

Myanmar: Diagnoses and regulatory assessment of SmEs in the Mekong Region

This report analyses the policy and regulatory context in which small and micro enterprises (SmEs) engaged in timber extraction and processing operate in Myanmar. It develops a diagnostic analysis that reveals key constraints to productivity, competitiveness and economic viability. The study also assesses gender equity issues. It makes recommendations for policy and legal reforms and other mechanisms for improving the economic resilience of SmEs in ways compatible with Myanmar's evolving engagement with the European Union on Forest Law Enforcement, Governance and Trade (FLEGT).

The report analyses primary and secondary data on three main value chains – for furniture, doors and window frames, and wood-based handicrafts, respectively – that involve wood-based SmEs. It draws on interviews conducted with 24 SmEs in Yangon, Mandalay and Monywa. The urban focus of these interviews was due to the reluctance of rural households to be interviewed. Eight focus group discussions complemented the SmE interviews: Four with producer associations, two with state agencies, one with a civil society/NGO group and one with a women's group.

Notes on abbreviations and currency

Abbreviations: The following abbreviations appear often in this report – SmEs (small, micro and informal enterprises); SMEs (small and medium-sized enterprises); MTE (Myanmar [sic] Timber Enterprise). All other abbreviations are explained in the text.

Currency / exchange rate: This report usually presents financial data in Myanmar kyat (MMK) and the US dollar (USD) equivalent using an exchange rate (December 2017) of MMK 1,370 per dollar.

The interviews revealed that:

- The average size of the 24 SmEs was 13.5 household members and employees. A quarter of them had 20 or more staff.
- Most SmEs had a municipal operational licence, conferring basic permission to operate. Without this licence, they risk being sanctioned or shut down by the municipal government following, for example, complaints by neighbours.
- Less than a third of SmEs were registered under the Department of Industrial Supervision and Inspection or the Department of Cottage Industries, and therefore regarded as 'formal'. The low rate of registration can be explained by the fact that it is not a legal requirement and it makes an SmE subject to government inspection and income tax.
- For 70% of the SmEs, teak was the main species used, followed by ain (*Dipterocarpus macrocarpus*), padauk (*Pterocarpus macrocarpus*), pyinkado (*Xylia dolabriformis* and other related species) and tamalan (*Dalbergia oliveri*) – most of which are becoming increasingly scarce and/or endangered.
- About 40% of SmEs said they obtained teak directly or indirectly – though with considerable difficulty – from the state-owned Myanma [sic] Timber Enterprise auctions, followed by sawmills and the 'black market'. For the other species, timber traders and the black market were the most important sources.
- Women comprised 25% of permanent or household labour and 13% of seasonal or non-permanent labour. Men earned on average 70% more than women. The respondents, who were mainly men, said wages depended more on the nature of the work than on gender.
- Women's main tasks were marketing, book-keeping, polishing and finishing, including artwork. Women were sometimes the household's main decision makers regarding marketing/sales and, in some cases, they had wider management responsibilities including recruitment and deciding wages. But women rarely or never attended meetings or sat on committees.
- About 30% of SmEs received credit or loans from various sources, with friends or relations being the most common. In all except one case, the loans were used for buying timber. The annual rate of interest varied from 12% to 60%. Only one SmE said it had received an advance or forward payment from a customer or retailer.
- Only one very well connected SmE had received training, and no SmE had received technical assistance.
- Slightly over half of the SmEs said they cooperated in some way with other SmEs or exchanged information, almost always on how to obtain timber from MTE auctions.

1. Main findings

The main findings of this study are as follows.

1. It is very difficult for SmEs to source legal timber

Most SmEs use illegal timber because it is difficult for them to obtain legal supplies. In focus group discussions, it was estimated that 95% of timber SmEs use is illegal. Key informants attribute this firstly to the MTE's near-monopoly over teak (*Tectona grandis*) and other high-quality timber species. Most good quality legal timber feeds MTE's considerable wood processing capacity (mainly for export) or adds to MTE's large teak stockpile, causing artificially high prices and scarcity for SmEs and others.

The lack of legal timber supply for SmEs is also clearly linked to the problem of illegal timber extraction in Myanmar, as well as the lack of private sector plantation timber. A major but unknown proportion of timber comes from areas outside the control of the Government and Forestry Department, much of it from ethnic and border conflict regions where most of the forest is under the control of armed insurgency groups. In addition to the deep rooted and complex socio-political issues, a key problem is lack of official recognition of customary laws, rights and practices. These problems are exacerbated by the strong demand from China for high-value species and the porous nature of Myanmar's borders.

Another problem for SmEs is the difficulty of competing with more powerful stakeholders – such as timber traders, teak exporter groups, foreign investors and large sawmills – in the MTE tender process. This is due to the requirement to pay in US dollars, the lack of institutional finance/credit for SmEs, and the large size of the tenders. Some SmEs buy from the winners of MTE tenders or from Forestry Department auctions of confiscated timber, but they usually have to pay high prices for poor quality timber.¹ According to key informants, it is common for tender winners to substitute the MTE auction timber with illegal timber and sell it to SmEs.

Policy recommendations to counteract this set of problems are presented in Section 1.2.

2. There are strong disincentives to formalisation of wood-based SmEs

Currently, the costs of formalisation are clear. They include taxes, transaction costs, increased scrutiny from and interaction with state officials, and informal fees (charging of 'tea money') due to institutionalised petty corruption in the Forestry Department and other state agencies. By contrast, the benefits of being formal are not clear. Formalisation does not, for example, result in access to state credit, extension services or legal timber. A basic constraint is the prevailing mistrust or fear of state officials. In Myanmar, this is a national rather than a sectoral problem; improvement would therefore require fundamental national policy and institutional reforms.

3. SmEs suffer from diseconomies of scale and weak negotiation power

On their own, SmEs have little or no commercial negotiating power and are unable to absorb regulatory or compliance costs. This could be addressed through actions to promote the horizontal and vertical integration of SmEs.

¹ Timber confiscated and auctioned by the Forestry Department was widely-viewed to be of poor quality, while there were conflicting views on the quality of MTE auction timber, especially teak. On the one hand, the MTE has traditionally exported or processed most of the better-quality teak leaving lower-quality timber for the tender process; on the other hand, most interviewed SmEs were keen to enter the tender process in order to source better quality timber.

4. Gender equity issues and opportunities in wood-based SmEs

This study confirms that women are paid less than men and do not generally participate in meetings or sit on committees, although they do not seem to be particularly disadvantaged compared to men as regards the regulatory framework or access to credit.

This compares to national level data that show persistent gender differences in productivity and earnings across all sectors, and that women are more likely to be working in the informal sector, often in family-owned enterprises in vulnerable employment, ‘characterised by inadequate earnings, lack of social protection, low productivity and difficult working conditions.’ The forest and wood processing sectors are not therefore significantly different to other sectors, particularly those related to agricultural production, for example, as regards the gender pay differential in spite of women’s legal entitlement to equal pay.

Female household members often have a significant decision-making role as regards marketing or sales and/or setting wages and hiring labour. In formal SmEs they are often responsible for financial book-keeping. These roles provide some good opportunities or entry points for improving gender equity that have not been promoted.

2. Policy Recommendations

The recommendations of this study can be divided into a) urgent shorter-term actions, b) more strategic longer-term measures aimed at the underlying causes and structural problems outlined above, and c) recommendations for promoting gender equity.

Urgent measures, including some that are challenging from a political economy perspective, include:

- Reform of the Myanmar Timber Enterprise (MTE), especially as regards its near-monopoly control over legal teak and other high-quality timber species. This is vital for SmEs to be able to access legal timber at a ‘fair price’. More broadly there is an urgent need for the MTE to be more transparent and accountable.
- Reform of the MTE tender process – in which SmEs are severely disadvantaged – including by allowing payment in the national currency of Myanmar kyat rather than US dollars², having smaller tender lots (for example, 10 tonnes) and smaller decentralised auctions, and possibly by reserving a proportion of timber for registered SmEs.
- Reforms to reduce regulatory costs, especially transaction costs and the associated informal payments. This involves reducing the number of trips to government offices (each visit involves ‘tea money’ payments, transport and labour opportunity costs), simplifying transport permits, rationalising the system of licences and associated paperwork (for example, involved in obtaining a municipal operating licence).
- Other action to tackle institutionalised petty corruption in state agencies, e.g., by providing incentives such as prizes or promotion for employees who eschew ‘tea money’.
- Increasing incentives for formalisation by providing good quality technical and financial assistance to registered SmEs, especially when organised into cooperatives or groups.
- Simplifying the complex definitional and legislative framework for SMEs, which complicates effective policy support.

² The Myanmar Forest Products Merchants Federation, which mainly represents sawmillers, has written to the MTE and the Vice President with demands that tender bids be permitted in Myanmar kyat and for separate tenders be reserved for national businesses.

- There will also need to be some institutional reform of state agencies to be able to provide effective support services to organised SmE groups. One concrete suggestion is the creation of a bespoke SME/SmE support division in the Forestry Department. Currently, responsibility for SMEs falls under the Natural Forest and Plantations Division, which has a range of other functions. A dedicated department should ensure stronger support for wood-based SMEs and provide a better basis for them to benefit from international technical assistance.
- Development of a market information system for SMEs, especially as regards timber and wood product prices and market opportunities, so that there is a more level playing field when they negotiate with other value chain actors such as timber and wood product traders.
- Provision of training and technical assistance for SmEs. Only one of the 24 interviewed SmEs had received any training. The main training needs identified in the survey were on furniture making technology, business training, and how to use timber waste to make plywood and other products (for example, medium density fibreboard, particle board). Potential implementing partners are the Wood Based Furniture Association and the International Labour Organization, which already conducts business training in Myanmar.

Apart from reform of the MTE and its tender process, the above measures would not resolve the underlying problem of a very large SmE sector being based mainly on the use of illegal timber. It should also be noted that all policy measures are likely to involve some trade-off between environmental, social and economic objectives.

For example, a strict approach to legal compliance of SmEs could have major poverty impacts given the limited alternative livelihood options for forest-dependent communities in Myanmar. On the other hand, it is clear that a very large SmE sector, whether formal or informal, will continue to exert excess pressure on Myanmar's rapidly degrading forests with serious environmental, social and economic impacts.

³ Horizontal integration refers to cooperation between SmEs (for example, in the form of a producer or sales cooperatives). Vertical integration is a contractual or partnership arrangement between more upstream supply chain actors and a downstream business or company in which the former supply the latter with raw materials or semi-finished products for final processing and/or sale.

⁴ <https://mfp.or.id/index.php/en/>

⁵ The purposes of the WBFA (<http://www.myanmarwbfurniture.com>) include: 'to create employment opportunities and to train skilled-labours; to make local raw materials easily available and to be used systematically; to provide available world-class technologies and information in efficient and timely manner; and to organise Technical, Languages and Management Training Programs in collaboration with international organisations.' The WBFA has 522 members in 10 divisions, the largest of which are Yangon (222 members), Shan Town North (80) and Mandalay (58).

⁶ There is a draft statute to clarify ownership of planted teak trees in favour of landholders or planters, but progress on the many proposed forest sector legal and policy reforms is proving to be slow.

⁷ A draft reformed Forestry Law includes a clause that planted teak trees would belong to landowners, but when this will be ratified is uncertain.

⁸ If smallholders become better organised, and political economy and tenure constraints can be resolved, there could be potential to supplement timber-based revenue with carbon payments. A potential model is provided by The International Small Group and Tree Planting Program (TIST) programme, which has been operating in Tamil Nadu State, India, since 2004, and has also proved successful in Africa (<https://www.tist.org/tist/doverview.php>).

Long-term measures to reduce such trade-offs include:

- Promotion of horizontal and vertical integration³ of SmEs. This includes provision of effective financial and technical assistance, and support to networks that could facilitate links between larger-scale investors and SmEs – for example, in the supply of semi-finished furniture to bigger downstream companies. This would help absorb the fixed regulatory costs of compliance, reduce SmEs’ transaction costs, alter negotiation capacity and the associated power asymmetry, and result in other economies of scale.
- Promotion of horizontal and vertical integration will need action research. The Wood Based Furniture Association (WBFA) is best placed to coordinate an action research project that could draw on the experiences from Indonesia’s Multistakeholder Forestry Programme⁴— which the UK Department for International Development supported. An initial action could be a short study tour of Indonesia by key decision makers.
- Legal recognition of the customary property rights of ethnic groups. This would need to be part of a paradigm shift as regards policies in ethnic conflict areas.
- The WBFA is also the most appropriate organisation to lead and coordinate a networking and cooperation initiative for SmEs, according to key informants. This would fit well with the WBFA’s stated objectives⁵ and would build on a current pilot initiative. A strength of the WBFA, compared to a state agency, is its ability to work with the private sector, which can play a key role in raising technical efficiency and facilitating vertical integration. At the time of this report, WBFA had a dynamic chairperson.
- The creation of incentives (led by the Forestry Department) for the private sector plantations of high-value timber species. In particular there is untapped potential for community forestry enterprises and smallholder plantations to develop ‘vertical integration’ type relationships with wood-processing SmEs. To date, the creation of incentives has been highly constrained by the MTE’s ‘ownership’ of planted teak trees⁶, land tenure insecurity, high regulatory costs and weak support services to constrain private sector plantations. This can be addressed mainly by simplifying the regulatory basis (since planted timber has a very low legality risk), clarifying landowner and smallholder rights over planted teak trees⁷, and through technical and financial assistance packages to organised groups.⁸ There is an urgent need for a similar study to Hilary Smith’s analysis of the smallholder timber plantation sector in Laos.
- Increased commitment and resources to clamp down effectively on the rampant illegal cross-border timber trade with China and other neighbouring countries. This would increase the availability of timber for SmEs, including by reducing the presence of foreign (especially Chinese) timber traders in the MTE timber auctions with their consequential impacts on the price and availability of legal timber.

⁹ This can be part of trend of decentralising powers to state and region administrative structures and local governments in line with the 2008 Constitution, although it has been noted that this risks some policy incoherence between central and regional/local Government; this is partly due to capacity constraints at the regional/local level as well as top-down appointment processes (Myanmar Centre for Responsible Business draft briefing paper on biodiversity, human rights and business in Myanmar).

- In some forest areas where SmEs can be identified as key drivers of deforestation and forest degradation and/or where they are less receptive to horizontal or vertical integration, the best policy may be to reduce the number of timber-based SmEs by promoting alternative, more sustainable livelihoods for forest-dependent communities. There is an obvious link with REDD+ (reducing emissions from deforestation and forest degradation in developing countries) programmes or projects, which take this approach and for which there may be more funding (for example in the on-going UN-REDD Programme of Myanmar or from donor agencies such as the Norwegian Agency for Development Cooperation, NORAD). There is therefore an urgent need for increased collaboration or integration between the FLEGT and REDD+ programmes and projects in Myanmar.
- Decentralisation of forest management and governance, at least in the ten main producing States or regions⁹. SmEs could potentially benefit from decentralisation of decision-making of the management of, and access to, timber supply chains.

As regards the gender equity dimensions of support to the wood-based SME sector, this report proposes the following recommendations:

The Forestry Department, through the proposed new SME support division, should:

- Increase state support for women's participation and leadership in SMEs: This could include training in business management and administrative skills, market analysis and marketing, and improving access to finance that facilitates business growth.
- Work with producer associations such as the Wood Based Furniture Association and the Young Women Entrepreneurs Association – and with larger or national business associations (for example, the Union of Myanmar Federation of Chambers of Commerce and Industry) – to increase their reach to rural women entrepreneurs and workers with the aim of increasing the women's representation and voice within these associations.
- Build capacity of wood producer associations and networks to reach women-owned and co-owned SmEs, and support exchanges between business women in these value chains that can promote knowledge exchange and capacity building, especially on labour/employment rights.
- Encourage producer associations to support women's access to information and training opportunities, especially regarding market information, finance/credit and technologies.
- Encourage women's advocacy organisations such as the Myanmar Women Entrepreneurs Association and the Myanmar Women's Affairs Federation to work on gender issues in these value chains (while recognising that it may be hard to compete with other high-profile priorities).

About the EU FLEGT Facility

The EU FLEGT Facility supports the European Union, its Member States and partner countries in implementing the EU FLEGT Action Plan. The European Forest Institute has hosted the Facility since 2007. The Facility has its headquarters in Barcelona, Spain, with additional offices in Brussels, Belgium; Joensuu, Finland; and Kuala Lumpur, Malaysia.

Disclaimer

This briefing has been produced with the assistance of the European Union and the Governments of Finland, France, Germany, the Netherlands, Spain, Sweden and the United Kingdom. The contents of this briefing are the sole responsibility of the EU FLEGT Facility and can under no circumstances be regarded as reflecting the position of funding organisations.

© EU FLEGT Facility, 2018

