3. How Indonesia’s Best Known Forest Cooperative Lost Its Way

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Introduction

In order to restore soil fertility, protect landscapes and improve food security, the developing world faces the challenge of restoring over one billion hectares (ha) of degraded land. Much of it has been despoiled by the poorly regulated industrial forestry and plantation sector, and most could benefit from reforestation or being converted to farming landscapes with trees. Evidence shows that reforestation at scale is best carried out through encouraging locally controlled forestry, with landscape mosaics of forests and farms in various forms of individual and communal ownership and management (Elson 2013). This not only leads to more resilient landscapes, but also creates diverse and productive rural economies — the backbone of any development policy.

For locally controlled forestry to succeed, organizations that represent communities need to become successful enterprises, or form partnerships with local enterprises while ensuring that accountability remains in the hands of the people who are the “owners” of the landscape (Elson 2012). Indeed, in the absence of successful enterprises that are linked to networks of related businesses, the goals of locally controlled forestry are very unlikely to be achieved.

Evidence suggests that successful enterprises do not emerge fully formed from the well-intended efforts of donors and NGOs (Mbile et al. 2010). Like any enterprise, community organizations need to acquire a range of technical and social skills while also coping with the external conditions that can threaten or upset their plans. To complicate matters further, such organizations are trying to balance social and environmental missions with the harsh reality of becoming financially viable and sustainable. In the experience of the authors, many organizations run into difficulty just when the business is looking most promising. How they and their partners respond to this situation will determine if the enterprise will ever succeed.

The donors for this successful forest cooperative provided essential capital, but at the cost of blurred vision.
This article describes a successful forest cooperative that hit hard times, and is now learning from failure and making itself more resilient. The story has lessons for similar producer organizations on how to overcome adversity, and for investors, donors, philanthropists, intermediaries and consultants. The authors have been involved with this cooperative for many years, and perhaps have contributed to both its highs and lows. The recommendations in Table 1 are based on this experience.

### Table 1. Recommendations for forest cooperatives

<table>
<thead>
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<th>For the organization</th>
<th>For the donor/investor/philanthropist</th>
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<td>Maintain a market focus at all times. Without customers, there is no business.</td>
<td>Keep “enabling” grants separate from “asset” investment.</td>
<td>Don’t turn a business into a project.</td>
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<td>Understand and develop the value proposition of the business.</td>
<td>Allow the organization to lead the process.</td>
<td>Approach grassroots organizations with humility.</td>
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<td>Evaluate certification schemes (e.g., FSC) in the context of the organization’s goals.</td>
<td>Let the business set its own production standards, based on local contexts and market demands.</td>
<td>Continually adapt as the business develops.</td>
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The picture of a healthy rural business

*Koperasi Hutan Jaya Lestari* (KHJL) is located in Sulawesi Tenggara Province, Indonesia. It started in 2003 as part of a government social forestry programme. There was a good deal of illegal logging in the area, and the founders of KHJL had the insight that forming a timber business by means of a cooperative would enable local farmers to legally and sustainably market the teak growing on their land. The founders organized 46 villages into a productive group in order to support a community forest cooperative. The organization has now grown to 756 households, with an additional 1,352 households prepared to work in the newly expanded area.

KHJL aims to improve the economic security of local communities through increasing incomes and by contributing to the regional economy through taxes and fees. It does this through sustainable forest management, building capacity for management, and the production and marketing of high-quality FSC-certified teak (*Tectona grandis*), gmelina (*Gmelina arborea*), albizia (*Albizia falcata*) and mahogony (*Swietenia macrophylla*). By 2029, KHJL aims to be a strong, independent organization, with over 2,000 households enjoying a decent livelihood managing 7,000 ha of tropical hardwood plantations. KHJL obtained FSC certification in May 2005, the first community plantation in Asia to do so.
There are three components of its business:

- buying timber from cooperative members, who manage timber lots on their own private land;
- restoring and planting a 4,640-ha mixed-species plantation under a 60-year government lease, in partnership with the local community (the *Hutan Tanaman Rakyat*, or HTR scheme); and
- processing teak logs into flooring and dimensional timber to order, in a small sawmill where the cooperative owns a majority (60%) share.

Until 2012, KHJL operated in a way that embodied many of the principles of an effective forest producer organization. It was one of the first organizations in the country to take advantage of a government scheme to allocate leases of degraded land to cooperatives for replanting as a means of increasing production and expanding membership. It implemented FSC management principles and systems that ensured systematic production planning and avoided overproduction that would depress prices and degrade the landscape. During the first five years of FSC membership, the prices KHJL received for raw teak increased tenfold, removing any incentive for members to side-sell to intermediaries. KHJL also advocated to ensure that local government continued to support the cooperative. Since it was established, KHJL has been supported by a local NGO, *Jaringan Untuk Hutan* (JAUH), national NGOs (e.g., Telapak) and international organizations such as The Forest Trust and the Skoll Foundation.

For many years, KHJL was often cited in articles and presentations as a good example of a community-led forest producer organization. Academics and researchers praised its strength, its clear market focus for selling high-quality FSC teak, and its bold ambitions to expand the planted area using the *Hutan Tanaman Rakyat* scheme. KHJL has an international profile that belies its small scale and the model has been successfully replicated by other groups in Java and Sumatra.

**Growing pains**

In order to expand into the 4,640 ha granted by the government (the HTR scheme), KHJL needed access to financial capital. In 2011, they designed a financial model to support the business case for investing in the expanded plantation. This demonstrated that a capital investment of approximately US$1.5 million would cover the cost of planting the new area, assuming that each household co-invested through their labour. However, no bank in Indonesia would lend money to a venture with such a long payback period. The government scheme set up to finance the HTR scheme was designed on the assumption that farmers would plant fast-growing species to feed the pulp mills. Since this was not appropriate to the KHJL situation, this type of financing was not available to them.

Eventually, a donor was willing to support KHJL as part of its sustainable forestry programme. However, for various reasons connected to the way the programme was
designed — which perhaps in hindsight could have been overcome — the donor eventually chose not to invest in KHJL through a loan, but instead allocated the money as a grant. Furthermore, the donor selected a technical forestry consultancy company to manage the grant and the technical assistance to be provided, with the support of an Indonesian environmental NGO from another province.

Be careful what you wish for
For six years, the cooperative made a profit selling timber and paid dividends to its members. The members gained in three tangible ways: from much higher prices for their timber; from participation in annual profits; and from a better managed environment with improved hydrology and fertility. They also shared in the sense of empowerment felt by all members of KHJL; farmers with only an elementary education could, through their own dedication, build a successful business. The fact that KHJL was able to meet the exacting standards of FSC — while many large companies in Indonesia were unable to do so — was a particular source of pride.

Over the past couple of years, however, the business has been unable to sell timber at the price it expected. As a result, KHJL has sold no timber at all since 2012. With no sales income, the organization could not afford the cost of renewing the FSC certificate. It was allowed to lapse in 2014, which means KHJL can no longer sell FSC-certified timber. After a number of years of profitability, the business now operates at a loss, surviving only because of the grant received from the donor. During this period, the sawmill ceased operations, and the factory and machinery fell into disrepair. The expansion of the HTR plantation business fared better, including the development of a 20-ha demonstration plot, and the allocation of one hectare each to 720 local families. Outside the demonstration plot, however, no other trees have been planted. There is also evidence that some members are beginning to sell their timber to local traders. It seems as if the business is in a state of hibernation: still breathing, but not moving.

The atmosphere within the cooperative is tense. Many members are disappointed, and what used to be an impressive solidarity among the governance board and management team has started to crack. Jealousies have emerged over differences in salary. The foreign consultants made staff changes and fired some managers who they deemed to be underperforming, creating problems between KHJL and its long-term partner, Jaringan Untuk Hutan. The NGO brought in as a facilitator had a good reputation in its own province, but did not seem to be accepted by local management, causing further resentment.

So despite KHJL receiving the funds that it needed to grow the business, and having access to technical expertise from an international firm, the net effect of the initiative was to greatly diminish the effectiveness, solidarity and viability of the organization. KHJL is caught up in a situation that superficially appears more viable, but under the surface it has been weakened by the experience of the past two years.
The organization has taken steps to get back on its feet, however. The original sawmill manager has been reinstated, and the mill is once again processing teak flooring. A meeting will soon be held with all members to discuss strategic options for the business. Plans are afoot to develop new ways to generate investment capital for the business; e.g., through crowdfunding. The organization’s founders have not given up hope. On the contrary: they see the recent problems as a good opportunity to learn new ways of working.

**Lessons learned**
This summary of the lessons from this experience may help others avoid similar pitfalls.

**A debt is obligation to repay; a grant is an obligation to report**
This is an example of what happens when the purpose of the investment is not clearly defined. Since it was paid as a grant, it compelled the management to shift the focus from the needs of the business and its stakeholders to the needs of the project and the donor. The initiative failed to succeed as either an investment or a grant, however, as it was trying to be both.

It is important that donors find a way to channel funds to innovative enterprises in a way that mimics conventional investment; for instance, through debt and equity financing. This avoids moral hazards, keeps management focused on commercial goals, and enhances opportunities for learning. Enabling investments can be channelled to NGOs that support social enterprises; asset investments can be made directly in the company itself.

**Good enough is better than best**
Just because foreign experts can do one thing well, it does not mean they can do everything well. The real experts in the complex and finely balanced social situation inside the cooperative are the local people, especially *Jaringan Untuk Hutan*, the NGO that has worked with KHJL for the past 12 years. A deep understanding of technical forestry is less relevant when planning an intervention that needs to be operated by local people.

In response to their terms of reference, the consultants focused on technical forestry, instead of advising KHJL on how to run a business. Their advice seemed to be based on making every hectare as productive as possible, to high standards of silviculture, but such standards are not applied in most industrial plantations in Indonesia. It would have been better to set more appropriate standards, and aim for steady improvements over time.

**Play to strengths**
KHJL has a successful history of social engagement, and was able to turn illegal loggers into tree farmers. Rehabilitating 30 million ha of degraded forest land in Indonesia — with complicated vegetation and land-use history and contested claims — is a task for a social
organization, rather than a scientific or business challenge. Companies and consultants can bring in technical knowledge. A producer organization with local legitimacy has the strengths most suited to the main task: managing the people, not the trees.

Don’t turn a business into a project
Before the donor became involved, the managers worked as a team, and their salaries depended on how much timber they sold. The management approach was entrepreneurial, and was effective enough to successfully run the FSC system and make a profit. The consultant advised that a general manager be appointed and be paid a higher salary than the management team, which was possible only because of the grant. This created a schism between the manager and the governing board. Because of the new funding structure, the manager answered to the donor and the consultant instead of being accountable to the members. The hard work of selling timber was abandoned, and the focus shifted to delivering project results as defined by the donor. This approach insulated the management from risk, and thus from learning.

The paradox of certification
Some of KHJL’s problems predate the recent donor intervention, however. It seemed to be a good idea to introduce KHJL to the FSC process in 2005, and the steep increase in timber prices that the members enjoyed appeared to be evidence of success. It is possible, though, that KHJL was given a false prospectus, or at least overlooked or misunderstood some important aspects of FSC. KHJL seemed to assume that FSC inherently supports locally controlled forestry, and members were disappointed when an FSC certificate was granted to Perum Perhutani, the huge state-owned company that dominates teak sales in the country and thus dictates prices. Perhutani’s FSC label enabled them to undercut the prices that KHJL was charging for timber by at least 30%.

It would have been better had KHJL understood that FSC rewards verifiable sustainable forestry practices. It does not directly reward hard work or authenticity, or have much effect on colonial injustice and a rent-seeking state. KHJL would have had a more resilient relationship with FSC if it had understood that at the heart of any certification scheme lies a paradox. FSC is driven by the need to certify as many companies as possible, while each individual company wants a unique market advantage. As FSC gets closer to meeting its goal, then the premium paid for certified wood must fall, until prices return to a natural equilibrium. The lesson here is that organizations such as KHJL should see certification schemes as a means to gain a market foothold and to improve management, not as a long-term guarantor of privileged market access.

Keep an eye on the market at all times
The only way a business can survive without customers is to find an indulgent donor. One would hope that any donor would wish to help a business become better at sales and
marketing. In this case, the donor overestimated its market access and, having promised to introduce KHJL to foreign buyers, failed to do so. A better strategy would have been to tie funding allocations to sales targets, as a venture capitalist would do. By being forced to get on the road and talk to buyers, KHJL would have found out that all contact with customers is instructive. For instance, they would have had much better intelligence about the real market perception of FSC. When intermediaries get stuck between the producer and the buyer, even with the very best of intentions, they fail to see important signals, such as quality, price, delivery, market intelligence and trends.

Conclusions
Like many forest producer organizations, KHJL is a social enterprise. When it was first set up, it had a clear mission: to encourage local farmers to stop illegal logging and invest in a legitimate, sustainable business. For years, this was a successful, if small, model. But in trying to scale up, the organization became reliant on donors and consultants, a situation that provided essential capital, but at the cost of blurred vision. It forgot that its success had been due to a blend of business acumen and generating income to fulfill social goals. As the business focus was lost, the social goals seemed unreachable. This is why investors, donors and intermediaries should treat any social enterprise as a business first, and not a project. It is better to invest real money and face losses, rather than to finance yet another project that delivers reports but no transformational change.

Several key lessons were learned:
- Even a social enterprise must still maintain market focus at all times. Without customers, there is no business.
- Donors must keep “enabling” grants separate from “asset” investment, or they risk suppressing the entrepreneurial spirit.
- The business should set its own targets and production standards, based on local context and market demand.
- Intermediaries must continually adapt their support so it fits the changing needs of the business, and must know when to withdraw.

References
