BUSINESS CLIMATE FOR FOREST INVESTMENTS: A SURVEY

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PROFOR
PROGRAM ON FORESTS
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## CONTENTS

### ABBREVIATIONS

<table>
<thead>
<tr>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>v</td>
</tr>
</tbody>
</table>

### EXECUTIVE SUMMARY

<table>
<thead>
<tr>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>vii</td>
</tr>
</tbody>
</table>

### 1. BACKGROUND

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Scope of Work</td>
<td>3</td>
</tr>
<tr>
<td>Methodology and Work Process</td>
<td>4</td>
</tr>
</tbody>
</table>

### 2. REVIEW OF EXISTING INVESTMENT CLIMATE STUDIES AND TOOLS

<table>
<thead>
<tr>
<th>Study</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brief of the Existing Tools</td>
<td>7</td>
</tr>
<tr>
<td>Forest Investment Attractiveness Index</td>
<td>8</td>
</tr>
<tr>
<td>Tree Farm Investment Attractiveness Ranking</td>
<td>11</td>
</tr>
<tr>
<td>Doing Business Rankings and Investing Across Borders</td>
<td>12</td>
</tr>
<tr>
<td>WB Rural Investment Climate Assessments</td>
<td>15</td>
</tr>
<tr>
<td>Annual Global Competitiveness Report</td>
<td>16</td>
</tr>
<tr>
<td>Worldwide Governance Indicators and Corruption Perception Index</td>
<td>18</td>
</tr>
<tr>
<td>Commonly Used FDI Country Benchmarking and Risk Assessment Tools</td>
<td>20</td>
</tr>
<tr>
<td>Annual Index of Economic Freedom and Annual Economic Freedom Report</td>
<td>22</td>
</tr>
<tr>
<td>PROFOR Forest Governance Indicators</td>
<td>22</td>
</tr>
<tr>
<td>Conclusions</td>
<td>24</td>
</tr>
</tbody>
</table>

### 3. FOREST INVESTOR TYPOLOGIES AND INVESTMENT FRAMEWORKS

<table>
<thead>
<tr>
<th>Typology</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forestry and Forest Industry Investor Typologies</td>
<td>29</td>
</tr>
<tr>
<td>Mapping the Investment Framework of a Strategic and Financial Investor</td>
<td>33</td>
</tr>
<tr>
<td>Mapping the Investment Framework of an SME Investor</td>
<td>36</td>
</tr>
</tbody>
</table>
4. ALTERNATIVES AND FRAMEWORKS FOR FOREST INVESTMENT ASSESSMENT 39
   Main Principles and the Investment Framework for Developing the Tool 39
   Options for a Tool to Measure the Forest Business and Investment Climate 40

5. END-USER SURVEY/EXPERT INTERVIEWS 41
   Introduction 41
   Case studies 41
   Investor Survey/Expert Interviews 46

6. OPTIONS FOR MEASURING FOREST BUSINESS AND INVESTMENT CLIMATE 49
   New Tool 49
   Improved Use of the Existing Tools 53
   Summary Analysis of Different Options 58
   Next Steps 61

REFERENCES 63
**ABBREVIATIONS**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPI</td>
<td>Corruption Perception Index</td>
</tr>
<tr>
<td>DD</td>
<td>Due Diligence</td>
</tr>
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<td>DFI</td>
<td>Dutch Florint</td>
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<tr>
<td>ECR</td>
<td>Euromoney Country Credit Ratings</td>
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<td>ESG</td>
<td>Environmental, Social, and Governance</td>
</tr>
<tr>
<td>FAO</td>
<td>Food and Agriculture Organization of the United Nations</td>
</tr>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GCR</td>
<td>Global Competitiveness Report</td>
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<td>IAB</td>
<td>Investing Across Borders</td>
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<td>IAIF</td>
<td>Investment Attraction Index</td>
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<td>IDB</td>
<td>Inter-American Development Bank</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IRR</td>
<td>Internal Rate of Return</td>
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<tr>
<td>ITTO</td>
<td>International Tropical Timber Organization</td>
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<td>MAF</td>
<td>Ministry of Agriculture and Forestry in Lao PDR</td>
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<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<td>MNTR</td>
<td>Ministry of Natural Resources and Tourism of United Republic of Tanzania</td>
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<td>MOIC</td>
<td>Ministry of Industry and Commerce in Lao PDR</td>
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<td>MPI</td>
<td>Ministry of Planning and Investment in Lao</td>
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<tr>
<td>NGO</td>
<td>Nongovernmental Organization</td>
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<tr>
<td>ONDD</td>
<td>Office National du Ducroire</td>
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<tr>
<td>PAFO</td>
<td>Provincial Office of Agriculture and Forestry in Lao PDR</td>
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<td>POIC</td>
<td>Provincial Office of Industry and Commerce in Lao PDR</td>
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<td>PPI</td>
<td>Provincial Office of Planning and Investment in Lao PDR</td>
</tr>
<tr>
<td>PROFOR</td>
<td>Program on Forests</td>
</tr>
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<td>PROMECIF</td>
<td>Process to Improve the Business Climate for Investment in the Forestry Sector</td>
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<td>Abbreviation</td>
<td>Full Form</td>
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<td>-----------</td>
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<td>RIC</td>
<td>Rural Investment Climate</td>
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<td>RICA</td>
<td>Rural Investment Climate Assessments</td>
</tr>
<tr>
<td>RISI</td>
<td>Resource Information Systems Inc.</td>
</tr>
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<td>SME</td>
<td>Small and Medium Enterprise</td>
</tr>
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<td>TFS</td>
<td>Tanzania Forest Service</td>
</tr>
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<td>TIMO</td>
<td>Timberland Investment Management Organization</td>
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<td>WB</td>
<td>World Bank</td>
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<td>WGI</td>
<td>Worldwide Governance Indicators</td>
</tr>
</tbody>
</table>
The main objectives of this study were to assess if there is a need to develop a tool to measure the investment and business climate in the forest sector, outline key elements of the tool and assess its feasibility, and make recommendations concerning possible development of such a tool. The work comprised a desk review of the existing investment climate tools, developing a forest investor typology, and a framework for measuring investment climate in the forest sector, field testing in Tanzania and Lao People’s Democratic Republic, including interviews of government representatives, as well as a survey and interviews of experts among potential investors within the sector.

The main findings of the study are as follows:

- There is demand for this type of information in the forest sector. The main end users and uses of the investment climate analysis are as follows:
  - **National policy makers.** Benchmarking and guidance to government decision makers for improving the administrative and regulatory framework and identifying priority areas of action/reform needed to improve the business climate for sustainable forestry and forest industry investments.
  - **Development agencies.** Helping development agencies to target their interventions (country, specific policy/reform/sector area within a country) and providing a tool for policy dialogue and help with monitoring the impacts of various interventions over time.
  - **Strategic and financial investors.** Providing (complementary) screening information to investors concerning attractiveness of various countries for investment.

- There are already plenty of tools that are commonly used for measuring business/investment climate in a broad range of countries. Some of them are public domain (Doing Business Indicators, Global Competitiveness Index, Worldwide Governance Indicators, and so on), and others must be subscribed to (for example, Euromoney Country Credit Risks, foreign direct investment [FDI]). However, with a possible exception of the Doing Business indicators, government forestry officials appear not to know about these indicators.

- Most of the crucial extrasectorial factors influencing the investment climate of forest investors are similar to the other sectors, and vice versa. Small and medium enterprises (SMEs) operating in rural areas face more or less similar challenges caused by, for example, weak infrastructure, or poor access...
to markets and finance. Therefore, many of the already available tools such as International Finance Corporation (IFC) Doing Business Indicators, Investing Across Border (IAB) Indicators, and World Bank Rural Investment Climate Assessments (RICAs), in addition to some others, provide information that can feed into policy dialogue and initiate possible reforms that also improve investment climate in the forest sector.

- Most of the interviewed stakeholders see the investment climate only as one key factor influencing decision making. They appear to be quite content with the existing tools and available information regarding the general business climate. However, there are gaps or deficiencies in how well the publicly available and regularly updated indicators describe the business or investment climate relevant for forest investors. The main gaps of the existing instruments are linked to the instruments’ capability to assess technical, physical, and social characteristics of the forest sector, as well as some forest-sector-specific governance issues related, for example, to the security of land tenure, land policies and regulation, and various administrative requirements and corruption in the forest sector.

- Strategic and financial investors apply the available indexes particularly in the screening and prefeasibility phases of potential new investments. They also have the resources to carry out their own more detailed studies and assessments to fill key data gaps from their perspective particularly related to land issues, raw material procurement costs, market access, and social and environmental risks.

The main conclusion of this study is that there is demand for this type of information, but the development of a new instrument would be costly and time consuming if done properly and maintained systematically across a large number of countries. Launching and establishing a new instrument would pose a challenge to the hosting organization, requiring long-term commitment.

One feasible option is to improve the use of the existing instruments considering improved awareness and accessibility of the instruments among the key stakeholders. An online portal (a practitioner’s guide) for “Forest Business and Investment Climate Assessment” could be developed. The electronic guide should include the following:

- Basic concepts and methods of measuring the investment climate (in the forest sector)
- A conceptual framework for and checklist measuring the investment climate (in the forest sector)
- Operationalized framework with detailed guidance, and importantly, links to existing tools and indicators (what they mean and measure, what kind of new data are needed, and best ways of collecting the data)
- Links to relevant case studies
INTRODUCTION

Business climate or investment climate is defined as the economic and financial conditions in a country that affect whether individuals and businesses are willing to lend money and acquire a stake in businesses operating there. Investment climate is affected by many factors, including poverty, crime, infrastructure, workforce, national security, political instability, regime uncertainty, taxes, rule of law, property rights, government regulations, government transparency, and government accountability.¹

Favorable business climate is critical for economic development, job creation, and poverty reduction. This concerns also development of the forest sector from tree growing to wood processing and product marketing. The rationale is that positive business climate accelerates forest investments,² promotes good governance, generates rural employment, improves overall sector competitiveness, and creates wealth. The role of the private sector has been gaining increasing attention in discussions about financing sustainable forest management and forest sector development at large. Sustainable economic use of forests is also part of the Reducing Emissions from Deforestation and Forest Degradation (REDD+) and Green Growth agendas. Job creation, particularly for the rural population, has become increasingly important as a development objective, and this will require new investments.

It is recognized that in order to scale up sustainable forest management and create employment, value added, and revenue based both on wood production and related processing and trade, private financing flows from domestic and international sources must be accelerated. This applies both to large-scale commercial investments and to small-scale investments in community-led business enterprises and farm forestry. At the same time, it is known that currently private sector investment flows are distributed very unequally between developed and developing regions, and also within developing countries (Castrén et al. 2014). One of the reasons that can explain variations in the level of forest investment activity between countries, and also between urban and rural areas, is related to the quality of the business environment.

¹ This is the definition by Investopedia (http://www.investopedia.com).
² Forest investment refers to investment in wood production, harvesting, and transport and processing. Sometimes the term “forestry” investment is used to differentiate wood production investments from forest industry investments.
The development of policies, strategies, programs, and various investment promotion measures requires a better understanding of the factors that influence forest investments by major investor types and tools to measure the forest business climate. The focus of this type of analysis is often on promotion of foreign investments. However, it needs to be noted that in “successful” forestry countries, domestic investments, often by the small and medium enterprise (SME) sector, play a key role, for example, in terms of employment generation and provision of services needed by bigger companies (subcontracting). Hence, the analysis of forest business climate must pay attention to both foreign (including increasing South-South investments) and domestic investors of different size and nature.

There are a large number of studies, indexes, and rankings that are used to measure different aspects of investment climate. Some of the tools, for instance, World Bank/IFC Doing Business and Global Competitiveness Report (GCR), aim at measuring the overall business environment for both SMEs and large companies. Others, for example, Worldwide Governance Indicators (WGI), measure different elements of the investment environment such as governance including political stability and regulatory quality. The Forest Investment Attractiveness Index formulated at Inter-American Development Bank (IDB) in 2004–07 is only one index that has been developed particularly for the forest sector, but it has not been updated or applied in recent years.

Traditionally bilateral and multilateral development agencies and financiers have mainly focused on financing and working with the public sector. Private sector financing has been mainly channeled through special institutions like IFC and several national development financing institutions. These institutions aim at promoting global development agenda through providing capital to commercially viable private businesses. This separation is needed to ensure that official development assistance does not lead to unsustainable market distortions.

This separation does not mean that public developing institutions like the World Bank, other multilateral institutions, or bilateral agencies would not recognize the importance of the private sector—be it domestic or foreign, large or small—in meeting global development goals. For example, the World Bank (2013) strategy identifies two goals for the organization: ending extreme poverty and promoting shared prosperity.3 The strategy recognizes the importance of the private sector and finance in ensuring growth in the global economy. It is recognized that private sector resources and expertise are critical to achieve the two goals. Particularly it states that the World Bank Group will help countries improve the business environment, and to support the private sector in overcoming constraints to investment and growth—to create jobs; promote innovation, technology, and skills transfer; and develop supply chains and export markets.

As a source of growth, forests and trees can contribute to the development of a diverse economic base, especially when markets for forest products can be tapped at scale. Local markets for timber, woodfuel, and wood products are driving the development of small and medium as well as large-scale forest industries in many parts of the developing world. These are creating jobs and income. Much of that employment is in the informal sector, but at a scale which is extensive. The long-term future of this informal sector, in turn, depends on the sustainable management of forests, as does the future of the formal sector as well.

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3 End extreme poverty: reduce the percentage of people living on less than $1.25 a day to 3 percent by 2030. Promote shared prosperity: foster income growth of the bottom 40 percent of the population in every country (World Bank 2013).
Against this background, the World Bank/PROFOR initiated as study to analyze if there is a need to develop a new diagnostic tool to measure the investment and business climate in the forest sector at a country level.

**SCOPE OF WORK**

The overall objective of the study was to develop and test a methodology, or a tool, to assess systematically administrative and regulatory requirements for forest and wood products investments and to identify action to improve the business environment. Using the index for country ranking was not an objective.

As part of the process it was essential to develop a relevant forest investor typology (see chapter 3) that in a way also defines the scope of the study. This typology was narrowed down to cover on one hand domestic and international strategic investors and financial investors, and on the other hand small and medium forest enterprises (SMEs). Microenterprises play an important role in improving rural people’s livelihoods and generating employment. However, they are not specifically addressed in this study because they work largely in an informal sector, and the dynamics and challenges faced by them are in many respects different from the larger investors operating in the formal sector. Their investment decision-making process is also different and would not be well served by investment climate assessment tools appropriate for large-scale investors and operators.

It is well known that there are other types of investors and different lines of businesses that have specific investment features. However, the developed investor typology is believed to capture the most relevant investors both in terms of numbers and investment value, as well as impact on value added, income, and employment.

The main end users and uses of the investment climate analysis are assumed to be as follows:

- **National policy makers.** Benchmarking and guidance to government decision makers for improving the administrative and regulatory framework and identifying priority areas of action/reform needed to improve the business climate for sustainable forestry and forest industry investments
- **Development agencies.** Helping development agencies to target their interventions (country, specific policy/reform/sector area within a country) and providing a tool for policy dialogue and help with monitoring the impacts of various interventions over time
- **Strategic (for example, international forest industry companies) and financial investors (for example, timberland funds).** Providing (complementary) screening information to investors concerning attractiveness of various countries for investment

Tanzania and Lao PDR were selected as target countries for case studies. The studies (1) summarized the general role and trends of the private sector in forestry development; (2) developed a representative forest investor typology paying due attention to differences between foreign and domestic investors; (3) identified and described investment process for the most typical investor categories, including national SMEs; (4) assessed to what extent the critical elements affecting business climate affect different types of forestry businesses; and (5) reviewed the use of existing
business climate assessment tools in the forest sector and the demand for new, more forest-sector-specific indicators or a tool.

**METHODOLOGY AND WORK PROCESS**

The work was carried out applying a kind of prefeasibility/feasibility study approach. The work process included finally three different phases: (1) prefeasibility assessment, (2) feasibility assessment, and (3) elaboration of recommendations for follow-up.

- **Prefeasibility phase (chapters 2–4)**
  This phase covered a review of existing investment climate studies and tools, development of typologies for relevant subsectors, and mapping decision making. The phase was mainly based on a desk study approach, combined with initial interviews of selected investor representatives (industry, development finance institution, and timberland investment fund).

  The review was carried out by analyzing the existing documents and experiences with various types of analytical instruments (surveys, indexes, rankings, and so on) used for assessing investment climate. Moreover, selected relevant stakeholders, and in particular potential users, were interviewed in order to understand the demand for the tool. The interviews also provided inputs for building the tool (concept) for piloting and enhancing its relevance/applicability from the perspective of key investor typologies.

  The outputs comprised ideas for developing the tool and especially understanding the value added potential of the tool, finalizing the investment typologies and subsectors, as well as developing the frameworks for decision-making processes by key investor types.

- **Feasibility phase (chapter 5)**
  This phase covered field testing and survey among potential investors. The survey was targeted at selected investors representing key investor categories (SMEs and large companies, strategic and financial investors, entrepreneurs). The survey did not aim at statistical analysis but on tapping expert knowledge, including personal interviews that were undertaken with selected company representatives.

  The existing indexes/tools were tested primarily by (1) applying the case study approach in Tanzania and Lao PDR including stakeholder interviews among policy makers and development agencies, (2) carrying out a survey among potential investors, (3) summarizing main findings from end user surveys, and (4) assessing and consolidating findings from all the previous phases. The feasibility was assessed mainly by field testing and targeted expert interviews among key stakeholders cross-checked with findings and conclusions from the prefeasibility phase (desk review).

  The key results from this phase were as follows:
  - Conclusions on actual demand for this type of tool (main potential users and uses)
  - Improved understanding of the applicability of the existing instruments
  - Identification of gaps in measuring the forest investment climate and understanding the value added potential of a new instrument
  - Identification of key development needs
The main criteria for assessing the feasibility were the following:

- The actual demand for this type of a tool and value added in relation to the needs of the “clients” and already available tools and sources of related information
- The likely impact of this type of a tool primarily in terms of helping to guide national reform process to improve business climate for forest and forest industry investments, and also to provide analytical information for the donor community to facilitate and guide policy dialogue
- The cost-effectiveness of the tool—that is, comparing the potential value added to the cost of developing a concrete, applicable tool and updating it regularly to maintain its relevance

Other feasibility criteria included the following:

- Sectoral coverage: can the tool be easily applied to all relevant sectors or is there a need to come with a set of tools?
- Client coverage: does the tool address all the main investor typologies well?
- Geographical and country context coverage: can the tool be applied (easily) in all main geographical areas and country contexts?
- How regularly are the indicators updated and published?
- Public domain versus a commercial product

Making recommendations for follow-up (chapter 6)

Finally, key recommendations for PROFOR, World Bank, and other stakeholders were developed. These were based on assessment of existing tool, needs assessment from interviews, and field work in the two pilot countries and feedback from the client.
BRIEF OF THE EXISTING TOOLS

The main existing relevant business climate assessment tools and surveys were reviewed, and they can be divided into three basic categories: (1) forest- and rural-sector-specific tools, (2) tools and guidelines for self-assessment, and (3) general business climate assessment tools. These tools have been developed for various purposes, including ranking, cross-country comparisons, self-assessment, or addressing just a specific, focused theme such as corruption. The review does not compare these tools but rather tries to identify in which way (for example, providing information or methodological ideas) they could contribute to the development of a tool for forest business climate assessment. Further, these tools are viewed specifically from the perspective of applying them for assessing the forest investment climate.

Forest- and rural-sector-specific tools:

- Forest Investment Attractiveness Index (earlier at the IDB, now in a nonprofit organization Sustainable Forest Business [http://www.sustainableforestbusiness.org])
- DANA/RISI (Resource Information Systems Inc.) Tree Farm Investment Attractiveness Ranking
- World Bank RICA

General business climate assessment tools or tools that can be used to measure some aspects of business/investment climate:

- ONDD (Office National du Ducroire) Country Risk Assessment covering political, commercial, war, expropriation and government, and transfer risks (http://www.ondd.be/)
- Annual GCR published by the World Economic Forum
- Worldwide Governance Indicators (WGI) by the WB (http://info.worldbank.org/governance/wgi/)
- The Financial Times fDi Attractiveness Index that allows investors to adjust their sensitivity to cost and quality to rank the attractiveness of locations for a specific sector or project (http://www.fdibenchmark.com)
Business Climate for forest investments: a survey

- Annual Index of Economic Freedom reported annually by the Heritage Foundation (http://www.heritage.org/)
- Annual Economic Freedom Report by Fraser Institute (http://www.fraserinstitute.org)
- Corruption Perception Index (CPI) by Transparency International (http://www.transparency.org/)

Self-assessment tools:
- Forest governance indicators developed by PROFOR (http://www.profor.info/sites/profor.info/files/docs/AssessingMonitoringForestGovernance-guide.pdf)

Based on previous experience with private sector operators and interviews of selected companies and timberland investment management organizations (TIMOs), companies appear to know and use only the CPI, Doing Business, and the GCR regularly. They are mainly used as general background information and as an input for screening potential investment targets. However, consulting companies including DANA/RISI, Indufor, and Sustainable Forest Business use some of the above-listed indexes in constructing their own indexes or tools to assess forest business environment and related risks. Below, the current uses of the identified tools in the forest sector are described in more detail. There are also other tools such as the Resource Governance Index (http://www.revenuewatch.org) that may have methodological relevance but are not applied and do not concern the forest sector.

The advantages and weaknesses of the most relevant tools are described in the sections below. For others, a more cursory assessment is carried out.

FOREST INVESTMENT ATTRACTIONS INDEX

The IDB developed the Foreign Forest Investment Attraction Index (IAIF, using its acronym in Spanish) in the mid-2000s to measure the business climate for sustainable forest investment. At present it is operated by Sustainable Forest Business Organization, a U.S.-based nonprofit (http://sustainableforestbusiness.org). The tool had the following intended main uses:
- Allowing comparison across countries in a given year and the evolution of each country’s IAIF performance over time
- Helping investors in making an initial screening
- Supporting countries and donors to identify key factors affecting sustainable investment in the forest sector, clarify policies, simplify regulations, and in general plan action to increase the investment attractiveness
- Improving stakeholder dialogue, and indicate areas for further research

The IAIF measures the business climate for investments in sustainable forestry and forest enterprises as a single index. It comprises 20 indicators using more than 80 variables. The indicators include exchange rate stability, political risk, trade openness, rule of law, licenses and permits, social and economic infrastructure, agricultural policies, planting and harvesting restrictions, forest resources stock and flows, supportive or adverse activities, the forest products domestic market size, and so on. These indicators are classified under three weighted subindexes: supra, inter, and intrasector
(Tomaselli 2009, Nascimento 2006). The various variables under each subindex can be seen in figure 2.1:

1. **Suprasectoral subindex.** Calculates the macroeconomic impact and other factors that affect business profitability in all business sectors of a country
2. **Intersectoral subindex.** Measures the factors generated from other economic sectors, which affect direct investments in the forest sector
3. **Intrasectoral subindex.** Evaluates the factors intrinsic to the forest sector that affect the profitability of forest businesses

In order to help countries to design strategies and actions to improve their attractiveness to direct forest investment, a process tool called Process to Improve the Business Climate for Investment in the Forestry Sector (PROMECIF) was also developed. This tool was intended to be used after carrying IAIF analysis to identify and execute priority actions to improve investment attractiveness in the forest sector. It was piloted in a few countries such as Nicaragua, Panama, and Paraguay with donor support. However, there was no real demand for such a tool by government decision makers, and it had only limited impact. Similar to the IAIF tools, PROMECIF was not institutionalized at the IDB and according to IDB staff interviews was subsequently dropped. Both tools were costly to maintain and continuous funding was not available.

**FIGURE 2.1. FOREST INVESTMENT ATTRACTIVENESS FRAMEWORK**

Source: Adapted and modified from Nascimento 2006.
In order to come up with a rating for a specific country, extensive stakeholder surveys and collection of data were needed to be undertaken in each IDB borrower country. These were carried out by research and educational organizations and consultants. The tool also relied on available public domain indexes measuring corruption and economic freedom, and so on.

**Assessment**

This is the only available comprehensive tool for systematically assessing the business environment for forest investments in the individual forest sectors within Latin America. The main advantages of this tool are as follows:

- It is comprehensive and detailed covering all the possible elements both within the sector and beyond influencing the business environment for forest investment. It can in principle be applied in a range of countries and continents.
- It can cover both forestry and forest industry and both domestic and foreign investors.
- It relies a lot on primary data collection.
- It is transparent.
- Initially it is in the public domain; available in principle to anyone.

The main weaknesses of this tool are as follows:

- It is very detailed and time consuming, and hence, also costly and simply not practical. In one country case, it cost up to $100,000 to apply the IAIF tool the first time.
- It is not very cost effective. It definitely generated new information on the investment climate in the forest sector; however, this was at a high cost without concrete evidence on the index findings being used to actively initiate reforms and changes to improve the investment climate.
- It is not demand driven but more instrument and data (supply) driven.
- It required considerable input from national stakeholders, and it was often difficult to get input and elicit participation from them.
- Many stakeholders had difficulties interpreting the actual outcome of the index.
- It was very difficult and costly to update. In the end it was not regularly updated and ceased to be public domain.
- The index gave little value added to the top-ranking countries where the bulk of new investments have, in any case, taken place.

The IAIF index ended up being more like an IDB project that ended when funding was over. Government stakeholders in various countries were not prepared to allocate their own funds for helping to develop and update the index. Government representatives could not see the long-term value of this index. There were discussions with the International Tropical Timber Organization (ITTO) and major European forest industry companies about financing and using the index, but these plans were not realized. This was mainly due to shortage of funds and to the high costs in relation to perceived benefits. The index was simply not sustainable. So when the IDB funding was over in 2008, it was decided that the “rights” to the IDB-supported investment attractiveness tools would be passed to a nonprofit organization. The Sustainable Forest Business Organization/Institute was established in Washington and run by the key person involved with the development of IAIF.
(Jose Rente Nascimento) and supported by a board with representatives (for example, from ITTO and IFC). It looks like the organization has not been very active, and applications of the tool are very limited.

In conclusion, this tool is conceptually fully consistent with the objectives of this study. It contains all the key elements that should be included in such a tool. It is still available through Sustainable Forest Business (http://sustainableforestbusiness.org). However, it is not pragmatic and fully operational considering its institutionalization and having broader appeal among the key potential clients (government policy makers, private sector, and Dutch Florint [DFI]/donors). In principle, a much simplified and less detailed version of this tool could provide a basis for a more focused tool that would combine relevance with cost effectiveness, including ease of updating.

**TREE FARM INVESTMENT ATTRACTION RANKING**

DANA/RISI has developed a commercial Tree Farm Investment Attractiveness Ranking. This is updated from time to time. There have been four such rankings in 1997, 2002, 2006, and 2011 covering seventy countries. The rating by country is based on thirteen parameters/international benchmarks covering political risk, judicial strength, competitiveness, economic freedom, corruption, country risk, WB/IFC’s Doing Business Ranking, and so on. As the name of the index suggests, this is a ranking of selected countries; it provides a single figure that indicates the position relative to the highest-ranked country.

Compared to the IAIF Index, the Tree Farm Investment Attractiveness Ranking is much simpler, albeit also less informative. It relies almost entirely on integrating various available indexes and rankings, such as the following:

- **Political risk.** Political Stability and Absence of Violence rating from the WB’s Worldwide Governance Indicators.
- **Judicial strength.** Fraser Institute rating covering factors such as protection of intellectual property, integrity of the lag system, and impartiality of courts.
- **Competitiveness.** Global Growth Competitiveness Index published annually by the World Economic Forum.
- **Corruption Perception Index** by Transparency International.

The main advantages of this ranking tool are as follows:

- It enables comparison between countries similar to the Doing Business Indicators; this is however not an important objective for this study.
- It is updated from time to time (usual time span is 4 years) and can thus provide an indication of improvements in the investment climate over time.
- It covers all relevant “forestry” countries.
- It provides information on important technical factors influencing the investment attractiveness such as land availability, growing costs, quality of infrastructure, and local labor costs (which are very important for timberland investors and plantation and processing companies).
Although it is a commercial product (must be bought as part of a bigger report), the report is relatively cheap given its comprehensive coverage and primary data collection of some sector-specific forestry data (less than $5,000).

The main weaknesses of this tool include the following:

- It does not provide much new information specific to the forest sector, and in particular it does not identify specific critical areas that possibly should be reformed to improve investment attractiveness in the forest sector.
- It is more relevant for wood production than for processing industry investments.
- It is more relevant for timberland investors than for other stakeholders.
- Data collection is not systematic, consistent, and transparent. Data are apparently mostly collected from secondary sources.
- It is not public domain; one needs to buy the study, and its quantitative information cannot be used publicly due to copyright issues.

However, the report Global Tree Farm Economics Review provides additional information and analysis that enhance the use of the Tree Farm Investment Attractiveness Ranking tool and make it more relevant and realistic thinking of the typical investor’s investment making framework. The report benchmarks forestry investment costs and returns (internal rates of returns [IRRs] for representative investments) for the main countries. It then combines the country attractiveness information with the expected IRR estimates and identifies those countries with the best long-term potential for forest plantation investment and industry development. The advantage of this approach is that it enables comparing trade-offs between risk and return for the various investment options (countries). This is how most investors approach the selection of investment targets especially at the screening or prefeasibility stage.

Many companies, including timberland investors and forest industry companies, use this ranking (and the report) especially as complementary information during investment screening and supporting assets/investment due diligences (DDs) in individual countries especially at a prefeasibility stage.

**DOING BUSINESS RANKINGS AND INVESTING ACROSS BORDERS**

The WB-IFC *Doing Business* publication is possibly the most commonly used tool for comparing business climate as regards the business regulatory environments of 180 countries. It is also one the World Bank Group’s flagship knowledge products; it was launched in 2004. The Doing Business Intel indicators provide consistent cross-country comparisons over time on ten specific aspects of a country’s regulatory framework. The main objective of the Doing Business Intel Indicator program is to advance the World Bank Group’s private sector development agenda in four ways: motivate reforms through country benchmarking, inform the design of reforms, enrich international initiatives on development effectiveness, and inform theory.

*Doing Business* benchmarking rationale is based on empirical findings indicating that the quality of the business regulatory environment affects firm performance. Simpler and smarter business regulation stimulates greater entrepreneurship, firm productivity, and economic growth. The ranking
provides one measure, based on quantitative, “objective” indicators on the quality of business climate in relation to other countries. The benchmarks are based on two types of indicators: indicators relating to the strength of legal institutions relevant to business regulation, and indicators relating to the complexity and cost of regulatory processes.

The Doing Business Intel analysis is based on a concept of a single hypothetical SME that wants to do business in a specific country. The project collects information, based on few “informants,” on the number of days, as well as the number of procedures and costs it takes to complete key business steps (World Bank 2013):

- Starting a business
- Dealing with construction permits
- Getting electricity
- Registering property
- Getting credit
- Protecting investors
- Paying taxes
- Trading across borders
- Enforcing contracts
- Resolving insolvency

The main advantages of this ranking tool are as follows:

- It enables systematic cross-country comparisons between countries, and allows individual countries to monitor their performance over time in improving the business environment.
- It is updated annually.
- It covers more than 180 countries including all the countries of interest from a forestry perspective.
- It covers all sectors in general terms with focus on tracking changes in the regulations applying to domestic and SMEs; however, it also provides useful information to foreign investors.
- The focus on SMEs is relevant for the forest sector, where SMEs tend to dominate in terms of employment and number of companies.
- It has a very high profile and has contributed to policy dialogue concerning the burdens of business regulation and initiated policy reform processes.
- It is a public domain product and is easily available.

The main weaknesses of this tool from the perspective of assessing the forest sector investment climate are as follows:

- It is not sector specific and does not provide any information applying specifically to the forest sector, for example, on the regulatory requirements concerning land/forest concessions and environmental and social aspects relating to sustainability of forest management.
The Doing Business Indicators are now complemented by Investing Across Borders (IAB) indicators that covers 87 countries and is updated annually. This World Bank Group (WB, IFC, Multilateral Investment Guarantee Agency [MIGA]) initiative compares regulation of foreign direct investment (FDI) around the world. Interestingly it also contains sector-specific measures of investment climate including agriculture and forestry. It is based on the same methodological approach as Doing Business Indicators, but the focus is on four themes important for foreign investors (http://iab.worldbank.org):

1. **Investing Across Sectors indicators** measure the degree to which domestic laws allow foreign companies to establish or acquire local firms.

2. **Starting a Foreign Business indicators** record the time, procedures, and regulations involved in establishing a local subsidiary of a foreign company.

3. **Accessing Industrial Land indicators** evaluate legal options for foreign companies seeking to lease or buy land in a host country, the availability of information about land plots, and the steps involved in leasing industrial land.

4. **Arbitrating Commercial Disputes indicators** assess legal frameworks for alternative dispute resolution, rules for arbitration, and the extent to which the judiciary supports and facilitates
The indicators analyze national regimes for domestic and international arbitration for local and foreign companies.

The land indicator has several subindexes, all of which are relevant for assessing one of the key issues influencing the investment climate in the forest sector. The indicator does not cover directly rural agriculture or forest land, but the tool has relevance beyond industrial land. The main problem with this index is that its country coverage is still limited and interesting countries from forest perspective are left out including, for example, Lao PDR, Argentina, Uruguay, and many African countries. Also, the indicator and its subindexes focus mainly on already registered land, whereas forestlands are often not registered and face sometimes conflicting claims of ownership (formal and informal).

The subindexes are as follows:

1. **Strength of lease rights index.** Compares economies on the security of legal rights they offer to investors interested in leasing industrial land, whether or not foreign and domestic companies are treated differently and whether the land can be subleased, subdivided, mortgaged, or used as collateral.

2. **Strength of ownership rights index.** Compares economies on the security of legal rights they offer to investors interested in purchasing industrial land.

3. **Access to land information index.** Compares economies on the ease of access to land-related information through the countries’ land administration systems including land registries, cadasters, and land information systems.

4. **Availability of land information index.** Compares economies on the availability of general land-related information to interested private parties through land administration institutions.

5. **Time to lease private land.** Benchmarks economies on the number of days needed to lease industrial land from a private holder.

6. **Time to lease public land.** Benchmarks economies on the number of days needed to lease public land designated for industrial use from the government.

**WB RURAL INVESTMENT CLIMATE ASSESSMENTS**

Rural businesses, including forest-based SMEs, are an important source of livelihoods in rural areas. It is widely recognized that poverty reduction in rural areas, where most of the poorest people live, will require investment in both farm and nonfarm enterprises. For that to take place, an enabling rural investment climate (RIC) is needed (Sawada 2012, World Bank 2006). The Doing Business Indicators do not measure the investment climate (business regulatory) environment in rural areas and neither do they address microenterprises.

The WB (Sawada 2012, World Bank 2008b) has developed a framework and tool called RICA. The main objectives of this tool are to benchmark the broad investment climate in rural areas and to provide information and guidance for identifying areas for reform and improvement. The RICA indicators have been developed following the Doing Business approach. However, RICA scope and methodology differ considerably from the Doing Business approach. First, the RICA aims at analyzing the quality (constraints) of the overall rural investment climate and not only the regulatory environment as is indicated by its broad set of indicators. The framework includes the following...
categories: market development, access to markets, market information, access to finance, access to inputs, management services, agriculture extension services, government regulations, infrastructure, and other government-related rural investment climate components (political and economic stability, health, security and safety, education, disaster management, and so on). Second, it includes both farm and nonfarm enterprises. Third, the methodology is based on household and company surveys in rural areas, including ones operating in the informal economy (that is, not yet formally established companies).

The main advantages of the RICA tool from the perspective of assessing the forest sector investment climate are as follows:

- It measures all the relevant elements that influence the investment climate of a forestry entrepreneur or forest-based SME or larger companies involved in processing.
- Its scope covers the most important types of investors operating in rural areas, including microenterprises, SMEs, and large companies.
- It helps with the identification of areas for reform and prioritizing action.
- It provides international benchmarking information for those countries for which RICAs are carried out.

The main weaknesses of this tool are as follows:

- It may not reflect fully the regulatory environment faced by a potential large-scale foreign forest industry investor because the indicators are based on a hypothetical domestic company employing 50 people.
- Its country coverage is currently limited to less than 10 countries.
- It does not allow comparison of performance over the years since the assessments have been carried out as one-off exercises.
- The survey is detailed and comprehensive but also expensive.

The RICAs provide very useful information for assessing the quality of the investment environment for rural forestry enterprises. The challenges they face are similar to other SMEs operating in the rural areas. However, due to the limited country coverage and no updating, RICA-tools’ usefulness for assessing the business investment climate for forestry-related investments is limited.

ANNUAL GLOBAL COMPETITIVENESS REPORT

The annual Global Competitiveness Report by the World Economic Forum is possibly the most well-known report that measures systematically and comprehensively the investment climate. It is commonly used by countries to assess the progress they have made in improving their business climate and competitiveness and also by businesses that are screening new countries where they could invest. The report has been published since 1979. It ranks countries based on the Global Competitiveness Index that integrates the macroeconomic and the micro/business aspects of competitiveness into a single index. The most recent report (2012–13) covers 144 countries.
The main objective is to measure competitiveness in each target country and provide a measure that allows ranking between countries. Since the tool aims at measuring factors that determine the level of productivity of a country, it at the same time provides one indication of investment return expectations. The main source of information is the Executive Opinion Survey (more than 14,000 surveys in the most recent report) complemented with various national statistics.

The index is divided into three thematic groupings with altogether 12 pillars that drive productivity and competitiveness:

1. **Basic requirements**
   - Institutions
   - Infrastructure
   - Macroeconomic environment
   - Health and primary education

2. **Efficiency enhancers**
   - Higher education and training
   - Goods market efficiency
   - Labor market efficiency
   - Financial market development
   - Technological readiness
   - Market size

3. **Innovation and sophistication factors**
   - Business sophistication
   - Innovation

This report is widely used by the business community, including international forest industry companies, timberland investment funds, and advisors, in assessing country investment climates. Further, this index feeds into the construction of several composite indexes such as the Tree Farm Investment Attractiveness Rankings and Index of Economic Freedom.

The main *advantages* of the Global Competitiveness Index tool from the perspective of assessing the forest sector investment climate are as follows:

- It is detailed covering many of the key elements needed to measure investment climate.
- It has very broad country coverage.
- It collects data directly from the business sector.
- It provides breakdown information (subindexes) that allows extracting measures relevant to forest business climate including property rights, investor protection, burden of government regulation, efficiency of legal framework in settling disputes, quality of infrastructure (with nine indicators), macroeconomic stability (five indicators), labor market efficiency (eight indicators),
and so on. As an example the financial market development pillar comprises the following subindexes:

- Availability of financial services
- Affordability of financial services
- Financing through local equity market
- Ease of access to loans
- Venture capital availability

- It provides information to identify in general terms areas for improvement and enables international benchmarking.
- It is in the public domain and easily available.

The main weaknesses of this tool are as follows:

- It does not include any sector-specific measures.
- It is a general measure of competitiveness and is not well suited for (rural) SMEs including forestry businesses.
- It is likely to be more relevant to bigger companies.

**WORLDWIDE GOVERNANCE INDICATORS AND CORRUPTION PERCEPTION INDEX**

The *Worldwide Governance Indicators* is a long-standing World Bank project to develop cross-country indicators of governance (http://info.worldbank.org/governance/wgi). The rationale behind monitoring governance is based on the recognition of the link between good governance and successful development including an enabling investment climate.

The WGI report on six broad dimensions of governance for over 200 countries over the period 1996–2011:

1. *Voice and accountability*. The extent to which a country’s citizens are able to participate in selecting their government, as well as freedom of expression, association, and the press.
2. *Political stability and absence of violence*. The likelihood that the government will be destabilized by unconstitutional or violent means, including terrorism.
3. *Government effectiveness*. The quality of public services, the capacity of the civil service and its independence from political pressures, and the quality of policy formulation.
4. *Regulatory quality*. The ability of the government to provide sound policies and regulations that enable and promote private sector development.
5. *Rule of law*. The extent to which agents have confidence in and abide by the rules of society, including the quality of property rights, the police, and the courts, as well as the risk of crime.
6. *Control of corruption*. The extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as elite “capture” of the state.
WGIs are based on aggregating data and indexes from already existing sources. It is a composite index that provides a synthesis of the views of a very large and diverse group of stakeholders regarding the quality of governance across countries. Some of the data sources are GCR survey and CPI.

Many of these indicators are related to factors that form key elements of a business climate related especially to political stability, regulatory quality, and corruption and are hence relevant also for measuring the business climate from forestry investors’ perspective. The earlier described Tree Farm Investment Attractiveness Ranking and the IAIF index have used elements of the WGI in constructing their own measure of forest investment attractiveness rating.

The main **advantages** of the WGIs are as follows:

- It provides a comprehensive assessment of overall governance and various components of governance including those related to investment climate such as enforcement of contracts and regulatory quality in general.
- The data are easily available in a format that allows accessing indicators that are more relevant for forestry investors including the strength of property rights.
- It has very broad country coverage (more than 200 countries).
- It is updated annually enabling monitoring performance over time.

The main **weaknesses** of this tool from the perspective of assessing the forest sector investment climate are as follows:

- It is intended to measure only governance-related aspects and thus its scope in measuring business climate is quite limited.
- It is not sector specific but an overall assessment of quality of governance in each specific country. It does not provide any information on many key aspects that are crucial for forest governance.
- Although it is useful for cross-country comparisons and assessing changes over time, it is not useful in identifying and prioritizing action to improve governance.

As a whole, the WGI tool is not very useful from the perspective of assessing the forest sector investment climate. However, some elements and indicators of the WGI can contribute to the construction of a tool for measuring forest business climate as is demonstrated, for example, by the Tree Farm Investment Attractiveness by DANA/RISI.

The **Corruption Perceptions Index** by Transparency International is used widely by the WGI and other composite indexes for measuring corruption as one element of governance. The CPI annually ranks countries “by their perceived levels of corruption.” It is a composite index determined by expert assessments and opinion surveys. As of 2012, CPI covers 176 countries.

This index is narrowly focused on one key area determining the business investment climate. In fact, there is empirical evidence on linking a higher CPI score to higher rates of foreign and domestic investment in a country (Podobnik et al. 2008; Shao et al. 2007). Corruption is difficult to measure, and therefore, CPI is based on perceptions by various stakeholders. This allows extensive country
coverage but in some cases may lead to misalignment between the ranking and actual in-country situation.

CPI has a very high international profile. Since it allows cross-country comparisons and monitoring performance (how perception of corruption changes) over time, it is commonly used by national governments in policy dialogue concerning how to address corruption. It also feeds into many other indexes such as Annual Index of Economic Freedom, Annual Economic Freedom Report, and Worldwide Governance Indicators.

CPI does not include any sector-specific information, but it is commonly used by international investors (forest industry companies, timberland investment companies) as part of their country risk assessment, especially during screening and pre-due-diligence, as well as due diligence stage. It serves as a kind of general proxy of a country risk and easiness and costliness of doing business. Both the IAIF and the Tree Farm Investment Attractiveness Ranking use CPI in constructing their own measure of investment attractiveness rating.

**COMMONLY USED FDI COUNTRY BENCHMARKING AND RISK ASSESSMENT TOOLS**

Firms evaluating alternative investment options use various country risk assessment tools in assessing the investment climate and related risk. They usually cover political, economic, and financial risk assessments. These tools belong to the mainstream and influence even capital and insurance costs in addition to contributing to the investment risk assessment and financial modeling. They are being used in addition to firms by institutional investors, banks, export credit agencies, importers, exporters, foreign exchange traders, shipping companies, and so on.

Some of the most commonly used such tools include the following:

   - Online databases and location assessment tools to appraise the attractiveness of countries for specific sectors and investment projects, including forest industries.
   - Indicators clustered around six key themes which are central for firm’s decision making: operating costs, general business environment, labor availability and quality, presence of industry cluster, infrastructure and accessibility, and living environment.
   - Commercial service; updated continuously.

2. *Euromoney Country Credit Ratings (ECR)* (http://www.euromoneycountryrisk.com): ECR is the new online tool for analyzing country (economic, political, and structural) risks:
   - Covers 186 countries, updated biannually.
   - Scores can be broken down into 15 individual country risk variables under economic, political, and structural risk scores.
   - Can be used for monitoring performance over time, as well for cross-country comparisons.
   - Commercial service, very widely used and easily accessible.
   - One of the flagship tools for political risk assessment, commercial risk assessment, war risk assessment, and assessment of expropriation, government action risk, and transfer risks.
   - Covers 240 countries and regions, continuously updated.
   - Public domain, country information easily available from the website.

4. **Economist Intelligence Unit Country Risk Service (http://www.eiu.com):**
   - Monitors currency, sovereign debt, banking sector political, economic policy, and economic structure risks in some 140 countries on a continuous basis.
   - Two- and five-year forecasts for the economic variables that are most important for risk assessment.
   - Commercial service; easily available.

   - Political risk: government stability, socioeconomic conditions, investment profile, corruption, and so on.
   - Commercial service; updated biannually.

6. **Different credit ratings**, for example, by Moody’s and Standard and Poor’s:
   - Sovereign credit rating indicates the risk level (including political risk) of the investing environment of a country and is used by investors looking to invest abroad.
   - These are very widely used and influence capital costs of investors, and financial modeling and risk-adjusted return calculations which provide the most crucial information for decision making.

These tools are very useful to all investors and financiers, including those related to the forest sector. They do not provide sector-specific information in most cases but measure especially supra- and intersectoral elements of the business climate that are very relevant also for the forest sector investors. In fact, according to various surveys (Glauner et al. 2012; Tomaselli 2009), supra- and extrasectoral factors such as political and economic stability, established property rights, well-functioning legal and banking system, a stable tax system, currency risk, and level of corruption are very important factors when making decisions concerning investments in a developing country.

These tools are less useful for initiating policy dialogue and reform because they are targeted specifically at the private sector and especially foreign operators. Further, many of them are commercial services. However, for example, sovereign credits ratings are closely followed by national governments and can hence act as a general stimulus for reforms concerning the national economy.
ANNUAL INDEX OF ECONOMIC FREEDOM AND ANNUAL ECONOMIC FREEDOM REPORT

Annual Index of Economic Freedom reported annually by the Heritage Foundation (http://www.heritage.org/). This index has been calculated since 1995 and currently it covers 185 countries. It measures ten components of economic freedom using altogether 50 economic variables, many of which constitute key elements of a business climate:

- Rule of law. Property rights, freedom from corruption
- Limited government. Fiscal freedom, government spending
- Regulatory efficiency. Business freedom, labor freedom, monetary freedom
- Open markets. Trade freedom, investment freedom, financial freedom

The annual Economic Freedom Report by Fraser Institute (http://www.fraserinstitute.org) is similar (not only in the name) to the Index of Economic Freedom.

The index published in Economic Freedom of the World measures the degree to which the policies and institutions of countries are supportive of personal choice, voluntary exchange, freedom to compete, and security of privately owned property. This is a composite index using 42 variables to measure the degree of economic freedom concerning the following:

1. Size of government. For example, taxation
2. Legal system and property rights. For example, protection of property rights, legal enforcement of contracts, regulatory restrictions concerning the sale of real property
3. Sound money. For example, inflation, freedom to own foreign currency bank accounts
4. Freedom to trade internationally. Tariffs, trade barriers, black market exchange rates, and controls of capital and people
5. Regulation: Credit, labor market, and business

For both of these indexes and especially their subindexes dealing with openness of the economy and trade, strength of property rights are very important when assessing the investment climate. Forest industry companies and timberland investors must have secure and easy access to inputs and freedom to trade as well to exit and transfer profits.

Both of these indexes have been used to construct composite timberland investment attractiveness indexes by DANA/RISI and IDB (see pages 8–12).

PROFOR FOREST GOVERNANCE INDICATORS

Quality of governance is known to influence the level of investment activity and economic growth. There are general indexes describing the quality of governance such as the WB WGI. International timberland and forest industry investors put a lot of value on some aspects of forest governance including in particular those related to land tenure and property rights, transparency and accountability, and stability of policy making, as well quality of legislation and its enforcement. WB/PROFOR has
developed a specific tool that consists of a set of 130 indicators and a protocol for scoring the indicators under three pillars:

1. Policy, legal, institutional, and regulatory frameworks
2. Planning and decision-making processes
3. Implementation enforcement and compliance

The PROFOR governance indicators are one of the few tools available that tries to measure directly based on stakeholder works and a survey instrument some key forestry-specific governance elements of investment climate. The most relevant indicators from the perspective of business climate assessment deal, for example, with the following:

- The role of the private sector in country’s national forest policy/strategy
- Access to means to resolve disputes related to land tenure, ownership, and use rights
- Government promotion of forest-based SMEs
- Transparency of concession and sale allocation processes
- Freedom of the forest agency from political interference
- Stability of forest policies and regulations
- Existence of market-based incentives to encourage private investments
- Competiveness of the timber market
- Access to capital
- Enforcement of forest-related contracts, and forest-related laws in general
- Several indicators dealing with clarity and strength of land tenure and property rights and their enforcement
- Corruption in forest sector
- Availability of forest resource (growth) information

The advantages of the PROFOR forest governance tool from the perspective of assessing the forest sector investment climate are as follows:

- It addresses a large number of factors that influence specifically the investment climate in the forest sector.
- It is in principle relevant for a range of forest investor typologies including communities, households, and SMEs.

The main weaknesses of this tool in assessing the investment climate are as follows:

- Country coverage is very limited; as of now Burkina Faso, Uganda, Kenya, Liberia, Madagascar, and (part of) Russian Federation. In fact, the tool has not been intended for systematic coverage but more as a tool to be applied based on demand.
- The tool would be cumbersome to apply as such because of the huge set of indicators.
- The involvement of the private sector in contributing to assessment in the selected countries has been quite limited.
- It is not known by investors, or the private sector in general.
CONCLUSIONS

The review of the available tools against the evaluation criteria allows drawing the following conclusions:

1. There are already plenty of tools that can be used and are commonly used for measuring business/investment climate in a broad range of countries. Some of them are public domain (Doing Business Indicators, Global Competitiveness Index, WGI, and so on) and others require subscriptions (Euromoney Country Credit Risks, fDi, and so on).

2. Doing Business Indicators and the new Investing Across Borders indicators provide systematic and comprehensive information covering both domestic and foreign investors, and SMEs, as well as bigger companies (to a lesser extent, though). It is difficult to see the benefit of trying to develop indicators covering the regulatory environment just for forest-based enterprises.

3. Commercial services assess well most of the key extrasectoral elements of the business climate for the various sectors including forestry and forest industry, and complement the measures of the business climate provided by public domain tools such as the Doing Business, Corruption Perception Index, Investing Across Borders, and so on.

4. Only the WB RICA tool provides assessments of the investment climate in the rural settings relevant for micro- and SMEs and in particular to decision makers concerned about improving the rural investment climate. It is, however, more a research type product and has very limited country coverage. But, it is relevant for carrying out a diagnostic study on constraints related to rural investment climate, in general including forest-based formal and informal enterprises. There is in principle no need to develop a new tool for such a one-shot analytical purpose.

5. Most of the tools that provide relevant information for domestic and international manufacturing companies apply also to forest industry companies that want to assess the investment climate. This applies both to public and commercial tools.

6. However, the commercial tools, albeit often monitored and used even national decision makers, are less useful for governments and donors from the perspective of identifying areas for reform to improve the business climate than, for example, Doing Business Indicators.

7. There are two available tools that have been tailored to measure/rank forest investment attractiveness: IDB-developed IAIF (originally public domain, now not a very actively used commercial service) and DANA/RISI Tree Farm Investment Attractiveness Ranking (commercial report). Both of them were evaluated. Out of these two the IAIF is most comprehensive in terms of scope capturing all key elements of the forest sector investment climate. However, it is not practicable and cost effective because of the very large number of indicators and a complex system of collecting data. The Tree Farm Investment Attractiveness Ranking provides useful information for ranking countries and some guidance in selecting investment targets but does not provide guidance for government decision makers and the donor community regarding key areas and priorities for reform.

The available tools and their applicability to measure forest investment attractiveness/investment climate are presented in table 2.1.
### Table 2.1: Existing Tools for Business Investment Climate and Their Capability to Measure Critical Factors for Forest Investment Attractiveness

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<thead>
<tr>
<th>Factors Impacting Forest Investment Climate Versus Existing Tools/Indices</th>
<th>Index/tool</th>
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<tr>
<td></td>
<td>IAIF / IDB</td>
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<td>Common Factors</td>
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<td>Political, social and economic stability</td>
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<td>Economic and demographic growth</td>
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<td>Trade openness</td>
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<td>Taxation</td>
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<td>External Factors on Forest Sector</td>
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<td>Economic and social risks (and infra)</td>
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<td>Infrastructure (roads, ports, energy)</td>
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<td>Regulation (permits, licenses)</td>
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<td>Governance, law enforcement</td>
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<td>Enforceability of contracts</td>
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<td>Corruption</td>
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<td>Property rights; security of land tenure</td>
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<td>Internal Forest Sector Factors</td>
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</tr>
<tr>
<td>Existing forest resources</td>
<td></td>
</tr>
<tr>
<td>Access to markets / logistics</td>
<td></td>
</tr>
<tr>
<td>Financial services</td>
<td></td>
</tr>
<tr>
<td>Growing conditions</td>
<td></td>
</tr>
<tr>
<td>Costs of key inputs</td>
<td></td>
</tr>
<tr>
<td>Social and environmental risks</td>
<td></td>
</tr>
<tr>
<td>Subsidies and other incentives</td>
<td></td>
</tr>
<tr>
<td>Sector specific regulations; enforcement</td>
<td></td>
</tr>
<tr>
<td>Availability, quality, and cost of land</td>
<td></td>
</tr>
<tr>
<td>Available technology and skilled labor</td>
<td></td>
</tr>
<tr>
<td>Management services and partners</td>
<td></td>
</tr>
</tbody>
</table>

- **Included by the tool/index**: Covered by the tool/index
- **Not covered by any tool**: Not covered
- **Only covered by commercial DANA/RISI reporting**: Only covered by commercial DANA/RISI reporting
- **Only very limited coverage**: Only very limited coverage
- **Only Latin America and not updated any more**: Only Latin America and not updated any more
Based on this analysis, there are no major gaps related to assessing factors common for all businessmen that influence the forest investment climate, though there are a number of deficiencies, which are discussed later in the report. There are a number of tools available even in the public domain, which are updated annually and are easily available (assuming that one knows about their existence). However, there are gaps especially concerning assessment of internal factors influencing the investment climate:

- The rural investment climate under which most forest-based enterprises operate is not well captured by any existing regularly and widely (in terms of country coverage) applied tool. WB’s RICA is a comprehensive and relevant tool that focuses solely on the rural investment climate, but its country coverage is limited. International Finance Corporation Doing Business indicators have a comprehensive country coverage, but the focus is on urban SMEs and on regulatory constraints to SME investment.

- Due to the specific long-term nature of forestry investments linked to land, it would be important to get more relevant information on the investment climate and risks related to forest land tenure and property rights. This issue was raised also in the interviews of senior representatives of two of the leading international forestry and forest industry companies.

- None of the available tools are good in measuring social and environmental risks related to forestry (plantation) investments. Often these risks are related to land use and also to environmental policies and regulations as well as to the fact that the existing tools do not really address informal systems related, for example, to forest tenure.

- With an exception of PROFOR’s Forest Governance Indicators, governance elements specific to forest investments are not really measured by any of the available tools.

- Finally, internal physical, technical, and market factors within the forest sector of the investment climate are not addressed adequately by any of the tools with an exception of the IAIF tool, and to a lesser extent the DANA/RISI Tree Farm Investment Attractiveness Ranking.

The main conclusions based on the desk review are as follows:

- There is not enough value added (in relation to costs) in developing new tools and indicators just to cover the common investment climate assessment of the industrial forest investors. The coverage is already quite good in terms of countries and range of factors determining the common investment climate. This is confirmed by the fact that major forest companies and their financiers, insurers, and exporters already widely use the various available tools. The commercial tools/services have been developed to meet the demand; they prosper year after year because clients are prepared to pay for the service.

- There are apparent gaps when it comes to the internal forest sector factors of the investment climate. Some of them are beyond the control of policy makers (location, market growth, growing conditions, and quality of land) but many such as incentives, sectorial governance, infrastructure, improving land availability and tenure security, and improving access to finance, for example, through better integration of national companies with international companies and capital, can be influenced by government and donor action. Hence, having more information on these determinants of the forest specific investment climate would be desirable and needed especially by policy makers.

- A lot of the more detailed intrasector information is something that the private sector (investors) should be responsible for obtaining. Companies must and, in most cases, are ready to invest
themselves in removing some constraints to investing such as lack of information or technology, for example, collecting some of the needed information themselves or using consultants. Private consulting companies have already identified demand for these types of services and are filling some of the gaps—for a fee. However, there are also public good elements in information provision. For example, ensuring access to reliable data on weather, availability of suitable land, and existing forest resources can facilitate private sector investments.

The adequacy of the existing instruments in measuring the business and investment climate in a country depends on from whose perspective the investment climate is viewed. Donors and government decision makers would use this type of tool for different purposes than the private sector, for example, for policy analysis and dialogue and initiating reforms. Private companies, especially large international investors, would use this type of information, for example, to screen countries for investment. Further, different types of private investors have different needs and face different challenges (or feel same constraints differently). Hence, developing a representative investor typology and forming a generic investment decision-making framework by investor type is important.
FOREST INVESTOR TYPOLoGIES AND INVEStMENT FRAMEWORKS

FORESTRY AND FOREST INDUSTRY INVESTOR TYPOLoGIES

The forest investor universe is broad ranging, from family-run microbusinesses to large-scale international pulp and paper industries. Table 3.1 provides an overview of the most common types of investors. It provides a realistic picture of the forestry and forest enterprise investor universe, and pays attention to differences in the nature of investors. It also includes SMEs operating in harvesting and transport and various service providers as well as joint ventures between different types of investors. Table 3.2 outlines the main features of investor categories.

Considering the objectives of this study, it is necessary to narrow the investor categories into a more pragmatic framework. Determination of the most representative and relevant investor typologies was based on the following criteria:

- To what extent the investment process and the likely impact of the business environment, and its different elements, differ (or are similar) between the different investor types
- Which types of investors/businesses are most important in terms of volume of investment, value added potential, and employment potential
- To what extent investors in different categories are themselves likely to benefit from this type of tool

Microenterprises. Microenterprises and small enterprises, as well as investments in locally controlled forest and land resources by smallholders represent an important rural investor category. The typical investment size is often below $1,000 and the number of workers limited to 5 to 10 persons. However, as mentioned in section 1.2 on the scope of the study, the focus of this study is on formal forestry and forest industry investors.

Small and medium enterprises (SMEs). Small and medium forest enterprises, like all SMEs, play a crucial role in forest sector investment and development and in developing countries, and also in the provision of auxiliary services, for example, through outsourcing and subcontracting. The investments range often between $1 to 5 million and number of workers can be up to 50 to 100. They can make up to 80–90 percent of enterprise numbers and more than 50 percent of forest-related jobs (Macqueen 2008). The smallest operators may be serving only very local markets and are often family businesses. Their challenges are in some respects, for example, regarding access to financing and regulatory constraints, similar to those
of microenterprises. However, some medium-sized enterprises may be major suppliers both to the national and export market. Their operating/business environment is in some respects closer to large-scale national and international investors, but they face their own challenges due to smaller size. In many, especially small, developing countries they represent the biggest investor group in totality in the sector.

Strategic investors (domestic and international) and financial investors. In terms of investment volume and value, large-scale forestry and forest industry companies dominate investment flows in developing and emerging countries. The typical investment size ranges from $50 to $100 million and number of workers exceeds 100 persons. In some countries such as Brazil, Chile, and Indonesia, large companies are mainly national or regional operators. Some of them are so big and growth-oriented that they have started investing abroad, especially within the same region (South-to-South investment). However, in most developing and emerging countries international forest companies are still the leading investors in wood production and industrial processing; in recent years South-to-South investments have been increasing. In many developing countries, international investors may be the only ones investing on a large scale. In the last ten years, a new important international forestry investor class has emerged. TIMOs and timberland investment funds are increasingly active in Latin America and Asia, and to some extent also in Africa. Their investments in developing/emerging countries may already exceed $20 billion but still pale in comparison to the volume of forest industry investment. In most parts, their investment framework and critical factors influencing investment attractiveness are similar to large-scale foreign forest industry companies.

The most important difference between international TIMOs/timberland funds/forest industry companies and national investors is the fact that international operators have the freedom to choose where to invest. The quality of the business environment is one of the key factors they use in screening investment targets (countries). Further, a domestic investor is not exposed to foreign exchange risk like a foreign investor (for example, a timberland fund whose investment may be 100 percent exposed to foreign exchange fluctuations at time of exit) and does not have to meet some of the regulatory requirements specific to a foreign investor such as getting a license to operate in the country, or deal with risks related to expatriation of profits and some taxation issues.

The investor categories are also site and context specific. In large economies (for example, Brazil or Indonesia), even medium-sized enterprises would be considered large in smaller forest economies. When making comparisons the relative size needs to be considered even if there are no specific limits.
### Table 3.1: Overview of the Most Common Types of Investors

<table>
<thead>
<tr>
<th>Nature of operators</th>
<th>Entrepreneurs, Communities, Smallholders</th>
<th>Strategic Investors</th>
<th>Financial Investors</th>
<th>Other: Prestige Environmental Nongovernmental Organizations (ENGOS): Social and Environmental Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of operators</td>
<td>Entrepreneurs, difficulty expanding operations and complying with international standards to obtain financing. In some cases these companies have international links.</td>
<td>Raw material sourcing for industrial production. Minimizing costs. Increasing markets, scaling up. Mainly large-scale but also medium-scale operators. Both international and local. Large companies are often linked to SMEs that provide a range of services.</td>
<td>Raw material sourcing for industrial production. Minimizing production costs. Many new operators, energy companies looking at feedstock.</td>
<td>For financial profit, portfolio diversification. Many cases keen on direct involvement, for example, in teak. Long-term conservation-driven interest, however, want to make positive bottom line.</td>
</tr>
<tr>
<td>Nature of operators</td>
<td>Often informal, opportunistic, not capable of complying with normal business reporting or accessing finance.</td>
<td>Often family entrepreneurs, difficulty expanding operations and complying with international standards to obtain financing. In some cases these companies have international links.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Subsector

<table>
<thead>
<tr>
<th>Subsector</th>
<th>Nature of operators</th>
<th>Entrepreneurs, Communities, Smallholders</th>
<th>Strategic Investors</th>
<th>Financial Investors</th>
<th>Other: Prestige Environmental Nongovernmental Organizations (ENGOS): Social and Environmental Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural forest management</td>
<td>Annual cutting licenses, community concessions, joint forest management (JFM)</td>
<td>Concession management, often only exploitative harvesting</td>
<td>Concession management, often only exploitative harvesting</td>
<td>Concessions (only few such examples exist)</td>
<td>Conservation concessions, REDD pilots, payments for environmental services</td>
</tr>
<tr>
<td>Plantation establishment</td>
<td>Own plantations, outgrower schemes, small-scale tree growing for combined own and commercial use</td>
<td>Both integrated industrial plantations and stand-alone commercial plantations, including bioenergy</td>
<td>Plantations—feedstock for power plants</td>
<td>Both greenfield and “brownfield”; that is either establishment of new assets or acquisition of existing assets</td>
<td></td>
</tr>
<tr>
<td>Harvesting and transport, various service providers</td>
<td>Often own labor used</td>
<td>Own and local labor</td>
<td>Forest industry companies increasingly outsource harvesting and transport and even forest management</td>
<td>TIMOs can also outsource harvesting and transport and sometimes even forest management</td>
<td></td>
</tr>
<tr>
<td>Processing</td>
<td>Micro- and small enterprises</td>
<td>Oriented for local markets</td>
<td>Often export-oriented pulp and paper, but also sold wood industry</td>
<td>Bioenergy plants</td>
<td>Investments (often relatively small) almost always linked to the forestry investment</td>
</tr>
<tr>
<td>CHARACTER</td>
<td>MICROENTERPRISES</td>
<td>SMES</td>
<td>LARGE SCALE</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-------------------------------------------</td>
<td>--------------------------------</td>
<td>----------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Typical number of workers</td>
<td>5 to 10</td>
<td>10 to 100</td>
<td>&gt;100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Possible investment size</td>
<td>&lt;$1,000</td>
<td>Up to $5 million</td>
<td>&gt;$50 million</td>
<td></td>
<td></td>
</tr>
<tr>
<td>“Status”</td>
<td>Informal</td>
<td>In most cases registered, in rural areas sometimes informal</td>
<td>Registered; sometimes rated</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decision-making process</td>
<td>Opportunistic, often linked to livelihoods, very risk averse</td>
<td>Opportunistic but business oriented</td>
<td>Systematic, higher appetite for risk</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk assessment</td>
<td>Not systematic and analytical</td>
<td>Opportunistic</td>
<td>Systematic</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technology</td>
<td>Low</td>
<td>Low</td>
<td>High/appropriate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to finance</td>
<td>No beyond informal financing</td>
<td>Limited</td>
<td>Good</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Permits/license</td>
<td>Can act as barriers to entry</td>
<td></td>
<td>Managed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal compliance</td>
<td>Often weak—for example, taxes are not paid. On the other hand, microenterprises are usually beyond regulating</td>
<td>Higher requirements but better resources for compliance</td>
<td>Good compliance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Environmental compliance</td>
<td>SMEs often in a weak position to address environmental regulation. On the other hand, microenterprises are usually beyond regulating</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to information</td>
<td>Limited</td>
<td>Better access than what SMEs have</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to markets</td>
<td>Often only local markets</td>
<td>Access both to domestic and international markers is important</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Same in principle, but since markets for microentrepreneurs are local, needs are more constrained</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land issues</td>
<td>Same but small operators often have to deal in an informal environment and are in a weaker position to secure or enforce rights crucial for investing in land</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Costs of inputs</td>
<td>Same in principle but unit costs can be higher to smaller operators</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulations, enforcement</td>
<td>Same but the burden can feel heavier for very small operators</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to support services</td>
<td>Very little or no services to microentrepreneurs; rural SMEs have weaker access than urban SMEs</td>
<td>Good access</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Large-Scale (Strategic) Industrial Investor

A generic framework for a large-scale industrial investor was developed based on literature review and expert interviews. There are also some relatively recent studies which have surveyed the most critical factors influencing forest investments (for example, Glauner et al. 2012; Mendell et al. 2011; Smith 2010; Tomaselli 2009). The investment environment of a firm is in business literature and research commonly divided into firm, industry, and macroenvironment. This coincides with the concepts of supra-, inter-, and intrasectoral factors under the IAIF framework in table 2.1 (Nascimento 2006). It is also consistent with approaches used in advising international forestry companies, investment banks, and timberland funds to help them in screening countries and new areas for major forestry and forest industry investments. For the sake of clarity, the factors have been divided into common factors impacting all businesses, external factors that originate from other sectors, and factors internal to the forest sector as discussed earlier. In figure 3.1 these factors are presented in a simplified investment decision-making cycle. (There is naturally some overlap between the factors, especially in phases 2 and 3, but the question is more about the detail and depth of the assessment.)

In order to understand what types of assessments and information are needed by investors or their advisers, it is important to look at the decision-making process affecting the location of the investment(s). This will put the role of the planned forest investment climate assessment tool into perspective.

An industrial investor planning to establish integrated forestry and processing operations in new areas, for example, in a developing or an emerging country, would do it theoretically in three phases:

**Phase 1:** Product supply chain and wood fiber sourcing strategy: determines already the regional priorities

**Phase 2:** Screening investment locations

**Phase 3:** Choosing the exact location (executing)

The main demand for tools measuring business climate would be at phase 2, that is, screening facility/investment location (country). This phase is similar to the Host Country Determinants (Smith 2010). However, at least the large-scale industrial investors will do their own homework with or without the existing tools provided by various organizations.
Forestry and forest industry companies are targeting new markets especially to look for opportunities for growth and naturally increasing revenues and profits (often with emphasis on production and distribution cost minimization). One of the key determining factors of the broader investment climate is the potential offered by large, growing markets (domestic and export).

Forest industries’ competitiveness and potential to scale up and expand are dependent on having good access to wood fiber at a reasonable cost. All the factors that influence the wood fiber cost at the mill gate and final product price are of crucial importance to industrial investors, including access to trained labor at a reasonable cost. External elements of the investment climate influence the investment decisions of the international investor, but they are just a set of factors among many that affect profitability and risks. One can simplify that in the end all these factors come down to the (cost) competitiveness of wood production either at the mill or at the port, or the price of the final processed product at the main market areas. Firms’ decision making is in most cases driven by perceived business opportunities (see discussion above and figure 4.1, also Tomaselli 2009). Business climate factors of course affect decision making, but unless the companies initially see significant business opportunities, they will not necessarily start assessing risks related to business climate.

Further, an industrial investor is often prepared to accept higher risks and costs related to burdensome regulations as long as the risks are compensated by having access to adequate, high-quality land with good growing conditions. However, this requires looking at all key elements of the investments climate and having some kind of measures of related risks and costs to enable analysis of trade-offs between profitability or wood fiber costs and various risks associated with the investment environment.
Timberland (Financial) Investor

Based on the various studies (for example, Glauner et al. 2012; Tomaselli 2009) and practical experience from investors, the key factors timberland investors identify as most crucial for investments have been summarized in table 3.3. What naturally varies is the “weight” the investors give to different factors, reflecting the investment objectives and priorities, and the portfolio and risk management policies of the underlying organizations (often pension funds).

In principle, the timberland investors view the investment climate in a similar way as industrial investors, although the investment cycle is a little bit different. Timberland investor’s focus is on maximizing the risk-adjusted returns and ensuring a successful exit. This means that factors such as “thinness” of national secondary timberland markets (including shortage of other funds and TIMOs) and the number and capacity of national forest industry companies are part of timberland critical investment climate (table 3.3).

**TABLE 3.3. INVESTMENT CYCLE OF A TIMBERLAND INVESTOR (FUND)**

<table>
<thead>
<tr>
<th>INVESTMENT PHASE</th>
<th>CRITICAL FACTORS</th>
<th>INFORMATION NEEDED</th>
<th>TOOLS USED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>Portfolio diversification opportunities</td>
<td>Institutional and other investors often influence the country selection based on their return expectations, risk management policies, and own environmental, social, and governance (ESG) principles</td>
<td>General tools such as country risk (premium), credit ratings, CPI</td>
</tr>
<tr>
<td>strategy</td>
<td>New opportunities offered by growing demand and supply imbalances and market imperfections (for example, asymmetrical information)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>formulation</td>
<td>Perceived regional and country risks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Screening</td>
<td>Business opportunities offered by the country</td>
<td>Market analysis</td>
<td>Doing Business Indicators</td>
</tr>
<tr>
<td></td>
<td>Growing conditions</td>
<td>Review of growing conditions and operating environment</td>
<td>CPI</td>
</tr>
<tr>
<td></td>
<td>Access to markets</td>
<td>General assessment of key risks</td>
<td>Global Competitiveness Index</td>
</tr>
<tr>
<td></td>
<td>General business climate</td>
<td></td>
<td>Tree Farm Attractiveness Index</td>
</tr>
<tr>
<td>Pre-due diligence</td>
<td>Main focus is on technical asset and market appraisal, including appraisal of a forest management service company as well as risk analysis covering country, financial, market, environmental and social risks</td>
<td>Already at this stage, assessment of critical investment climate aspects relies on more in-depth analysis than what can be provided by various tools/indexes</td>
<td>Doing Business Indicators</td>
</tr>
<tr>
<td>Due diligence</td>
<td>Includes a thorough assessment of financial, legal, technical, market, social, and environmental aspects, costing, and financial modeling</td>
<td>Most of the work is based on collection and analysis of primary data, and carrying out separate legal, financial, and tax due diligence assessments. Information needs for decision making go far beyond general information provided by existing business climate tools Country risk (premium) analysis using available tools is a critical element of financial modeling to determine risk-adjusted return</td>
<td>Doing Business Indicators, CPI, Global Competitiveness Index, Tree Farm Attractiveness Index, and other indicators such as WGI are used to complement general background describing investment climate and related risks</td>
</tr>
</tbody>
</table>

continued on next page
#### MAPPING THE INVESTMENT FRAMEWORK OF AN SME INVESTOR

The developed typology of main forestry investors highlights the importance of treating forest-based SMEs as well as microenterprises separate from large companies. Many of them operate (almost by definition) in rural areas and face different challenges than bigger operators. Quality of rural infrastructure (roads, transport, communication, electricity, water), access to markets and information on forest product markets, and access to financial and business development services are primary constraints to nonfarm SMEs. Further, the burden of regulations (licenses and permits) falls harder on rural SMEs, for example, because the costs are relatively higher (sometimes maybe even excessive) and it is not as easy for rural SMEs to deal with the bureaucracy.

Forest-based entrepreneurs face specific challenges related to insecure land tenure and access rights. Most of the forest land has not been registered, and there are commonly conflicts between informal land rights and state control of land.

At the same time, there are many similar elements in the investment climate (constraints) between larger industrial and financial investors and rural forestry investors (compare figure 3.1 and figure 3.2). This is also explained by the fact that forest investments almost by definition take place in rural areas (where land is available). However, the investment decision-making process of SMEs and microenterprises is typically opportunistic and does not follow a systematic cycle as the large-scale strategic and financial investors do.

In many developing and emerging countries, large industrial investors and timberland funds treat farms and rural entrepreneurs as integral parts of the business operations; they provide labor and also often land. Large companies are regularly dependent on SMEs for plantation establishment, road building, nurseries, maintenance, harvesting, and logistics in many locations such as Brazil, Chile, China, Tanzania, South Africa, and so on. Smallholders and companies can also create partnerships to their mutual benefit, which can also include investments in locally controlled land and forest resources. Critical conditions that can enable this type of investment include the clarity of land and forest tenure, transparency and accountability, and functioning governance systems including the possibility to organize for joint action (for example, wood producer associations).

A tool that would capture the above described elements of the investment climate could help with identifying corrective action. For example, the tool can indicate the need to develop rural electricity and communication systems, improve roads to connect entrepreneurs and customers to the market,

<table>
<thead>
<tr>
<th>INVESTMENT PHASE</th>
<th>CRITICAL FACTORS</th>
<th>INFORMATION NEEDED</th>
<th>TOOLS USED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment execution</td>
<td>• Focus on value creation through good asset and risk management, business development, and strategic positioning</td>
<td>• Own information collection and analysis</td>
<td>• No need for any external tools</td>
</tr>
<tr>
<td>Exit</td>
<td></td>
<td>• Own information collection and analysis</td>
<td></td>
</tr>
</tbody>
</table>

---

**TABLE 3.3. INVESTMENT CYCLE OF A TIMBERLAND INVESTOR (FUND) (continued)**
expand business development services to rural areas, and develop tailored financing mechanisms attractive for forest investments and accessible by small entrepreneurs.

**FIGURE 3.2. RURAL INVESTMENT CLIMATE FOR FOREST-BASED SMEs**

Source: Simplified and Modified based on Sawada 2012.
PART IV

Chapter 4. ALTERNATIVES AND FRAMEWORKS FOR FOREST INVESTMENT ASSESSMENT

MAIN PRINCIPLES AND THE INVESTMENT FRAMEWORK FOR DEVELOPING THE TOOL

A forest-sector-specific tool for assessing investment climate should focus on providing information needed by the “clients” and generating value added in relation to the already available tools and sources of related information. This requires an initial analysis on what would be the main likely uses and who would be the most relevant users of the tool.

The tool has to be relevant for the national policy development. It should provide guidance for the national reform process to improve the business climate for forest and forest industry investments, and also provide analytical information for the donor community to facilitate and guide policy dialogue and planning of reforms. Moreover, it is important that the existing relevant tools and information are made use of to enhance cost efficiency. Ways of using, for example, relevant subindexes of existing tools must be maximized. It makes sense to try to collect/measure data in a consistent manner with already widely used tools.

The tool should be able to fill gaps and focus on those important areas that are not yet adequately covered. It also has to be cost effective and practical. This can be tested by comparing the potential value added to the cost of developing a new, applicable tool and updating it regularly to maintain its relevance. The tool should be simple, easily updatable and maintained, and as widely applicable as possible instead of having a range of tools for each different context.

Finally, the tool should ensure a clear focus. This is partly related to the simplicity and cost criteria but more on ensuring that the tool is not overloaded, making it difficult to apply.

The generic framework covering the most important factors impacting the forest investment is presented in figure 4.1. The factors have been divided to common factors impacting all businesses, external factors that originate from other sectors, factors internal to the forest sector, and finally key business opportunity drivers.
OPTIONS FOR A TOOL TO MEASURE THE FOREST BUSINESS AND INVESTMENT CLIMATE

Two options were identified for further development of a tool to measure the forest business and investment climate:

1. Make use of the existing tools and information in a more efficient way.
2. Develop an instrument that is built on the foundation of existing tools; that is, taking full advantage of the existing indexes. The additional data requirements would be limited to the most critical information regarding the sector specific investment environment.

There are advantages and disadvantages to using the existing tools for measuring investment climate in a more efficient way or developing a totally new instrument. Country case studies and the end user survey were carried out to gain more insights on the demand for this kind of a tool and guidance for deciding what would be the best way to proceed.

FIGURE 4.1. FRAMEWORK FOR THE FOREST INVESTMENT CLIMATE TOOL
INTRODUCTION

The feasibility of the two options—whether to use the existing tools measuring investment climate in a more efficient way or whether to develop a totally new instrument—was tested with country case studies in Tanzania and Lao PDR as well as with an investor survey focusing on interviewing some of the key players and informed individuals and organizations. The country case studies covered all the stakeholders: forest companies from SMEs to forest funds, government agencies, and policy decision makers. The investor survey focused on global strategic investors (forest and energy companies), forest funds, and development finance institutions.

CASE STUDIES

Overview

Two case studies were conducted: one in Lao PDR and the other in Tanzania. In both cases, national consultants completed the following:

- Summarized the general role of the private sector in forestry development and the recent developments concerning investment trends in the forest sector, policy and regulatory frameworks, and forest investment promotion activities
- Developed a representative forest investor typology paying due attention to differences between foreign and domestic investors
- Identified and described the investment process for the most typical investor categories
- Assessed to what extent the critical elements affecting business climate affect different types of forestry businesses (large-scale tree planters, medium-scale tree planters, small-scale tree planters, large wood industries, medium-size wood industries, and small-scale wood industries)
- Reviewed the use of existing business climate assessment tools in the forest sector and the demand for new, more forest-sector-specific indicators or a tool

The work was based on (1) reviewing policy and legal documents, (2) interviewing forestry officers and other government officials dealing either directly or indirectly with forestry and wood processing investments during different stages of the investment cycle, and (3) interviewing industry representatives.
Investment Process and Investor Typologies

Typical investment processes were identified in Tanzania (figure 5.1) and Lao PDR (figure 5.2).

**FIGURE 5.1. DESCRIPTION OF A TYPICAL INVESTMENT PROCESS IN TANZANIA**

- Obtaining Information/Feasibility Study
- Formation and Registration of a Company
  - Registration with TLC
  - Registration with MNRT
- Procurement of Land
- Procurement of Forest Resources for TFS and Industrial Buildings
- Environmental Certification
- Licenses and Permits
- Small Enterprises
- Operationalization

**Abbreviations:**
- **TLC:** Tanzania Land Commissioner/Commissioner of Lands
- **MNRT:** Ministry of Natural Resources and Tourism
- **TFS:** Tanzania Forest Service
Using this framework, an assessment was made on how the general business climate with focus on regulatory aspects (but also access to credit and markets) in the country affects each of the identified investor categories. The main findings from these case studies are summarized below.

**Investment processes differ between different types of investors.** The main differences are between small tree growers and processors and medium-size/large operators. At least in these two countries, regulatory requirements do not differ much between foreign and domestic investors when it comes to the investment process, for example, registering a company. However, if a company is exporting, new regulations step in force. The survey did not assess in detail the differences in taxation and subsidies, but a review of investment promotion policies in Tanzania confirmed that foreign investors could receive preferential treatment. Hence, from that perspective business climate indicators should pay attention to the origin of the forest investor.

**Indicators should pay attention to the nature (size) of the investor.** Although many of the regulatory business climate elements, such as a need for a business license or access to credit are similar, there are also significant differences. Foreign investors (naturally) face more regulations and more cumbersome processes when compared to domestic investors, for example, in relation to getting an investment permit, and forming and registering a company. Small domestic tree growers and
processors do not need to acquire as many permits as bigger operators. However, since most operators, irrespective of size, face the same regulatory requirements, one can draw a conclusion that these requirements can hinder or even prohibit formal investments by small operators operating especially in rural areas. For example, in the case of Tanzania, it is necessary that a company must be registered to obtain credit from a bank, but small and microenterprises are not registered. Also, in Tanzania only companies registered in the Investment Center could receive subsidies.

These findings suggest that in general there is a need to have indicators that pay attention to the nature of investors: large-scale industrial tree growers and small-scale tree growers face different challenges concerning the business climate.

**Use of Existing Business Climate Tools and Indicators**

In Lao PDR, the WB/IFC Doing Business indicators were not well known or used in the forest sector. This applies both to forestry and forest-related administration, as well as to forestry and forest industry operators. In addition, other available indicators/indexes/tools were not known. Only Western investors were familiar with the Doing Business tools, but most investors in the Lao forestry sector come from Asia. In Tanzania, some medium and large enterprises were aware of the existence of the WB/IFC Doing Business indicators. These were companies that had some dealings with IFC. Small-scale tree planters and processors had not heard about this tool.

In both countries, indicators such as those included in the WB/IFC Doing Business framework, are simply not well known and not easily accessible to the majority of those involved in the forestry sector development. Government officials and bigger companies can in principle access these tools, but they do not know enough about them to be able to demand them. Apart from companies associated with IFC, the rest of the players in the sector in these two case study countries seemed unaware of the indicators. Lack of information, as well as likely inadequate interest in this type of information among the majority of operators in the forestry sector renders the tools ineffective. If this applies to a powerful tool such as Doing Business Indicators, one can question what kind of challenges a new forest-sector-specific tool would have in creating visibility and demand from the private sector. However, as discussed earlier the main users would likely be found in the public sector and the donors.

**Validity/Relevance of Existing Business Climate Indicators**

Based on interviews and assessment of the provided set of Doing Business Indicators against the environment in the forest sector, it appears that many of the Doing Business Indicators describe reasonably well the overall business climate in the Lao and Tanzanian forest sector regarding the following elements relevant also to those interested in investing in the forest sector:

- Procedure of starting new business
- Getting electricity
- Registering property
- Investor protection
- Export procedures (however, in Tanzania experience shows that export of forest products covers more steps and more regulatory requirements than recognized by the associated Doing Business Indicator)
Enforcing contracts

Employment

However, important areas specific to forestry are covered weakly, or not at all. There are major gaps regarding following key elements of the forest business climate:

- **Land-related issues.** None of the tools available for Tanzania and Lao PDR cover adequately the procedures for acquisition of land for forestry purposes and forestland-related issues (quality of land, land tenure, costs of land, concessions and leases, and so on) in general. This is a major weakness of the existing tools applicable in Lao PDR and Tanzania. However, the new Investing Across Borders by the WB Group has very relevant subindexes covering land tenure, lease system, and access to land information (see chapter 2, Doing Business Rankings and Investing Across Borders, page 14), which would serve the purpose, if the country coverage were wider.

- **Licensing processes and environmental regulation.** None of the existing tools cover the aspect of environmental licenses and processes needed in forestry (plantation) investments, including harvesting and transport permits.

- **Access to extension and management services.** Existing indicators do not capture aspects related to the quality and access to forest extension services.

- **Governance (in the sector).** Existing indicators do not capture the governance challenges specific to the forest sector.

- **Access to credit.** Obtaining credit for financing establishment and expansion of forestry business are vital for forestry sector due to the long-term nature of forestry investments. The existing indicators apply better to general investments in urban areas. Obtaining credit for forest plantation investments is however slightly different from other businesses, for example, regarding collateral requirements, challenges in valuation of large areas of forestry as collateral when accepted, and also analysis of social, economic, and environmental factors. Existing tools do not address these unique aspects of forestry adequately.

- **Access to sector-specific information.** Information from public sources on (suitable) land available for forestry investments, forest inventory data, forest growth, and such parameters as rainfall, soil characteristics, and growing conditions from government sources is scanty and not easily available. Investors have to employ consultants to identify available land, assess soils and growing conditions, and even carry out long-term studies.

- **Access to domestic markets.** Most of the forestry products are produced in rural areas for the local market. The process of transporting wood and wood products to markets can be very lengthy and costly due to inefficiencies in the infrastructure and the presence of many nontariff barriers like police roadblocks, forest produce inspection blocks, weigh bridges, and so on. Existing indicators do not capture these dimensions of rural investment climate in the case study countries. (Note that the RICA indicators capture these dimensions, but they are currently available in only a few countries.)

**Need for a More Forest-Sector-Specific Tool for Measuring Business Climate**

In both case study countries, there was considerable interest in having a separate tool for measuring forest business climate. In Tanzania, the Chamber of Commerce and the Tanzania Private Sector Foundation showed interest in this kind of a tool in order to generate more attention to issues that need to be addressed in the forest sector to improve the business climate. In both countries,
government authorities saw this kind of tool as useful for pointing to areas in the forest sector needing reforms and improving service delivery to the private sector. In Lao PDR, the Department of Investment promotion stated that this kind of tool could help with promoting foreign investments in the Lao forest sector, especially from Western countries, if the indicator performance would improve over time.

Bigger enterprises showed more interest in having a new tool. This was not the case for small-scale tree planters and saw millers as many of the aspects of the tool do not affect their operations. Interestingly, in Tanzania the industry association representatives stated that they do not need such a tool to help in investment decision-making. Nevertheless, they could use it as a platform to carry out dialogue with the government on reforming the business climate and monitoring progress in removing barriers to investments and trade.

It is important to note that these views did not pay any attention to the issue of cost and trouble that would go to the development of the tool and updating it regularly. In Tanzania, the national expert tried to estimate this and concluded that developing a new tool is not only costly and time consuming, but one also needs to ask the question whether it provides adequate value added. The existing tools already cover many key elements of the forest business climate. The issues currently inadequately addressed are not many, and they do not warrant development of a new tool as such, if the information gaps were otherwise filled.

In these two countries, there is a great potential to make more efficient use of the existing tools. At present, information about the indicators is not adequately circulated, and hence, many actors in the sector are not informed about them. Also, the WB/IFC indicators that are reviewed on an annual basis could be expanded to encompass critical elements currently not sufficiently addressed, such as land-related issues.

**INVESTOR SURVEY/EXPERT INTERVIEWS**

**Description**
A targeted survey that relied on identified relevant organizations and investors as well as well-informed experts was conducted in order to find out the interest among potential investors in an instrument for assessing forest investment climate in developing and emerging markets, and assessing investor perception of the need for a completely new instrument.

First the most relevant potential investors were categorized. They are (1) strategic investors (major forest and energy companies); (2) timberland funds (timberland management organization with focus in emerging markets); (3) private equity investors; and (4) development finance institutions.

A total of 26 strategically important participants were chosen for the survey. The survey was carried out using an e-mail questionnaire. In addition, three in-depth telephone interviews were conducted. The questionnaire consisted of a short introduction describing the matter in hand, a list of examples of existing public domain and commercial instruments/indicators, and finally six questions for the participants to answer in free form.
The following survey questions were asked:

1. Which public or commercial indicators have you used for measuring business climate?
2. For what purpose have you used such tools or indexes?
3. Are the existing indicators sufficient for your purposes?
4. How could the indicators be improved to address better forest industry investment climate?
5. Is there a need to develop a tool and related new indicators specific for forest sector?
6. What should the possible forest investment attractiveness index primarily focus on?

The response rate to the questionnaire was low as only four responded. This may indicate that there is not much interest in the new instrument. Combined with earlier interviews and companies interviewed during the case studies some twenty companies were interviewed.

The survey benefits from having good access to some of the leading players and well-informed experts in the field of international forestry and forest industry investment. The sample included (1) two of the world’s biggest forest industry companies who are actively involved in investing and searching for new forestry and forest industry investment opportunities in Latin America, Asia, and Africa, (2) a leading European development finance institution, (3) one national European development finance institution, (4) two leading timberland investors operating in developing and emerging countries, and (5) two of the biggest forest plantation investors in Sub-Saharan Africa.

**Main Findings**

The respondents showed overall a strong interest in business climate indicators. Some of the existing indicators appear to be already quite widely used, in particular the IFC Doing Business Indicators. The following indicators have been used by the surveyed investors:

- WB/IFC Doing Business Indicators were mentioned by all participants.
- Transparency International Corruption Perception was mentioned by most participants.
- Heritage Foundation Index of Economic Freedom was mentioned by one participant.
- The Economist Intelligence Unit was mentioned as a commercial indicator by one participant.

The tools and indexes were used for the following purposes: (1) for rating and benchmarking the investment target countries and their markets, (2) as input for assessing risks and adjusting discount rates, (3) for asset valuation, and (4) to help in assessing major risks and identifying how to manage specific risks.

Based on the survey and earlier interviews, the current general indicators are seen as relevant also for the forest sector. They can be used to measure the overall business climate that is relevant also for forest investments.

Out of some 20 interviewed companies, some 50 percent were of the view that the existing indicators—albeit useful for general business climate assessment—are not sufficient for forest investments. Many of the companies acknowledge that the investment climate/risk assessment related directly to a specific forest investment would need to be carried out in detail by them.
anyhow on a case-by-case basis. However, responses also indicated that it would be good to have more forest-sector-specific information.

The majority of the participants indicated that the current indicators could be improved. The following improvements were suggested:

- Scoring systems to help determine the country weaknesses
- Better addressing of the property rights systems, land ownership, and leasehold arrangements
- Better addressing of the government forest policies and regulations
- Information on taxes and import-export duties and the risk of export bans/tariffs
- Information on technical and labor capacity
- Indication of forest-related risk elements concerning legal environment (for example, independence of judiciary, incidence of fraud by joint venture partners, and access to independent international arbitration)

Some of the interviewed companies indicated a need to develop a new tool/set of indicators specific to the forest sector. Two of these participants represented a timber fund and one a financial institution. One respondent justified the need for such a new instrument by noting that the current frameworks are too focused on corporate risk. The respondent representing a financial institution noted that the existing indicators are generic, and industry-specific information would be useful for benchmarking purposes.

The participants listed the following things that the possible forest investment attractiveness index should primarily focus on: (1) land tenure issues; (2) technical capacity in forest sector; (3) physical risks related to the forest sector; (4) how foreign investors are treated; (5) currency risk issues, taxation, interest rates; (6) capital control; and (7) access to markets, including duty issues.
The desk study and feasibility study phase, including related interviews/surveys and country case studies, enable drawing some conclusions concerning the development of a tool, or set of tools, for assessing the business and investment climate. Based on the earlier study phases (see chapters 2–4 for phase 1 and chapter 5 for phase 2), two options stand out: (1) to develop an entirely new tool, or (2) to improve the use of existing tools. A third option could be developing a one-off guidance note for practitioners on how to access and use existing information.

The key conclusion of this study is that although a new forest-sector-specific investment climate tool would be useful, the cost of developing and systematically updating it are too high in relation to the value added of the new instrument. As mentioned in chapter 2, Assessment (page 10), a country case study can cost around $100,000 for the first year. Annual updating costs after the initial exercise would naturally be lower, and piggybacking with other indicator work could reduce costs but still the overall costs would be significant, assuming comprehensive country coverage and regular updating.

Below these options are described. The elements of a new instrument are outlined in reasonable detail because they provide a kind of benchmark of how one could measure the investment climate comprehensively in the forest sector, assuming that all the feasibility criteria such as sustainability were met.

**NEW TOOL**

**Rationale**

The rationale to develop a new instrument is based on an argument that there are gaps or deficiencies in how well the publicly available and regularly updated indicators describe the business or investment climate in the forest sector. General business climate indicators work well, but there are many external factors that influence the investment climate faced specifically by forest-based SMEs and large forestry and forest industry indicators. Best examples of such important factors are land policies and regulation, (forest) governance and corruption prevailing in the forest sector. The new instrument could also cover selected critical internal and business opportunity related factors (as described in chapter 3).

The main gaps of the existing instruments are not in their capability to measure regulatory environment—it is rather the instrument’s capability to assess technical,
physical, and social characteristics of the forest sector. In addition to common macroeconomic factors, the new instrument should address enabling elements such as quality of infrastructure, security of forest land tenure, access to markets, information on markets, access to financial services, required licenses and permits, as well as key factors for profitable business that are particularly challenging for the SMEs (as discussed in chapter 3, Mapping the Investment Framework of a SME Investor, page 36). However, even in the case of a new instrument it would have to be understood that the details needed to truly assess the investment environment regarding internal factors and business opportunities are such that no indicator will be able to cover these factors well.

To some extent, the new tool could also improve understanding the trade-offs between sector-specific risks and potential returns in different geographies. All investors—strategic, financial, and SMEs—are willing to invest, if the foreseen returns compensate the risks due to weaknesses in the business climate. This is as long as there are no critical limitations such as major country (political or economic risks) constraints crucial especially to foreign investors. Assuming that the investments are already profitable even in challenging business environments, large-scale investors can lead and create critical mass and hence bring along SMEs. When a critical mass of operators exists, the actors tend to address the key constraints directly to the government agencies and drive required improvements. Examples of such development have been demonstrated, for example, in Brazil, Uruguay, and South Africa.

In principle, the tool could indicate whether the requirements exist for feasible forest investments—that is, available land areas, adequate growing conditions, strategic location/logistics, and markets. In some cases, government or donor agencies have promoted business development in areas that could never gain sustainable comparative advantages for profitable forestry or forest industry (for example, plantation development too far away from realistic logistics or in areas with poor growing conditions).

### Principles

This instrument could in a way combine a simplified version of the IDB IAIF investment attractiveness tool and the DANA/RISI tool—that is, assessing potential profitability against sector-specific risks caused by common macroeconomy, other sectors, and particularly the internal sectorial factors. When it comes to the measurement of the factors external to the sector, the tool should be a composite, weighted index of already existing tools such as IAB, Doing Business, CPI, WGI, ONDD, and so on. However, the difference is the clientele. DANA/RISI regularly updated reports tend to be focused on strategic and financial investors—that is, global forest industry and energy companies and TIMOs. The new instrument should cover both the SME sector and larger strategic and financial investors. It should also address the key factors relevant for them in more detail to enable identification of areas for policy and regulatory reform and other action to improve the investment climate.

The new instrument should be based on the existing tools and indexes as much as possible. The additional data collection would only focus on such critical factors as land, yields, logistics, technology, labor, and services, as well as additional social and environmental issues—that is, critical information that hardly can be obtained from the existing public or easily available commercial sources.

The basic concept of this type of instrument is illustrated in figure 6.1.
The existing indexes could indicate the “goodness” of the investment environment at the target area (that is, the risk level), while additional data would be required primarily to indicate profitability factors such as potential land areas, yields, volumes, logistics, technology, labor availability, and costs.

Main Steps Needed to Develop a New Instrument

If one were to proceed with the development of a new tool, the following main steps would have to be undertaken:

1) **The first step in developing the new instrument**

The core common macroeconomic factors can be drawn from the existing indexes, particularly IAB, WB Rural, WGI, and CPI. These indexes would cover

- Political and social stability
- Economic stability
- Economic and demographic growth
- Trade openness
- Stability and clarity of taxation, tax burden

In addition, the indexes would cover partially the factors concerning

- Economic and social infrastructure
- Regulatory burden (permits, licenses, and so on)
- Governance, law enforcement, security of land tenure, and property rights
- Enforceability of contracts
- Corruption
- Overall security of property rights, including land

With this information, and after expressing the indicators using common metrics, it is possible to “measure” the current level of “goodness” of the business climate in a particular geography for a specific forest investor typology (for example, SMEs or large-scale strategic and financial investor). (This is shown by the x-axis in figure 6.1.)

The indexes would have to be transformed into similar types of measures, for example, based on a “grading” scale of one to five.

2) The second step in developing the new instrument

In the second step, the core data on internal factors should be collected. One should in particular indicate from where and how the data are obtained, and what are the costs (time, money) of obtaining the following data/information:

- Availability, quality, and cost of land (potential to scale up)
- Security of forest land tenure and related property rights
- Existing forest resources
- Market potential for example, though linking to major industrial (forest industry, energy production, mining) expansion
- Access to markets/logistics
- Potential to benefit from infrastructure development: roads, rails, ports
- Growing conditions: soil, rainfall, temperature [yields
- Costs of key inputs
- Available technology
- Availability of skilled labor
- Subsidies and other incentives
- Management services and partners
- Financial services
- Sector-specific regulations and their enforcement
- Social and environmental risks

If one were to go ahead with development of a new instrument to measure forest business and investment climate, the development work should be made closely with those organizations and units who are already active with the development and application of tools for measuring business climate.

Challenges

Development of a new instrument would be costly and time consuming, especially if it is to have meaningful country coverage and regular updates. In addition, launching and establishing a new instrument would require a long-term commitment, including an institutional home with staff, and
secure annual financing. At the national level, it would be a major challenge to secure the continued interest and inputs from national stakeholders.

Other challenges that would have to be tackled, if one were to decide to go ahead with this type of instrument, are as follows:

- How can the needed visibility for the tool be created and how can the demand both from the public sector and the investors be secured?
- If used in initiating policy reforms, what would be the entry point for introducing and using the tool and how can it be determined that the information is really contributing to decision making?
- How can the “brand” be created and maintained?

These are critical questions that need to be answered if the tool is to become sustainable and relevant and have the planned impact. To a large extent these were also the main challenges faced by the IDB in developing and applying the Forest Investment Attractiveness Index, and thus explain why the instrument failed (see section 2.2).

**IMPROVED USE OF THE EXISTING TOOLS**

**Rationale**

Instead of developing a new tool, possibly a cost-effective approach to measure forest business and investment climate is to rely on the existing instruments but make better use of them. The most relevant instruments for forest business/investment climate are the ones developed by the World Bank Group; that is, Doing Business Indicators, Investments Across Borders, and WB RICA; as well as the Global Competitiveness Report and Corruption Perception Index by Transparency International. The last two are probably the most cited and respected with high brand value together with the Doing Business Indicators. There are also several other relevant tools as the review in chapter 2 indicated.

The rationale for the option “make better use of existing tools” is based mainly on the following:

- Most of the interviewed stakeholders see the investment climate only as one key factor influencing decision making. They appear to be quite content with the existing tools and available information, especially regarding the general business climate. They can obtain information from public sources or from commercial information providers and experts/expert organizations. Furthermore, local and sometimes regional private sector investors, particularly SMEs, are not even aware of the existing instruments. Consequently, why would they need a new instrument?
- Strategic and financial investors apply the available indexes particularly in the screening and prefeasibility phases of the potential new investments. National investors such as SMEs on the other hand have other priorities; the tools really do not add enough value to them considering the basic challenges they face in the business. The existing gaps—particularly related to land issues, raw material procurement costs, market access, and social and environmental risks—can be fulfilled with their own studies or with assistance from consultants and experts including local research organizations and nongovernmental organizations (NGOs).
In practice, most of the information needed by key investor typologies in actual decision making is so detailed and specific to a situation that primary data collection and analysis are needed.

Many of the already available tools such as IFC Doing Business Indicators, IAB Indicators, and WB RICAs, as well as some others, already provide information that can feed into policy dialogue and initiate possible reforms and targeted actions. Most of the crucial extrasectorial factors influencing the investment climate of forest investors are similar to the other sectors, and vice versa. All SMEs operating in rural areas face more or less similar challenges caused, for example, by weak infrastructure or poor access to markets and finance.

**Principles**

There are two complementary ways of making better use of existing tools and indicators for measuring the forest business and investment climate. First, try to introduce some improvements in the existing tools, and second, improve access to already existing tools and indicators.

The existing tools such as Doing Business Indicators and IAB promoted by the World Bank Group could do a better job in addressing rural, natural-resource-based enterprises that often dominate the national firm landscape. However, it is not feasible to do it from a forestry perspective alone. The inclusion of a hypothetical rural enterprise, or including questions that would somehow address the regulatory challenges faced by rural entrepreneurs (for example, as part of the Doing Business indicator), would provide useful information related to all rural enterprises including forest-based businesses.

The most critical action is to improve access to all the available relevant tools and make them more known at different levels. This includes the national level (for example, the key ministries) that can influence regulatory environment and governance in the forest sector, and a much broader set of investors than those currently using, for example, Doing Business indicators. As the case studies indicated, the Doing Business Indicators—not to mention other available indicators—may not be well known within the forest sector. Also, it looks like more responsible, often Western, investors are using this type of tool more commonly.

An online portal (a practitioner’s guide) for “Forest Business and Investment Climate Assessment” could be developed. The electronic guide should include the following:

- Basic concepts and methods of measuring the investment climate (in the forest sector)
- Conceptual framework for and checklist measuring the investment climate (in the forest sector)
- Operationalized framework with detailed guidance and links for indicators (what they mean and measure, what kind of new data are needed, and best ways of collecting the data) and importantly links to existing tools and indicators
- Links to relevant case studies

Table 6.1 summarizes how this framework or checklist could look.
<table>
<thead>
<tr>
<th>CRITICAL FACTOR FOR FOREST INVESTMENT</th>
<th>SOURCE OF INFORMATION</th>
<th>COMMENTS</th>
<th>FOREST SECTOR RELEVANCE</th>
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</thead>
<tbody>
<tr>
<td>Common factors</td>
<td></td>
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<tr>
<td>Political social and economic stability</td>
<td>WGI</td>
<td>Well-established, regularly updated tools with comprehensive country coverage available</td>
<td>Very relevant</td>
</tr>
<tr>
<td>Economic and demographic growth</td>
<td>Annual Global Competitiveness Report</td>
<td></td>
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<tr>
<td>Trade openness</td>
<td>Private (for example) bank country risks assessments and ratings</td>
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<tr>
<td>Taxation</td>
<td>Annual Index Economic Freedom and Annual Economic Freedom Report (for trade openness, but a composite index)</td>
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<td></td>
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<td>Well-established, regularly updated tools with comprehensive country coverage available</td>
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<td>Economic and demographic growth</td>
<td>Annual Global Competitiveness Report</td>
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<tr>
<td>Trade openness</td>
<td>WB/IFC Doing Business and IAB</td>
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<tr>
<td>Economic and social risks</td>
<td>Annual Global Competitiveness Report</td>
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<tr>
<td>Infrastructure (road, ports, energy)</td>
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<tr>
<td>Regulations (permits, licenses) for starting a business, registering a company and property, and so on</td>
<td>WB/IFC Doing Business and IAB</td>
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<td>Governance, Rule of Law, law enforcement</td>
<td>WGI</td>
<td>Well-established, regularly updated tools with comprehensive country coverage available</td>
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<td></td>
<td>WB RICA</td>
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<td>PROFOR (but available only for few countries)</td>
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<td>Annual Index Economic Freedom and Annual Economic Freedom Report (for Rule of Law, but a composite index)</td>
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<td>Enforceability of contracts/settling disputes</td>
<td>WB/IFC Doing Business and IAB</td>
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<td>Annual Global Competitiveness Report</td>
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<tr>
<td>Corruption</td>
<td>CPI</td>
<td>Well-established, regularly updated tools with comprehensive country coverage available</td>
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<td>Property rights; security of land tenure</td>
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<td></td>
<td>WB RICA</td>
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<td>Annual Global Competitiveness Report</td>
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<td>However, forest land tenure issues and related risks warrant special attention</td>
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<th>FOREST SECTOR RELEVANCE</th>
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<tbody>
<tr>
<td><strong>Internal Forest Sector Factors</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to markets/logistics</td>
<td>WB RICA (rural focus)</td>
<td>Well-established, regularly updated tools with comprehensive country coverage available</td>
<td>In principle relevant but access to finance in the forest sector faces its own challenges; RICA has relevant info on rural finance but scope limited and not regularly updated</td>
</tr>
<tr>
<td>Financial services</td>
<td>WB RICA (rural focus)</td>
<td>Well-established, regularly updated tools with comprehensive country coverage available</td>
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<tr>
<td></td>
<td>WB/IFC Doing Business</td>
<td></td>
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<tr>
<td></td>
<td>Annual Global Competitiveness Report</td>
<td></td>
<td></td>
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<tr>
<td>Existing forest resources</td>
<td>DANA/RISI (some info)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growing conditions</td>
<td>DANA/RISI information is private.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Costs of key inputs</td>
<td>Most of the data must be collected country by country</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social and environmental risks</td>
<td>WGI</td>
<td>Strategic and financial investors must do their own homework.</td>
<td>In general relevant but forest-sector-specific information is needed.</td>
</tr>
<tr>
<td></td>
<td>CPI</td>
<td></td>
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<tr>
<td></td>
<td>Have to assess also separately for forest sector</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subsidies and other incentives</td>
<td>These are not covered—in any case have to be assessed country by country</td>
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<tr>
<td>Sector-specific endorsement;</td>
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<tr>
<td>enforcement</td>
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<tr>
<td>Availability, quality, and cost of</td>
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<tr>
<td>land</td>
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<tr>
<td>Available technology and skilled</td>
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<td></td>
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<tr>
<td>labor</td>
<td></td>
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<tr>
<td>Management services and partners</td>
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</table>
Advantages and Disadvantages

The main advantage of this option is that it is cost-effective. The existing tools appear to serve valuable purposes and have untapped potential for wider application in assessing forest business and investment climate among different “client” groups. Hence, one can avoid the cost of developing and maintaining an entirely new instrument.

The other advantages include the following:

- Easy and cheap to update since it relies on already existing tools and indicators which are updated annually (most of them).
- Sustainable because it does not require major funding and the key tools it relies on are well established.

The main disadvantage is that evidently this approach is based on a compromise and a trade-off between the usefulness and comprehensiveness of the tool, as well as cost efficiency and sustainability. In fact, this option does not really represent a tool as such but rather a guide to different “clients” on assessing the forest business and investment climate. Moreover, it does not address the identified gaps of the existing tools as regard to their applicability to rural conditions and forestry businesses.

Main Steps Needed to Improve the Use of Existing Tools (Portal)

If one were to proceed with the development of a new tool, the following main steps would have to be undertaken:

1. Opening a dialogue with relevant stakeholders currently active with development and application of business climate tools and forest financing/investment, including WB, IFC, Food and Agriculture Organization of the United Nations (FAO), Tropenbos, UNIDO, and so on.

2. Developing the concept for the online “Practitioner’s Guide on Assessing Forest Business and Investment Climate” further. The online guide could be a “one-stop shop” for end users who need guidance in measuring business climate. The guide would enable easier access to the measurement tools for all end users.

3. Developing the concrete framework and checklist for assessing the investment climate. Table 6.1 presents an approach for a checklist that can be further elaborated to respond to the specific needs of different end users, for example, national decision makers or local industry associations.

4. Preparing all the supporting materials, considering also different end users’ geographies. Supporting materials can be country or region specific for natural resource sectors. The materials can include also case studies that help to understand the required conditions for different investments.

5. Studying lessons learned. Development and application of the online guides should be a continuous process with focus on (1) national policy makers and development agencies and (2) investors in emerging countries especially representing SMEs. Business climate can change quickly in different environments, and it is crucial to get feedback from the stakeholders.
SUMMARY ANALYSIS OF DIFFERENT OPTIONS

The three options for proceeding, including a one-off guidance note, are assessed below using many of the criteria, which have already been applied above when describing the first two options. The analysis demonstrated that in terms of information value and relevance for the identified main users, options 1 and 2 are the best ones thinking of long-term use. Also, there are major trade-offs involved between the quality and applicability of the tool, and the efforts that it takes to develop and maintain the tool.

It needs to be noted that if done well, one-off Guidance Note can provide access (although not as easily) to similar information as through a portal (the second option), and hence the assessment is similar to option 2. However, this option would not be sustainable, and over time this option would cease to be relevant; simply one would not be able to get regularly the same information value as in option 2.
### Table 6.2. Assessment of the Options

<table>
<thead>
<tr>
<th>EVALUATION CRITERIA/KEY FEATURE</th>
<th>1. A NEW TOOL</th>
<th>2. MAKING BETTER USE OF EXISTING TOOLS (PORTAL)</th>
<th>3. ONE-OFF GUIDANCE NOTE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sector coverage</strong></td>
<td>High: Can be tailored to include all relevant “forest countries”</td>
<td>Medium or low: Would not cover forestry (including harvesting and transport) and different processing subsectors</td>
<td>Medium or low: Would not cover forestry (including harvesting and transport) and different processing subsectors</td>
</tr>
<tr>
<td><strong>Coverage of key investor types</strong></td>
<td>High: Can be tailored to address all key investor typologies</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td><strong>Country coverage</strong></td>
<td>High: For most essential general business climate criteria</td>
<td>Medium or low: High: For most essential general business climate criteria</td>
<td>Medium or low: High: For most essential general business climate criteria</td>
</tr>
<tr>
<td><strong>Coverage of key investment climate elements</strong></td>
<td>High: Can be tailored to address both extrasectoral and intrasectoral elements</td>
<td>High: For most essential general business climate criteria Low: For several key intrasectoral elements</td>
<td>High: For most essential general business climate criteria Low: For several key intrasectoral elements</td>
</tr>
<tr>
<td><strong>Relevance for public sector and donor community</strong></td>
<td>High: Could be developed as a diagnostic tool capturing the key constraints to private sector (in the broadest sense) investments</td>
<td>Medium or low: Can help with improving, for example, the over business climate for rural SMEs, including forest-based ones, but would not be relevant considering specific forestry issues</td>
<td>Medium or low: Can help with improving, for example, the over business climate for rural SMEs, including forest-based ones, but would not be relevant considering specific forestry issues</td>
</tr>
<tr>
<td><strong>Relevance for the private sector</strong></td>
<td>Medium: Private sector needs would be in most cases so detailed concerning especially forestry specific information that no “generic” tool would be able to address them</td>
<td>Medium: For general business climate Low: For intrasectoral elements because would not provide some key forestry specific information needed by private sector</td>
<td>Medium: For general business climate Low: For intrasectoral elements</td>
</tr>
<tr>
<td><strong>Reach</strong></td>
<td>Would depend on “marketing” efforts, and success in brand building. Reach could be good if the tool could somehow be linked to the existing tools with good visibility</td>
<td>Would very likely require “piggybacking” with other successful related portals with wide reach. Otherwise may get lost. On the other hand, having a portal allows building up reach over time.</td>
<td>The overall reach over would be grossly inadequate since after the initial visibility the Guidance Note would likely “disappear.”</td>
</tr>
<tr>
<td><strong>How easy to update</strong></td>
<td>Would require a lot of regular effort and dedicated full-time resources. However, can also benefit from “piggybacking” with already existing indicator collection activities</td>
<td>Easy because it would rely on secondary indicators sources which are updated annually anyhow.</td>
<td>This would be a one-off Guidance Note with updates prepared as needed.</td>
</tr>
</tbody>
</table>

*continued on next page*
<table>
<thead>
<tr>
<th>EVALUATION CRITERIA/ KEY FEATURE</th>
<th>1. A NEW TOOL</th>
<th>2. MAKING BETTER USE OF EXISTING TOOLS (PORTAL)</th>
<th>3. ONE-OFF GUIDANCE NOTE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>Costly (compared in particular to the other options)</td>
<td>Cost effective. Also, at low marginal additional costs the existing knowledge could be augmented to provide a more comprehensive source of information for wider audience.</td>
<td>Very cheap (but not effective) because of one-shot nature. At low marginal additional costs the existing knowledge could be augmented to provide a more comprehensive source of information for wider audience.</td>
</tr>
<tr>
<td>Sustainability</td>
<td>Would require a dedicated institutional home with access to long-term significant annual financing.</td>
<td>Would require an institutional home with human and financial resources.</td>
<td>Not sustainable (by definition) and is quickly outdated because links get old and the available tools and their subindexes structure and contents may change over time. However, can simulate private sector to develop such a tool or improve the existing private sector tools.</td>
</tr>
</tbody>
</table>
**NEXT STEPS**

The study has indicated that there is clear interest in understanding better the forest business and investment climate and having access to related tools and indicators. This type of information is needed for various purposes, for example, by national policy makers, international aid organizations, and government agencies that are promoting investments and supporting business development. The most important use would be to guide policy and regulatory reforms and monitor over time performance in improving the investment climate in forest sector. Business climate assessments could indicate the most critical factors that can and should be addressed in order to create a more enabling environment for SMEs and large enterprises.

Private investors also need more information on the investment environment. Implemented action to address identified key constraints can help with reducing the risks and thus lower the barriers to increased investments. It is also possible that these types of tools could provide a platform or tool for dialogue involving the government representatives, private sector, and civil society.

In the previous chapters, key steps to proceed with either option 1 or option 2 were suggested. Irrespective of the option, the most important immediate step is to discuss the report findings with relevant stakeholders that are internationally engaged with business climate measurement, private sector development, and investment promotion as well as forest financing. The stakeholders would include the World Bank Group and its relevant departments and programs, UNFF, FAO, UNIDO, DFID, and other donors active with related work, Tropenbos, and others dealing with forest financing.

An international workshop/meeting could be organized around these issues and use the occasion at the same time for the dissemination of this report, and possibly also the report dealing with private sector financing in the forest sector (Castrén et al. 2014). This step would be important in order to

- Further assess the demand for this type of tool
- Get feedback needed for possible further development
- Discuss the institutional "home" for the development and maintenance of the tool
- Agree on implementation steps
- Discuss financing options


Smith, A. 2010. What will determine if a plantation forestry investment in developing countries should be undertaken? MBA Thesis. Henley Business School, United Kingdom.


LINKS TO THE KEY ASSESSED TOOLS:

Forest- and rural-sector-specific tools:

- Forest Investment Attractiveness Index (earlier at the Inter-American Development Bank, IDB, now in a nonprofit organization Sustainable Forest Business (http://www.sustainableforestbusiness.org)
- DANA/RISI Tree Farm Investment Attractiveness Ranking (http://www.risiinfo.com/)
- WB Rural Investment Climate Assessments

General business climate assessment tools or tools that can be used to measure some aspects of business/investment climate:

- ONDD Country Risk Assessment covering political, commercial, war, expropriation, government, and transfer risks (http://www.ondd.be/)
- Annual Global Competitiveness Report published by the World Economic Forum
- Worldwide Governance Indicators by the World Bank (WB) (http://info.worldbank.org/governance/wgi/)
- The Financial Times fDi Attractiveness Index that allows the investor to adjust their sensitivity to cost and quality to rank the attractiveness of locations for a specific sector or project (http://www.fdibenchmark.com)
- Annual Index of Economic Freedom reported annually by the Heritage Foundation (http://www.heritage.org/)
- Annual Economic Freedom Report by Fraser Institute (http://www.fraserinstitute.org)
- Corruption Perception Index by Transparency International (http://www.transparency.org/)

Self-assessment tools:

- Forest governance indicators developed by PROFOR (http://www.profor.info/sites/profor.info/files/docs/AssessingMonitoringForestGovernance-guide.pdf)
THE BUSINESS CLIMATE FOR FOREST INVESTMENTS: A SURVEY REPORT PROVIDES AN OVERVIEW OF A LARGE DIVERSITY OF TOOLS TO ASSESS INVESTMENT CLIMATE AND THEIR APPLICABILITY IN THE FOREST SECTOR. IT DISCUSSES WHERE MAIN GAPS CAN BE FOUND AND WHAT WOULD BE POTENTIAL DEVELOPMENT NEEDS. FOR THE STUDY, A REVIEW OF EXISTING INVESTMENT CLIMATE TOOLS WAS CONDUCTED; A FOREST INVESTOR TYPOLGY AND FRAMEWORK FOR MEASURING INVESTMENT CLIMATE IN THE FOREST SECTOR WERE DEVELOPED. FIELD WORK WAS CARRIED OUT IN TANZANIA AND LAO PDR.

BASED ON THE ANALYSIS, THE REPORT DISCUSSSES THE NEED TO DEVELOP A NEW TOOL FOR MEASURING THE BUSINESS CLIMATE IN THE FOREST SECTOR; IT OUTLINES KEY ELEMENTS OF THE POTENTIAL TOOL, AND ASSESSES THE FEASIBILITY OF SUCH A TOOL. IT ALSO DISCUSSES THE FEASIBILITY OF DEVELOPING AND USING EXISTING INVESTMENT CLIMATE TOOLS. IN DOING THIS, THE REPORT PROVIDES A MENU OF OPTIONS FOR FURTHER DEVELOPMENT TO IMPROVE METHODOLOGIES TO IMPROVE INVESTMENT CLIMATE FOR SUSTAINABLE FOREST MANAGEMENT AND WOOD PROCESSING.