helped the company avoid the need to compete with the export trade for raw materials and minimised the risks posed by fluctuating timber prices.
Partnerships between banks, investors, SME associations and government institutions such as IPEME are crucial for ensuring that public financing streams are complementary and can leverage private finance. IPEME is providing much-needed long-term support in the agriculture sector to promote and build SME associations able to negotiate effectively with investors, banks and the government.

**Emerging successes as inspiration for more entrepreneurship.** Boxes 3 and 4 describe successful SMEs. Promoting such success stories in the forest and agriculture sectors can inspire more entrepreneurship in SMEs and help nurture a more favourable view of SMEs by banks and public and private-sector investors.

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**Box 4. Agro-Comercial Olinda Fondo: a success story in the agriculture sector**

**History of the business**

Agro-Comercial Olinda Fondo (ACOF) is a family-run seed company. Before starting the business, Olinda and her husband spent three years researching and producing their own improved rice seedlings. They are now producing seeds for rice, soya, beans, maize and sesame.

ACOF’s vision is to transform ordinary farmers into seed processors and thereby increase production to target both domestic and international markets. ACOF was created in 2000 with an initial share capital of MZN 1.5 million — the family savings — and today it has an estimated net worth of around MZN 10 million. The company was not formally registered until 2012. It has 27 workers, including two experts in agricultural techniques, and it hires more than 100 seasonal workers during harvesting. In total, ACOF has around 4,740ha under agricultural production and, in 2015, it produced around 100 tonnes of seeds.

**Means of financing**

ACOF reinvests all its annual profit in the business. Profit alone is often insufficient, however, and ACOF also obtains loans from banks and grants from donors. In 2013 and 2014, ACOF received a grant of MZN 600,000 from the African Fertilizer and Agribusiness Partnership for the construction of a warehouse and store in Mocuba. It also received a loan of MZN 6.5 million from Banco Terra de Moçambique at an interest rate of 18.5 per cent per year. The bank financing was possible thanks to a letter of guarantee from the chair of the board of the Dutch bank that holds a majority shareholding in Banco Terra de Moçambique.
Lessons learned

- **Setting up a socially inclusive and environmentally conscious business model helped attract public partnerships and thereby overcome financial hurdles.** ACOF’s objectives and business model are socially inclusive (helping small farmers and women) and environmentally friendly (increasing yields to reduce the need for land expansion). Having such social and environmental goals enabled the company to gain access to public funding and support and to build strategic partnerships that help the business (for example, it is working with the International Fertilizer Development Center in the production and sale of soya seeds).

- **Business diversification has helped mitigate risks and guarantee cash flow.** ACOF combines agricultural production with livestock farming (mainly dairy).

- **Success has stemmed from strong entrepreneurship, courage and a long-term vision.** In Olinda’s own words, “To be a farmer you need to be bold and have the courage to invest despite the fact that it is a high-risk business with returns in the medium and long term. You need to persevere and take a long-term view as profits will come much further down the line, and you must be persistent with field activities”. 
Country context

Guatemala had an estimated 6.97 million ha of forests in 1950, but it had lost nearly half of this by 2002, due mainly to rapid population growth and agricultural expansion (INAB, 2012). By the late 1980s, deforestation was so high that reducing it had become a national priority. The Guatemalan government realised that, to address deforestation, local people had to be made key stakeholders in the management and conservation of the country’s natural resources. In the late 1980s and early 1990s, the government introduced a series of innovative legal reforms that made economic and social development a key objective in the conservation of natural resources. The Protected Areas Law (1989) enabled the allocation of community forest concessions in the Maya Biosphere Reserve. The Forest Law (1999) created the foundation for two programmes designed to enable local forest owners, smallholder farmers and indigenous peoples to participate in forest restoration and management: the Forest Incentives Programme (Programa de Incentivos Forestales – PINFOR) and the Forest Incentives Programme for Small Forestry and Agroforestry Landholders (Programa de Incentivos para Pequeños Poseedores de Tierras de Vocación Forestal o Agroforestal – PINPEP). The Forest Law also provided a financial mechanism to secure more than 1 per cent of the national budget annually for forestry activities over a 20-year period (to 2016) and for the establishment of the National Forest Institute (Instituto Nacional de Bosques — INAB) with a mandate to manage the mechanism. Based on a review of the incentives programmes, the PROBOSQUE law was approved in 2015 to continue the mechanism for another 30 years.

A well-organised sector of forest owners (individuals and cooperatives) and community forest users has emerged in this enabling environment. The majority of individuals and cooperatives own relatively small areas of 0.5–15ha, but collectively they represent a large share of the country’s forest holdings. There are more than 1,000 community forestry
organisations in Guatemala (Elías, 2015), most of which are affiliated with second- and third-level organisations. The Association of Forest Communities of Petén (Asociación de Comunidades Forestales de Petén – ACOFOP) was created in the mid-1990s to represent community forest concessions in the Maya Biosphere Reserve. The National Alliance of Community Forestry Organisations (Alianza Nacional de Organizaciones Comunitarias de Guatemala – “the Alliance”) emerged in the early 2000s to represent community forest stakeholders at the national level. Today the Alliance comprises 11 second-level organisations (that is, subnational federations and associations comprising member-based organisations) and more than 250 first-level community organisations representing 50,000 families and 388,000 indirect beneficiaries (Kuper, 2014; FFF, 2015). The Alliance represents members who manage just over 750,000ha of forests and communal lands, which is 17.5 per cent of Guatemala's forest landscapes and nearly 4 per cent of all forests in Central America (FFF, 2015). The Alliance is an important stakeholder with political weight in negotiations on forestry as well as other issues concerning tenure and natural resources.

Case study regions: Petén and Verapaces

Key interviews and research under this project were carried out in the northern department of Petén and in the bordering departments of Alta and Baja Verapaz (the Verapaces region). These were selected to allow the analysis of two very different contexts, including in the influence of markets and in access to finance for forestry and agricultural SMEs.

Petén and its Maya Biosphere Reserve contain a large part (2.1 million ha) of Guatemala's remaining forest area. It is a priority area for Guatemala's national REDD+ programme, with three of the five REDD+ initiatives (Guatecarbon, Laguna Lachua, and Sierra la Lacandón) under implementation there. The Maya Biosphere Reserve contains highly valuable tropical timber species such as mahogany and cedar. Fourteen active forest concessions operate in the reserve's multiple-use zone, of which 12 are owned by community forestry enterprises managing a total area of 400,830ha of natural forest (Hogdon and Loewenthal, 2015). These SMEs provide ecotourism services and produce a variety of timber and non-timber products for export markets.

The Verapaces region is characterised by a mosaic landscape of (mainly) pine plantations, agroforestry, agrotourism and a variety of crops (e.g. coffee, allspice and cardamom) grown for both domestic and export markets. Cooperatives play an important role as aggregators, providing their members (individual farmers and SMEs) with access to the processing industry and export markets. The forest incentives programmes have played important roles for farmers and cooperatives, with nearly 25 per cent of all PINFOR plantations located in the region (Ochaeta, 2016b).
Finance for community forestry concessions in Petén is provided mainly by commercial banks, but international donors and NGOs have also provided significant support (Hogdon et al., 2013). SMEs in the Verapaces region have received much less donor support, and the banking sector offers only limited financial services. Cooperatives play an important role in the region as financial intermediaries – they offer financial services and credit to members and thereby help them overcome the lack of direct access to bank credit. The market for forestry activities in Verapaces differs considerably from that in Petén, where community forestry enterprises supply the international mahogany market. The predominant forest output in Verapaces is plantation-grown timber, which is mostly produced and processed for the domestic market and comprises relatively low-value products such as wood pallets and matches.

**SMEs in Guatemala**

Guatemala has an estimated 800,000–1.2 million active SMEs (De Leon, 2010), the majority of which are micro-sized enterprises operating in the informal sector. The Ministry of Economy (Ministerio de Economía – MINECO) defines enterprises as production units that carry out transformation, service or trade activities, and it classifies SMEs in terms of their employment and annual sales (Governmental Agreement, 211-2015) (Table 3).
Table 3. Classification of SMEs in Guatemala

<table>
<thead>
<tr>
<th>Classification</th>
<th>Number of employees</th>
<th>Annual sales (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro-sized</td>
<td>1–10</td>
<td>336–63,900</td>
</tr>
<tr>
<td>Small-sized</td>
<td>11–80</td>
<td>64,000–1,245,260</td>
</tr>
<tr>
<td>Medium-sized</td>
<td>81–200</td>
<td>1,245,600–5,189,720</td>
</tr>
</tbody>
</table>

The majority of SMEs are served by the formal financial system, which accounts for around 90 per cent of all financial-sector assets; microfinance accounts for the remaining 10 per cent (World Bank, 2010). SMEs contribute approximately 40 per cent of GDP in Guatemala and 85 per cent of employment (World Bank, 2010). Data on the overall contribution of SMEs to the forest sector are unavailable. Nevertheless, the combined contributions of families, cooperatives and community forestry enterprises under the Alliance and ACOFOP covers nearly one-fifth of Guatemala’s forest estate. The overall contribution of SMEs to Guatemalan society, the economy and forest landscapes is likely to be of major importance.

National information systems and registration of SMEs

The Guatemalan government has introduced a series of automated electronic information systems to collect data directly from enterprises and the ministries that have some form of interaction with them. The Guatemala Forest Information System (Sistema de Información Forestal de Guatemala – SIFGUA) is a centralised database for all information generated on forest-sector activities in the country (e.g. forest management, trade and technical service providers), collected from nine public and private-sector institutions. SIFGUA contains the National Forestry Register (Registro Forestal Nacional – RFN), which records the activities of all participants in the forest incentives programmes and provides a list of professionals and technical service providers in the different regions. Linked to the SIFGUA is the Electronic Information System on Forest Enterprises (SEINEF), which enables forest enterprises to record data (e.g. income, expenditure and harvesting volumes) online. A key objective of SEINEF is to improve the traceability of forest products while providing an incentive for companies to participate by facilitating trade via a marketing platform and making company reporting quicker and smoother.

This integrated electronic system for data collection and information sharing, which is still under development, provides key elements of a solid national forestry database. For those seeking to understand forest SMEs, however, it provides insufficient detail on the types of business organisation and forest products. In 2016, SIFGUA listed 1,828 active
forestry enterprises (Table 4), the majority of which are forest companies, wholesalers and export and import firms. The number of registered enterprises is lower than expected given the large number of communities and smallholder farmers participating in forestry activities through the incentives programmes. Moreover, the type of information collected suggests that entire datasets on SMEs have been missed. For example, the Guatemala Technical Institute of Training and Productivity reported having trained 3,423 furniture-manufacturing businesses in 2015, of which 89 per cent were micro-sized. The inability of national datasets to capture less-capital-intensive (and therefore lower-priority) subsectors is a challenge, not only in Guatemala (see Mayers et al., 2016 for a discussion on this). Informality in the forest sector is high, and smallholder forest producers face major barriers in accessing the finance they need if they are to invest in value adding. The number of farmers and communities that have been unable to develop enterprises through the forest incentives programmes is high, and therefore they do not appear in the RFN.

Table 4: Number of registered and active forest enterprises in Guatemala’s National Forest Registry

<table>
<thead>
<tr>
<th>Registered and active enterprises</th>
<th>Total</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chainsaw retailers and leasing agents</td>
<td>14</td>
<td>0.77</td>
</tr>
<tr>
<td>Forest product warehouses</td>
<td>642</td>
<td>35.12</td>
</tr>
<tr>
<td>Forestry consultants</td>
<td>1</td>
<td>0.05</td>
</tr>
<tr>
<td>Importers and exporters of forest products</td>
<td>343</td>
<td>18.76</td>
</tr>
<tr>
<td>Harvesting and collection enterprises</td>
<td>2</td>
<td>0.11</td>
</tr>
<tr>
<td>Forest industries</td>
<td>779</td>
<td>42.61</td>
</tr>
<tr>
<td>Forest nurseries</td>
<td>47</td>
<td>2.57</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,828</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: SIFGUA, undated.
Public policies on forestry and agricultural SMEs

The forest incentives programmes

The most important laws affecting the forest sector and SMEs in Guatemala are the Forest Law (1996) and associated regulations (2005), the Law on Forestry Incentives for Small-scale Possessors of Forests and Agroforests (the PINPEP law, 2010) and the PROBOSQUE Law (2015). The Forest Law of 1996 (Article 71) created PINFOR and INAB (Art. 5) as the main institutions in charge of managing the national system of incentives payments and technical support outside protected areas, and it guaranteed funding for INAB, an autonomous institution, from the Ministry of Agriculture, Livestock and Food (Ministerio de Agricultura, Ganadería e Alimentación – MAGA). INAB accounts for 10 per cent of MAGA’s budget and can also generate direct funding for its operations from other sources through partnerships and projects. PINFOR was set up to run for 20 years between 1996 and 2016. It was complemented by PINPEP, which was established in 2006 as a donor programme but is formally recognised in the PINPEP law; INAB has a mandate to manage PINPEP alongside PINFOR. PINFOR expired in December 2016, and the PROBOSQUE Law came into force to allow the achievements made under PINFOR to continue to 2033. Annually at least 1-2% per cent of the national budget is allocated for the PROBOSQUE and PINPEP programmes amounting to a total of roughly US$20-$US30 million per year. This covers only the maintenance of existing projects, and might be regarded as a modest amount. Nevertheless, it represents a strong, long-term government commitment to the sector, and it can also be a catalyst for leveraging private-sector investment. The funds generated and distributed under PROBOSQUE and its predecessors allow forest producers to implement initial income-generating activities that can be used to leverage additional private-sector investment or to access credit from commercial banks.

The main emphasis of PINFOR was reforestation, and nearly 80 per cent of its incentive payments were earmarked for that purpose. PINPEP, on the other hand, is designed to benefit communities and smallholders who lack formal title to land or who have less than 2ha of landholdings and face particular difficulties in accessing finance. Eligible participants need to prove landownership. This is done at the municipal level, where mayors verify claims and certify possession (known as “equitable title”). PINPEP also includes agroforestry activities, which were not part of PINFOR, and pays special attention to gender and equity issues. The minimum size of PINPEP projects is 0.5ha and the maximum is 15ha.

8 This has caused complications in some municipalities because effectively the mayor takes on responsibility for certifying possession, sometimes based on very limited evidence (Kuper, 2014).
PROBOSQUE builds on the experience of both PINFOR and PINPEP and includes new provisions to reflect changes in the sector and address some of the challenges identified over the years. For example, it includes new activities such as forest landscape restoration and environmental services and promotes agroforestry and wood production in both plantations and natural forests. PROBOSQUE has been designed to open up the incentives to new opportunities by diversifying activities and improving linkages with industry. It is expected to improve access to finance because business diversification — rather than a sole focus on the forestry value chain — can help reduce risk and meet short-term needs for income. PROBOSQUE includes safeguards for ensuring that SMEs and smallholders are the main beneficiaries of the incentives, and those with equitable title (as in PINPEP) are eligible to apply even if they do not own the land. Individuals and entities who have benefited previously from any of the incentives programmes (with the exception of water catchment areas) are ineligible for PROBOSQUE.

Table 5 sets out the conditions and modalities of the three forest incentives programmes.

### Mapping SME needs

INAB is the main institution in charge of mapping the needs of SMEs in the forest sector and within the scope of the incentives programmes; the work is carried out mainly by INAB's Department for Industry and Commerce. There is no systematic procedure for mapping SMEs in the forest and agriculture sectors, but this is changing with the adoption of more sophisticated online registration and information platforms. In 2017, INAB was in the process of developing an inventory of forestry enterprises. The high level of informality among SMEs makes a complete inventory difficult, but increasing understanding of the enterprises will help in estimating the informal segments. For now, the status of enterprises and needs are analysed mainly through diagnostic studies, inventories developed in collaboration with community forest and agroforestry associations such as the Alliance and the Association of Forest Communities in Guatemala (Utz Che'), and consultations with SMEs as part of business development activities. INAB has started organising regular business-to-business roundtables across the country to facilitate business for forest SMEs, and these are also used to assess SME needs for financial access, skills development and the provision of technical services.
Table 5. Conditions and modalities of Guatemala’s forest incentives programmes

<table>
<thead>
<tr>
<th>Programme</th>
<th>Who can access it</th>
<th>Minimum and maximum size</th>
<th>Requirements</th>
<th>Modalities</th>
<th>Cumulative distribution modalities (%)</th>
<th>Repayment period</th>
</tr>
</thead>
</table>
| PINFOR    | Landowners with legal title to the land | Minimum 2ha; maximum 1% of total PINFOR budget | - Forest management plan and licence (for production)  
- Assessment of land-use capacity (reforestation projects)  
- Certification proving ownership of the land  
- Tax identification number  
- Compliance contract for the full implementation of planned activities according to the management plan | Plantations and reforestation | 77 | 3–6 years |
| PINPEP    | Possessors of the land without legal title but with an eligible claim to the land and an “equitable title” certificate from the municipality | Minimum 0.1ha; maximum 15ha  
The 15ha maximum also applies to families, but groups of smallholders may present projects with areas larger than 15ha as long as there no individual areas in the group are larger than 15ha | - Forest management plan and licence (for production)  
- Equitable title proving possession of the land  
- For communal lands, additional documentation required proving community consent  
- For groups, a legal representative | Reforestation | 9.4 | 6 years |
<p>|           |                   |                          | Agroforestry | Agroforestry | 5.8 | 6 years |
|           |                   |                          | Management of natural forests for production | Management of natural forests for production | 6.7 | 10 years |
|           |                   |                          | Management of natural forests for protection | Management of natural forests for protection | 78.1 | 10 years |</p>
<table>
<thead>
<tr>
<th>Programme</th>
<th>Who can access it</th>
<th>Minimum and maximum size</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>PROBOSQUE</td>
<td>1. Individuals with legal ownership of the land</td>
<td>Minimum area of 0.5 ha</td>
<td>• Forest management plan document according to type of activity</td>
</tr>
<tr>
<td></td>
<td>2. Possessors such as cooperatives, indigenous groups and other groups with long-term collective tenure</td>
<td>Maximum: no individual or legal entity may receive more than 0.5% of total annual incentives</td>
<td></td>
</tr>
<tr>
<td></td>
<td>3. Social groups that occupy municipal lands through legal arrangement</td>
<td></td>
<td>• Land ownership document or similar proof of long-term possession of the land (e.g. “equitable title”)</td>
</tr>
<tr>
<td></td>
<td>4. Individuals or groups that have already benefited from incentives</td>
<td></td>
<td>• Approval by CONAP for areas under CONAP jurisdiction</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Proof of registration in the RFN</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Proof of registration of social groups with legal status</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Repayment period</th>
<th>Modalities</th>
<th>Cumulative distribution modalities (%)</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Implementation</td>
<td>Implementation and maintenance of forestry plantations for production</td>
<td>No data yet</td>
<td>INAB (2015) and Kuper (2014)</td>
</tr>
<tr>
<td>1 year, maintenance 5 years</td>
<td>Implementation and maintenance of forestry plantations for firewood</td>
<td>No data yet</td>
<td></td>
</tr>
<tr>
<td>b. Implementation</td>
<td>Implementation and maintenance of forestry plantations for firewood</td>
<td>No data yet</td>
<td></td>
</tr>
<tr>
<td>1 year, maintenance 5 years</td>
<td>Implementation and maintenance of agroforestry systems</td>
<td>No data yet</td>
<td></td>
</tr>
<tr>
<td>c. Implementation</td>
<td>Implementation and maintenance of agroforestry systems</td>
<td>No data yet</td>
<td></td>
</tr>
<tr>
<td>1 year, maintenance 5 years</td>
<td>Management of natural forest for production (including natural forests for seed production)</td>
<td>No data yet</td>
<td></td>
</tr>
<tr>
<td>d. A maximum of 10 years</td>
<td>Management of natural forest for the protection and provision of environmental services</td>
<td>No data yet</td>
<td></td>
</tr>
<tr>
<td>d. A maximum of 10 years</td>
<td>Restoration of degraded forest land</td>
<td>No data yet</td>
<td></td>
</tr>
</tbody>
</table>

Sources: drawn from INAB (2015) and Kuper (2014)
INAB carries out regular interactions with financial institutions as part of its efforts to improve access to finance for forest producers. This remains a challenging task despite years of engagement, and progress can be slow and frustrating. For example, the need for start-up capital for plantations (the first incentive payment does not materialise until one year into the programme) emerged as an issue in 2007 as part of a series of consultations with PINFOR beneficiaries, and it was subsequently raised with Banrural to see whether a product could be developed to address this need. It took four years after the initial engagement for Banrural to agree to develop a financial product. During the process it became clear that, although banks were willing to provide credit for the first and second stages (establishment and harvesting) of plantation projects, they were less willing to do so for the processing stage because the guarantee was seen as less reliable. This perception of high risk may seem odd considering that a mature plantation or collection of woodlots is, in most cases, more valuable than the land by itself, and processing equipment is an asset that can be used as collateral. The lack of willingness among some commercial banks to recognise timber or machinery as assets is an issue not just for smallholder farmers but also for the large-scale industry. It could be due to a lack of awareness or sector-specific expertise in the banks (because this issue does not arise with banks that specialise in the sector), or it may simply be due to a lack of incentives for commercial banks, which have other priority areas. The overall lack of investment options for business development is a key concern. Barriers to SMEs wanting to invest in value adding have implications for the sector as a whole, but more importantly they limit the many positive impacts that SMEs can have on local livelihoods and sustainable forest management.

**Capacity building to support business development**

To promote market opportunities and improve access to finance for forest SMEs, the Guatemalan government is scaling up its efforts to strengthen business capacities and increase opportunities for forest SMEs. INAB is collaborating with FAO and the Forest and Farm Facility (FFF) to strengthen the capacities of a recently developed network of SMEs within the Alliance in collaboration with Utz Che’. In the Verapaces region, the FFF is supporting the Federation of Cooperatives of the Verapaces (Federación de Cooperativas de las Verapaces – FEDECOVERA) in developing a rural agroforestry business school aimed at training youth and rural producers in production, marketing and cooperative business. INAB has developed the Linking of the Forest-Industry-Market Strategy with input from stakeholders at different points in the forestry value chain. A national network of business support units, called Promotional Units of the Micro, Small and Medium Enterprises (Centros de Promoción de la Micro, Pequeña y Mediana Empresa – PROMIPYME), is being established to facilitate support at the subnational level. Although
not specifically promoting the development of forest SMEs, PROMIPYME is designed to facilitate linkages with buyers and technical and financial services; INAB will train its own staff to deliver business development support to SMEs in the forest sector specifically.

To support the PROMIPYME, MINECO has partnered with Banrural to create a trust of US$12.4 million over 3.5 years, with special conditions for SMEs. Although the trust has not been created specifically for the forest sector, it will provide loans targeted at SMEs, with credit amounts not exceeding US$100,000 for individual enterprises or US$500,000 for business-oriented organisations (Cabrera Paz, 2015). Because the trust has not been set up specifically to support the financing of forest SMEs, it remains to be seen whether it will provide new opportunities for them.

The Guatemalan government has set up guarantee funds in the past to address the credit-risk concerns of commercial banks and to facilitate access to finance for participants in the incentives programmes. This has been done with the intention that the banks will use the guarantee funds to develop products and services designed specifically for the forest sector. The slow progress in this area is likely due to differences in objectives for the use of the guarantee funds. From the perspective of the banks, the funds were solely for the purpose of debt recovery should companies default on their loans. The government, on the other hand, considered that the guarantee fund itself would provide banks with the incentive to improve their services to the large pool of beneficiaries of forest incentives programmes. This did not happen. Even though increasing finance for SMEs is an urgent need in the forest sector and an INAB objective, commercial banks have had other interests. This misalignment has also been observed in other sectors in which the government has sought to facilitate access to financing for smallholder producers (see Rai et al., 2016, for examples in the renewable-energy sector).

NGOs play an important role in improving access to finance for forestry and agricultural SMEs. The FIDOSA mechanism aims to finance 72 small rural enterprises in Petén, the Verapaces region and Izabal that are managing and processing products from plantations and natural forests. The mechanism was established through a partnership between the Inter-American Development Bank (IDB), FIDOSA and the Rainforest Alliance. IDB and the Grupo Financiera del Occidente provided an initial amount of US$10 million in reimbursable funds to create the mechanism, and the Rainforest Alliance provided the technical assistance required to support enterprises with capacity building. The entry of the FIDOSA mechanism onto the market dramatically changed the financial environment in Petén because it offered a competitive product at nearly half the price offered by other banks. Within a couple of years it had helped push down interest rates from 18 per cent to 11 per cent. The initiative has been particularly successful in Petén, but its implementation has focused on a few enterprises (e.g. the five main community concessions in Petén) (Hogdon and Loewenthal, 2015). Thus, FIDOSA's positive effects are yet to spill over to other forest SMEs and other parts of the country.
Financing opportunities for forestry and agricultural SMEs

Three main options exist for SMEs in forest landscapes seeking finance: 1) grants from the forest incentives programme under PROBOSQUE or PINPEP; 2) credit services from cooperatives; and 3) credit from commercial banks. Donor and NGO funding, another form of financial support, has played an important role for many SMEs in the past, particularly by helping build capacity and facilitating enterprise development.\(^9\) Although physical access to financial services has improved nationally in recent years, only 6 per cent of private credit in Guatemala in 2015 was destined for the forest and agriculture sectors (IMF, 2016; FAST, 2015), the majority of which was concentrated in agriculture. Only 60 per cent of SMEs report having a cheque or savings account (which is much less than the Latin American average of 92 per cent), and credit terms for SMEs in Guatemala are estimated at 4–5 per cent higher than those for large companies (IMF, 2016) – a direct result of the perception that SMEs are high-risk. Public-sector financing remains one of the most important start-up financing options for SMEs in Guatemala, but a number of other private-sector options exist in the forest and agriculture sectors. Figure 2 provides an overview of the financial mechanisms identified for forest SMEs in Guatemala, and the following sections describe each of these.

Public financing

The forest incentives programme is by far the most important public-sector financial mechanism supporting forestry and agricultural SMEs in Guatemala. Since 1996 it has generated an estimated US$292.89 million of public-sector investment for more than 1 million farmers and SMEs. According to INAB’s estimates, this has leveraged double the amount from the private sector. Although PINFOR has had the largest impact in terms of scale, PINPEP has enabled the most marginalised forest and farm producers to participate in the management of forest resources and to access finance to invest in those resources (Table 6). PROBOSQUE has incorporated important lessons from both its predecessors and it also has more ambitious goals.

How it works

Payments under the incentives programmes are structured differently depending on the activity and end user. Because PINPEP and PROBOSQUE have been designed to address the needs of different types of forest users, there are restrictions on who can access the incentives of each programme. Landowners can only access PROBOSQUE,

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\(^9\) One study estimated that, from the early 1990s to 2006, donor support from USAID alone amounted to US$135 million (see Stoian et al., 2007); since then, USAID has continued to fund community forestry enterprises and conservation activities in the area.
whereas possessors of land can only access PINPEP. In the case of PINPEP, payments are structured as a minimum-daily-rate salary and are paid monthly; PROBOSQUE payments are paid annually per hectare and by type of activity.

Figure 2. Public and private-sector financial mechanisms for SMEs in forest landscapes in Guatemala
Natural-forest protection and production projects receive significantly lower amounts than reforestation projects, despite covering larger areas. The initial design of PINFOR was that it should cover approximately 35 per cent of the total investment required for plantations (although the percentage differed between project types), and the remainder was to be obtained from the private sector (PFN Guatemala, 2010). The underlying principle being that the incentive is not meant to cover the full cost of implementation but to enable further investment from the private sector.

INAB receives 15 per cent of the total incentive amount from PINPEP’s budget and 20 per cent from the PROBOSQUE budget to provide administration, supervision and support to participating institutions and beneficiaries (Art. 12 of the PINPEP law and Art. 16 of the PROBOSQUE law, respectively). Payments are channelled through three main models: 1) cooperatives that, in turn, administer transfers to member cooperatives or directly to smallholders; 2) through municipalities, which manage transfers to tenants of state-owned land (this model is used mainly in PINPEP); and 3) directly to private landowners (Figure 3). Where municipalities and cooperatives manage the administration and implementation of technical services, payments are retrieved retrospectively from INAB on an annual basis. These intermediaries receive a share of the incentives budgets to meet the costs of the services they provide; although this support is less direct than funds given to SMEs and private landowners, it fills an important need and ensures that the programmes are complemented by investments in rural service providers.

INAB explores various modalities for channelling payments to remote rural areas. For both PINFOR and PINPER payments were channelled via Banrural and, depending on the delivery model, via intermediaries such as cooperatives and municipalities. Banrural was selected for PINPEP because of its nation-wide presence and its reach in rural areas. Producers are given bank accounts on registration with PINPEP, and payments are made
directly to those accounts. Initially, this approach was problematic because the majority of PINPEP beneficiaries lacked experience in using bank accounts and did not realise the need to maintain funds in the account to keep it open (this created administrative challenges because Banrural had to manage the closing and re-opening of accounts). The approach also means, however, that a vast number of smallholders who otherwise would not have bank accounts have been able to establish them and develop relationships with the bank. Today, incentives programme payments are made via Crédito Hipotecário Nacional, a bank that manages both private and public capital.

Figure 3. Rights and responsibilities in delivering the incentives programmes

Private financing
The majority of forestry and agricultural SMEs in Guatemala use commercial banks (50 per cent) and cooperatives (30 per cent) to help meet their financing needs (FAST, 2015). Private savings are also an important source of finance for SMEs, with 56 per cent using internal savings to finance investments, compared with 38 percent using bank loans (World Bank, 2011). Credit is used mainly to finance working capital needs (40 per cent of medium-sized enterprises and 9.3 per cent of small enterprises) (World Bank, 2011), particularly in the harvesting season (Ochaeta, 2016a,b; Hogdon and Loewenthal, 2015). In this research, eight financial mechanisms were identified that are accessible to forestry and agricultural SMEs. Most of these offer two main lines of credit: one for working capital, and one for investment.
The largest commercial bank in Guatemala, Banrural, has the best reach in rural areas. It currently provides financial services for the community forest concessions in the Maya Biosphere Reserve, and has in the past administered financial mechanisms set up for PINFOR participants and for SMEs in general as part of MINECO’s SME development programme. Two other banks, Banco Agrícola Mercantil and Financiera Occidente, also offer competitive financial services to forest concessions in the Maya Biosphere Reserve. In the same area, FORESCOM, which is the marketing arm of ACOFOP, is managing the Financial Fund to Promote Community Forestry Development. This was set up exclusively for ACOFOP members (i.e. the community forest concessions) to help address working-capital constraints, using funds from CATIE (through the FINNFOR II project) and the community forestry concessions themselves. The fund differs from GuateCarbon, which has also been developed for ACOFOP members but which is based on payments for performance (i.e. REDD+).  

GuateCarbon is expected to generate a total of 37 million verified carbon units. The first verification was carried out in September 2016 for 1.2 million units in the period 2012–2014. Negotiations with buyers have commenced, but no deal had been reached at the time of writing. Payments will benefit community forest concessions in the form of improved services for monitoring and enforcement against illegal logging and wildfire.
Cooperatives are strong in terms of coverage, membership, loan portfolios and savings. Agricultural cooperatives account for 45 per cent and savings-and-loan cooperatives for 35 per cent of the country’s 646 registered cooperatives (World Bank, 2010). Savings-and-loans cooperatives operate in 21 of the country’s 22 departments. Federations of cooperatives such as FEDECOVERA (Box 5) and FENACOAC (operating under MICOOPE) also act as intermediaries between banks and members and facilitate access to capital for member cooperatives so they can create their own financial services (Annex 4 describes the financial mechanism of the Chicoj Cooperative).

Credit terms and conditions
Credit terms are best for community forestry concessions in Petén, with interest rates commonly 10–12 per cent; elsewhere the rates are 12–18 per cent. Agricultural export commodities such as coffee and cardamom have much better credit terms (starting at 1 per cent for short-term processing investments for cardamom, offered by FEDECOVERA), especially those for coffee administered by the Chicoj cooperative with funding from the national coffee association, Anacafé. These commodities are important for cooperatives and it is in their interest to provide members with attractive credit terms so they can increase the supply and quality of production. Overall, interest rates are not prohibitive, although this depends on markets: those SMEs with access to higher-value markets attract better deals on interest rates.

According to regulations, credit should not exceed 70 per cent of the value of the collateral. In reality, however, the collateral-to-loan ratio averages 157 per cent, which is moderate according to regional standards (IMF, 2016). In the past, SMEs have put up collateral of much higher value, such as land and houses; although this occurs, guarantees provided by individuals and purchase orders, and the use of assets such as timber and machinery as collateral, are increasingly common. Loan recovery rates for the financial institutions and service providers reviewed in this research was very high, at 95–100 per cent, suggesting that the risk (and consequently the need for collateral) is not as high as might be indicated by bank practice.

Repayment periods for working capital range from six months to three years and for investments from two to five years. In rare cases, SMEs may be offered a grace period in which they are not required to make repayments. For example, PINFOR participants in Banrural’s start-up finance product were offered a grace period of one year (timed to coincide with the first incentive payment). In the past, Financiera Occidente, who manages the FIDOSA mechanism, has offered grace periods of up to seven years for rubber plantations – but this is in the context of a bank with more than 50 years’ experience in the sector.

11 MICOOPE is the operating brand for a system of 25 savings and credit cooperatives under the national federation for savings and credit cooperatives Federación Nacional de Cooperativas de Ahorro y Crédito – FENACOAC.
Social and environmental sustainability

None of the private financial mechanisms reviewed here place strong emphasis on social or environmental criteria in their reviews of loan applications. SMEs are required to demonstrate a viable production plan or forest management plan and, in the case of the community forest concessions, Forest Stewardship Council (FSC) certification, but formally registered SMEs are legally required to do this anyway. In the case of the community forest concessions, FSC certification is a required part of acquiring a concession agreement.

Cooperatives are democratically controlled enterprises typically driven by values of democracy, equality, equity and solidarity, with defined principles of how to put these values into practice. For example, FEDECOVERA invests 50 per cent of its profits in the delivery of social and technical services to its members, which ultimately provides social and economic benefits to individuals and families. The community forest concessions in Petén invest an estimated US$200,000 per year in education, healthcare and forest protection (Hodgdon et al., 2013), and they also pay higher-than-average salaries and provide local people with consistent employment. Such socioeconomic contributions are often not captured in public datasets but form a core part of the locally controlled business model. Such contributions also require a trade-off in the economic performance cooperatives are able to achieve — a fact not recognised in credit evaluations in which applicants are expected to score highly against economic criteria.

Figure 4. The process of FEDECOVERA credit application, approval and management*

*The credit terms can be relatively flexible because of the high level of oversight the organisation has over the activities and accounts of its members. FEDECOVERA manages the majority of its members’ accounts and has regular interactions with producers through its field technicians and social development projects.
FINDINGS IN GUATEMALA

Box 5. FEDECOVERA: Federation of Cooperatives of the Verapaces

The business
FEDECOVERA is a federation of 43 forestry and agricultural cooperatives and 33 associations representing 25,000 families in the native Maya groups the Q’eqchís and the Pocomchís in the departments of Alta and Baja Verapaz. The business focuses on nine products (coffee, cardamom, cocoa, tea, essential oils, all spice, black pepper, turmeric and wood) and manages more than 4,500ha of FSC-certified plantations (mainly pine). FEDECOVERA acts as an aggregator for these products, and it is a key player throughout the value chain. It provides technical training and extension services to standardise quality so that the whole value chain can be certified and sold in high-value export markets. FEDECOVERA provides 14 types of social, financial, legal and extension services to its members and 115 group businesses. It is one of the Alliance’s 11 regional members and an active advocate of the cooperative movement and its principles, both locally and nationally.

FEDECOVERA started as a financial services cooperative in 1976, organising the collection and transformation of down-payments from buyers into financial services for cooperatives. FEDECOVERA nearly went bankrupt in 1990 by assuming too much of the financial risk of its members, but it survived after a dramatic restructuring process. In 1998 FEDECOVERA secured an opportunity, through the United States Agency for International Development (USAID), to manage a fund of US$1.5 million for the national coffee association, and it received professional training in credit management. Today FEDECOVERA is a shareholder of Banrural, one of the largest commercial banks in Guatemala, and it is legally certified as a type A financial mediator. This means that FEDECOVERA can grant loans with interest rates of 3–6 per cent above the credit it is paying on loans received from other financial institutions. Figure 4 illustrates the process of FEDECOVERA credit application, approval and management.

Means of financing
FEDECOVERA’s main investment decisions are guided by a five-year financial strategy. Its priority is to ensure that its members have sufficient working capital to buy raw materials for its processing industries, such as cardamom and timber, particularly to meet demand in high-value export markets. The challenge is to balance the working-capital needs of the various business lines during harvesting. A second priority is investment in value-adding technologies and machinery to improve product quality. A key strength of FEDECOVERA is that it has evolved into a highly diversified business, and this has enabled it to spread its risk and capital needs. The processing of raw commodities for export is the business’s main (50 per cent) source of revenue, followed by financial administration (28 per cent) and technical services for forestry.
A large share of Guatemala’s forestry and agricultural SMEs are members of producer organisations at the secondary (i.e. subnational) and tertiary level (i.e. the Alliance). This provides an additional level of oversight and accountability from outspoken peers with social and solidarity objectives and who can provide member SMEs with constructive criticism if they are seen to be employing socially or environmentally unsustainable practices. The benefits of maintaining membership and good relationships with such organisations, which have political weight and are strong advocates for forest and farm producers, should not be underestimated. The Alliance (which comprises organisations representing indigenous peoples, smallholder farmers and community forest groups), for

and agricultural production (14 per cent). Income from sales and services covers the majority of financing needs, and the remainder is covered by credit (it has direct access to credit from Banrural). FEDECOVERA receives grant support for its provision of technical and social services: for example, the Ministry of Agriculture, Livestock and Nutrition covers the costs of extension services and the National Foundation for Coffee Production helps meet the cost of community health centres.

**Lessons learned**

One of the keys to FEDECOVERA’s success has been the strong long-term vision and commitment of its founding members. The same people who experienced the initial crisis in 1990 are still part of the federation today. Over the years, FEDECOVERA has engaged with opportunities and taken necessary risks to develop its business. In the process, it has maintained a difficult balance to achieve both economic and social success. Key to this has been a vision of being a driver of rural development, which can only be achieved through economic self-sufficiency and continuous development of the business into value-adding activities.

FEDECOVERA holds 5 per cent of the Banrural’s shares. This ownership stems from when Banrural was restructured from being a state-owned bank and, as part of the privatisation process, cooperatives were invited to invest in shares.
example, was actively involved in the negotiation of the main articles of the PROBOSQUE Law and the World Bank’s FIP, including the formulation of regulations and budget allocations. In 2016, the Alliance secured US$28 million of pending incentives payments for PINPEP participants. This is only one outcome, but it demonstrates effective public engagement and the capacity to negotiate on behalf of Guatemala’s diverse forest-sector stakeholders.

Challenges and opportunities for financing sustainable SMEs

Increasing understanding and communication

After 20 years and millions of US dollars of investment through the incentives programmes, as well as numerous efforts by INAB and NGOs to engage, the commercial banking sector still regards forestry with little interest and as largely devoid of business potential. Are the expectations of commercial banks too high? Or is the expectation flawed that finance will flow if the conditions are right (e.g. if public-sector finance mitigates the risk)? The long-term nature of forestry investment requires credit and patient financing institutions that are confident in the viability of such investment. Other studies have found that, even in fragile legal conditions, financial institutions are willing to invest if the market potential is strong (Castrén et al., 2014). In Guatemala, after many years focusing on forest restoration and planting, INAB is turning its attention to developing sectoral markets and business capacity. This could help address some of the challenges if complemented with facilitated engagement between financial institutions and SME managers.

The challenge of balancing public and private-sector expectations

The Guatemalan government’s incentives programmes, particularly PINPEP, have revealed issues in the nature of collaboration between rural development programmes and commercial banks. It is an ongoing challenge to obtain sufficient understanding and flexibility in the relationship between commercial banks and government and to accommodate the financial needs of smallholder farmers and SMEs. Securing a certain percentage of the national budget for sectoral programmes is common practice in Guatemala, but this does not mean that funds are always delivered in full and on time (Kuper, 2014). From the perspective of banks, therefore, the government may also be a high-risk client – creating challenges in negotiating terms and conditions for what the banks might perceive as relatively unattractive deals.
Low priority of forestry

In some cases, INAB has developed financial products with commercial banks, but these have either not been promoted or have not been taken up by forest SMEs, despite relatively low interest rates. A key question is why this is so. Agreements about new products made centrally have not necessarily trickled down into practical follow-up and promotion at rural branches. Forestry remains a low-priority business compared with other sectors, and branches also have very limited experience and awareness of the forest sector. At the same time, SMEs producing for domestic markets face challenges due to low-value demand and high competition from illegal wood, which means that profit margins are low and the cost of credit is high.

Cooperatives – a better fit?

Cooperatives in Guatemala have strong rural coverage and knowledge of their members’ businesses. They also typically have the mandate to contribute to sustainable rural development, which commercial banks have not yet fully committed to. A key bottleneck for improving SME access to finance is risk. Cooperatives – which have better access to information and stronger relationships within the sector – might be more willing to take on a certain level of risk to reduce the cost of credit for SMEs and also to better tailor services to needs. This could help unlock the challenge of risk aversion among SMEs. Cooperative models differ, however. For example, a cooperative whose main business is providing financial services such as savings and credit may not have the same technical oversight and know-how as a cooperative whose main business is production and processing. In the case of FEDECOVERA, its own credit lines and financial services are a means of securing access to raw materials from its members to supply its processing facilities and markets, but the provision of financial services is not its main activity. Therefore, for both cooperatives and commercial banks, consideration needs to be given to the types of systems and partnerships needed to address the key concerns of risk, transaction costs, and ability to repay.
DISCUSSION AND CONCLUSION

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Discussion and conclusion

The development of sustainable SMEs in the forest and agriculture sectors does not seem to be hampered by a lack of potential investment funding: both Mozambique and Guatemala show rising public investment to support SMEs. Increasingly, governments and donors are looking for mechanisms to leverage private finance and create complementary financing to enable more investment in SMEs.

Both private-sector and public investors should look at innovative ways to address SME financing needs in eight key areas: 1) managing risks; 2) interest rates; 3) rates of return; 4) grace periods; 5) repayment periods; 6) the scale of investment; 7) social and environmental impacts; and 8) capacity. Mozambique and Guatemala shed light on the perspectives of both investors and SMEs in these key areas and illustrate some possible ways forward.

Risk

Creditors and investors view forestry and agricultural SMEs as high-risk borrowers because of the long-term nature of forestry investment; the informality of many SMEs; a lack of assets; low capitalisation; and low repayment rates (e.g. in Mozambique). Repayment rates among forest-sector SMEs are high in Guatemala, but a lack of knowledge and experience in providing financial services for forest-sector SMEs perpetuates the perception that they are high-risk.

It is also true that, in many countries, the circumstances of forestry and agricultural SMEs (for example their informality, lack of assets and reliance on a resource that can be complex to manage) make them highly vulnerable to macroeconomic shocks and the impacts of climate change and therefore more prone to failure and risk aversion. Resource dependence and high operational costs means that SMEs often have limited means to formalise their businesses and choose to deal with immediate risks first.
Related to the issue of risk is collateral. For many SMEs, a lack of collateral is a main stumbling block to accessing finance. In Mozambique, land belongs to the state and therefore cannot be used as collateral, and few SMEs have other assets they can use to secure loans. In Guatemala, the government found a way of including smallholders without land title in incentives programmes through the notion of “equitable title” by effectively stepping in as guarantor. This is unlikely to be effective with non-state creditors, however. Overall, there is a need to create credit guarantees and innovative definitions of collateral. This is a fundamental condition for increasing the uptake of credit by SMEs.

**Interest rates**

Unstable macroeconomic conditions in Mozambique have produced high and volatile base interest rates, which are prohibitive to SMEs. Moreover, perceptions that SMEs are high-risk means that SMEs face even higher interest rates than other businesses.

The experience in Petén in Guatemala shows that, when there is a critical mass of economically viable SMEs, creditors and investors will compete for their business, leading to lower interest rates and other more favourable conditions for accessing finance. This enables SMEs to scale up and creates a virtuous cycle that helps further leverage finance from private and public investors.

An option that could be further explored is the use of intermediaries with mandates or other motivations for ensuring that smallholder farmers and SMEs have access to finance. The FEDECOVERA and Chicoj cooperatives (discussed in Annex 4) are examples of such intermediaries, but a range of other actors in the value chain, and banks, may also qualify. Such intermediaries are less likely to prescribe prohibitive interest rates on credit (e.g. from climate and development finance) and have an incentive to ensure that such finance reaches the intended beneficiaries.

**Scale**

In Mozambique, the main bottleneck to finance for SMEs is the high cost of the equipment needed to scale up and improve businesses. Commercial banks are often limited by their preference for high liquidity in their customers – and by unstable macroeconomic conditions – in offering high-value loans. The public sector has provided partial financing options to reduce the hurdle but, in many cases, such support has not enabled SMEs to secure co-financing, resulting in low uptake.

On the other hand, financing myriad unorganised SMEs also constitutes an administrative challenge and imposes high transaction costs on both public and private investors. Aggregators such as producer organisations (for example, FEDECOVERA reaches at least 25,000 households) can channel both financial and technical services to help overcome the challenges posed by scale and risk. Aggregators are also better placed...
to access larger-scale investment opportunities, such as international finance. Global aggregators of producer organisations, such as the FFF (Box 6), can provide mechanisms for facilitating such opportunities at a global scale.

**Rate of return**

Making sufficiently high returns to satisfy the interests of third parties such as commercial banks and other investors and to meet the needs of SMEs and their local shareholders is a tricky balancing act. Locally controlled businesses prioritise local needs and invest in local job creation and social services, but this might restrict their access to finance from private investors that prioritise financial returns.

Forestry and agricultural SMEs often bear high transaction costs and have low rates of return due to a lack of economies of scale, excessive regulations, long distances to markets and poor infrastructure. Cost-sharing mechanisms such as producer organisations and processing hubs can help reduce these costs and increase rates of return. For example, FEDECOVERA members have increased their rate of returns by sharing access to a sawmill purchased by their cooperative. Producer organisations can also provide economies of scale, thereby increasing access to markets and producing higher revenues.

**Box 6. Forest and Farm Facility**

The FFF is a multidonor trust fund that funds partnership agreements and small grants for the producer organisations of smallholders, women, communities, indigenous peoples and governments at the local, national, regional and global levels. Operating since 2012, the FFF has reached more than 400 forest and farm producer organisations in ten partner countries: Bolivia (Plurinational State of), the Gambia, Guatemala, Kenya, Liberia, Myanmar, Nepal, Nicaragua, Vietnam and Zambia. The FFF’s global programmes engage an additional 30 organisations with a combined membership of more than 40 million people. The FFF’s work with governmental institutions and national, regional and global partners has leveraged over US$130 million to support the activities of forest and farm producer organisations. Funds are invested in strengthening the organisational, governance and business capacities of producer organisations and their members and in enabling government agencies related to agriculture and forestry to engage with producers on key issues.
Our finding that the perceived cost of lending to SMEs far outweighs the benefits resonates with the findings of other studies. Actions are needed to improve policies and facilitate enabling investments to reduce those costs. In the short term, identifying appropriate institutions with additional incentives for managing the trade-offs between the needs of financial institutions and SMEs can help overcome some bottlenecks.

**Repayment and grace periods**

The required repayment periods extended to SMEs by commercial banks and for publicly financed loans are often too short for paying off sizeable investments. This is especially true in the forest sector, where sustainably managed forests need long periods (more than ten years, in some cases) to generate sufficient profits to enable the repayment of loans (Oakes *et al*., 2012). Start-ups and SMEs expanding into new areas of investment also require grace periods (in which they are not required to make payments on interest or capital) to enable them to establish the financed operation and begin generating income.

For commercial banks in developing countries, a lack of savings (for example, only 20.9 per cent of the population in sub-Saharan Africa and 33.7 per cent of the population in Latin America and the Caribbean have saving accounts) and the strong preference of consumers for liquidity (i.e. deposits of less than one year) constrain the ability of banks to offer medium-term and long-term loans and grace periods of more than a year (AfDB, 2015; UNCTD, 2001). It is important, therefore, for private and public-sector investors to fill this service gap and to design long-term loans with grace periods sufficient to meet the needs of SMEs. Our review of the major public-sector financing options in Mozambique showed that all offer only a maximum of three-year loans, and none includes a grace period. These financing options, which are designed to support SMEs, are not helping the target group, especially those working in the forest sector. In Guatemala, government incentives programmes have enabled many SMEs to create bank accounts, but loans with longer repayment periods and grace periods are still difficult to obtain.

Some SMEs have diversified their businesses to ensure cash flow in both the short and long terms to reduce the need for grace periods and long-term loans. In Guatemala, the government is promoting diversification through PROBOSQUE.

**Social and environmental impacts**

Few private investors in Mozambique and Guatemala take social and environmental impacts into consideration in their lending. Those SMEs that are locally controlled or members of producer organisations are generally more socially inclusive and environmentally responsible. To ensure positive social and environmental impacts, public and private investors should prioritise investing in such businesses, which would involve the acceptance of lower financial returns.
Although locally controlled forestry and agricultural SMEs may find it hard to compete in terms of financial returns in the early years of their businesses, they can often more easily demonstrate their positive social and environmental impacts compared with international corporations with long supply chains. Their collective impact in forest landscapes is significant. Locally controlled SMEs would rank higher as investment opportunities if social and environmental impacts were included in lending criteria.

Equally important, however, is the need to ensure that SMEs that contribute to social and environmental sustainability also have market opportunities. In Guatemala, deforestation has been reduced significantly and forest degradation is being reversed because of the actions of local farmers and SMEs, many in response to the incentives programmes. Previously under the incentives programmes emphasis was mainly on creating income opportunities in the sector, in the form of the incentives payments, and increasing the area planted or sustainable managed. Ensuring that these positive social and environmental outcomes could later be sustained through linkages to markets was at the time less of a priority. Through PROBOSQUE INAB is now seeking to address this gap in forest-industry-market initiatives that provide business services and link forest SMEs to larger forest companies and finance.

**Capacity**

SMEs need support to build business capacity and, in some cases, to improve social and environmental practices. There is a lack of creditors and service providers who understand the needs of SMEs and a lack of public funding for ensuring that locally based qualified creditors and service providers are available to support SMEs in the long term. The success of Gapi in Mozambique shows it is crucial to build capacity to ensure that SMEs have access to financing and that this can be done in tandem with loans programmes.

National governments and international donors should support a network of qualified and credible local service providers to provide long-term financial services, ongoing training, technical assistance, and monitoring of enterprises based on economic, social and environmental performance indicators.
Recommendations

The following recommendations are made based on the findings of this report. National governments, international donors and financing institutions should:

■ Create innovative definitions and approaches to collateral and explore ways of guaranteeing credit to help create new mechanisms for granting access to finance for SMEs.

■ Develop a set of key principles and criteria for identifying appropriate institutions and models for channelling finance through intermediaries with mandates or specific motivations for enabling SME access to finance.

■ Establish agreements with global aggregators with strong partnerships with regional and national aggregators of forest and farm producer organisations to facilitate the effective delivery of climate and development finance to decentralised levels.

■ Design terms and conditions for financing in a collaborative process involving financial institutions, intermediaries and service providers, each of which has a good understanding of the key challenges, risks and incentives that can constrain and enable uptake. Those terms and conditions should consider environmental and social impacts.

■ Invest in national and regional networks of qualified service providers to develop business incubation processes to build the capacity of SMEs and help feed them into higher-value chains.


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UNLOCKING BARRELS TO FINANCING SUSTAINABLE FOREST-RELATED SMES


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Annex 1

Research questions

For public and private investors or those who manage public and private funding:

- What are the key motivations/incentives for investors? E.g. financial return; environmental or/and social impacts; mitigate reputational risks; secure raw material.
- How much funding is currently available?
- What is the source of the funding?
- Who are eligible for those investment opportunities? What criteria are they evaluated against? Including:
  - Rate of return;
  - Interest rate;
  - Repayment period;
  - Required scale: what is minimum scale of business or the amount of funding applied;
  - Required collateral
  - Social and environmental requirements;
  - Certification required;
  - Monitoring, reporting and evaluation requirements
- How are the funds administered and distributed?
- How can those who meet the criteria access the funds? How accessible are these ‘opportunities’ in practice? What are the practical opportunities and constraints for SMEs to access these investments even they meet those criteria?
- In the view of SMEs, how to improve existing financing options to make them more accessible?

For SMEs or NGOs supporting those SMEs include:

- **Status of the business:**
  - What is the business: what are the key products and activities?
  - What is the size of the business? How many people are employed and what is the size of the resource (e.g. forest plantations) and operations that they manage (e.g. in case of group business/ organisation number of smallholder members and suppliers)?
■ Who owns the business and how is it managed (ownership and management structure of the business)?
■ What is the annual net profit and net profit margin (price structure for main products, annual production volumes, and sales)?
■ What are their main financing priorities and needs in the short/medium/long term?
■ How much does the business invest annually in management/production of forest resources? How much of this is from own versus external funding sources and how is this generated?
■ What are the main motivations to invest in the business?

■ **Financing options:** If relevant, could they please provide the following information for each of the financing option:
■ What financing options are currently available to them? Where does the money come from?
■ What are they using?
■ How do they access those funds (e.g. do they apply through a local commercial bank? What evidence is needed? How long does it take to be granted the funds)?
■ How much can/do they access?
■ What are the funds used for? Do the options available meet their financing needs?
■ How are the financing distributed? (e.g. through NGOs? Directly transferred to the enterprise? Through cooperative structure?)
■ Is a certain amount of upfront capital required to access funds?
■ How much do they pay in interest rate (%)?
■ What is the repayment period?
■ What risks are involved with the financing options that are available to them?
■ What types of measures were required or taken to mitigate risks?
■ What are the social and environmental requirements, if any? How are they monitored and reported?
■ Is certification required to access finance? If so, what are they?

■ **Key challenges:** What are the key challenges in accessing financing? In their view, how to improve existing financing options to make them more assessable for SMEs?
### Annex 2

#### Table 7: Mozambique Participants

<table>
<thead>
<tr>
<th>No.</th>
<th>Name</th>
<th>Organisation</th>
<th>Position</th>
<th>Affiliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Daniel Maula</td>
<td>Organizations Network for Environment and Zambezia Sustainable Development (RADEZA)/ Cooperativa AcodeMuso</td>
<td>Executive Director</td>
<td>NGO</td>
</tr>
<tr>
<td>2.</td>
<td>Tomás Bastique</td>
<td>REDD+</td>
<td>Project Coordinator</td>
<td>Government</td>
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<tr>
<td>3.</td>
<td>Geraldo Sotomane</td>
<td>Industrias Sotomane</td>
<td>Managing Director</td>
<td>SME</td>
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<tr>
<td>4.</td>
<td>José Genclalo</td>
<td>Landscape</td>
<td>Provincial Coordinator</td>
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<td>5.</td>
<td>Mario Macheca</td>
<td>IPME</td>
<td>Provincial Delegate</td>
<td>SME</td>
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<td>Jaime Fernando Júnior</td>
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<td>Fiorentino Cardoso</td>
<td>CEPAGRI</td>
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<td>Dinis B. Dinis</td>
<td>Barclays</td>
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<td>Rui Borges</td>
<td>G24</td>
<td>Project Representative</td>
<td>SME</td>
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<td>10.</td>
<td>Pelágia Ana Mudengue</td>
<td>CPI</td>
<td>Information and Marketing Specialist</td>
<td>Government</td>
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<tr>
<td>11.</td>
<td>Miguel Correia</td>
<td>Standard Bank</td>
<td>Head of Agri-Business Department</td>
<td>Private sector</td>
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<tr>
<td>12.</td>
<td>Amilcar Sueia</td>
<td>FinAgro</td>
<td>Provincial Coordinator</td>
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<td>Cecohas/FONGZA</td>
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<td>Carlos Alberto Moniz</td>
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<td>Olga Maria Figueiredo</td>
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<td>16</td>
<td>Fatima Isac Mussa</td>
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<td>Manul Gudo</td>
<td>United Bank of Africa</td>
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<td>Carlos Nedson</td>
<td>FCA</td>
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<td>Da Silva</td>
<td>BCI Exclusive - Mocuba</td>
<td>Focal Point</td>
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<td>Jorge Chacate</td>
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<td>Aires Barneith</td>
<td>Farmer and forestry operator</td>
<td>Director</td>
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<td>25</td>
<td>Vasco Almeida</td>
<td>Farmer and forestry operator</td>
<td>Manager</td>
<td>SME</td>
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<td>26</td>
<td>Ana Maria</td>
<td>Farmer and forestry operator</td>
<td>Manager</td>
<td>SME</td>
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**Table 8: Guatemala Participants**

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<th>Affiliation</th>
<th>Location</th>
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<tr>
<td>1.</td>
<td>Ogden Rodas</td>
<td>Forest and Farm Facility (FFF Guatemala)</td>
<td>National FFF Coordinator</td>
<td>United Nations</td>
<td>Guatemala city</td>
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<tr>
<td>2.</td>
<td>Álvaro Samayoa</td>
<td>INAB, Directorate of Industry and Commerce</td>
<td>Director</td>
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<td>3.</td>
<td>Wilfredo Villagrán</td>
<td>INAB, Directorate of Industry and Commerce</td>
<td>Head of Certification of Forest Sources and Seeds</td>
<td>Government</td>
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<td>5.</td>
<td>Diana Menéndez</td>
<td>INAB, PINFOR Programme</td>
<td>Director</td>
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<td>6.</td>
<td>Edgar Martínez</td>
<td>INAB, PROBOSQUE Programme</td>
<td>Head of Planning Department</td>
<td>Government</td>
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<td>7.</td>
<td>Mario Salazar</td>
<td>INAB, PROBOSQUE Programme</td>
<td>Director, Forestry Development Directorate</td>
<td>Government</td>
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<td>8.</td>
<td>Hugo Morán</td>
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<td>9.</td>
<td>Héctor Caal Bol</td>
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<td>10.</td>
<td>Héctor Israel Cu Pop</td>
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<td>11.</td>
<td>Jorge Cruz</td>
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<td>Sergio Guzmán</td>
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<td>Carlos Combrones and Donald Grijaba</td>
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<td>16</td>
<td>Tomasa Gómez</td>
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<td>Glenda Lee</td>
<td>Co-head Terra Global Capital Latin America</td>
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<td>18</td>
<td>Carlos Roca</td>
<td>Executive of Corporate Business Banking</td>
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<td>Mario Rodríguez</td>
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</table>
Find out more about IIED’s work on financing forest enterprises

The potential multiplier effect that small and medium sized enterprises (SMEs) have in promoting sustainable forest management, addressing the drivers of deforestation and forest degradation and contributing to sustainable development goals is undeniable. Yet adequate and targeted finance is still limited. The barriers stem from perceptions of risk from both financiers and recipients that lead to apparent high supply finance, while the large demand is also unmet. What are the lessons on innovative and complementary public and private finance that overcome these barriers?

The following related briefings are free to download on pubs.iied.org:

Unlocking barriers to financing sustainable SMEs: uphill struggle or attainable ambition?
pubs.iied.org/17387IIED

Financing forest-related enterprises: lessons from the Forest Investment Programme
pubs.iied.org/17453IIED

“Money where it matters: Financing the SDGs and Paris Agreement at the local level”

On the 7th - 8th of December 2016 IIED hosted a meeting, all presentations made during the event are available through the IIED Slideshare www.slideshare.net/IIEDslides/presentations
This paper presents research aimed at understanding the barriers to sustainable small- and medium-sized enterprises (SMEs) in forest landscapes in accessing finance by examining the financial situation in forest landscapes in two countries – Mozambique and Guatemala. In both countries, subnational regions were examined for existing public and private financing opportunities available to forestry and agricultural SMEs; the requirements and processes of access to finance; and the key barriers and how to address them were identified.