



The IKEA linkage model in Viet Nam: Actual situation and options to improve timber industry value chain

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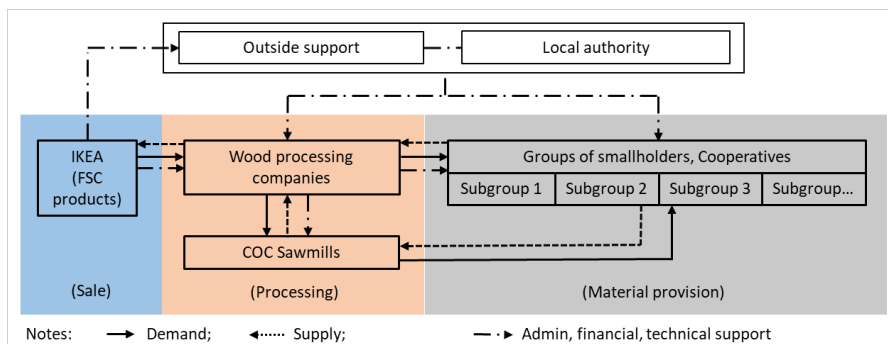
Outline

1. Introduction
2. Description of the model
3. Economic, social and environmental effectiveness of the IKEA linkage model
4. Discussions

Introduction

- Household forest plantations (1.4 mn households, 3.146 mn ha) have proven bringing about economic, social, and environmental benefits
- Households plantations contributed significantly to the country's wood processing industry (16 mn m³ annually)
- In order to maintain this source of legal timber, export-oriented wood processing companies in Vietnam have thus established, and are developing, strong links to plantation households
- One of the best examples of this "linkage model" is the partnership between companies that specialize in processing wood products for the IKEA Group, and forest planting households

Description of the IKEA linkage model



Description...

Linkages between IKEA and its Suppliers

- IKEA is not directly involved in manufacturing, choosing instead to source from qualified suppliers
- IKEA adopts a rigorous process with strict criteria in choosing suppliers
- Two parties sign a 3-5 year Strategic Partnership Agreement to formalize the relationship, as the basis for all contracts or signed orders between parties
- Strict requirements of IKEA, following its IWAY standards and FM/CoC FSC (100% FSC timber from 01/01/2017)

Description...

IKEA and its Suppliers

	IKEA	Suppliers
Rights	<ul style="list-style-type: none"> • To have a stable supply of FSC-certified products; to reduce the risks of using illegal timber materials • To create trust systems throughout the supply chain • To reduce monitoring costs. 	<ul style="list-style-type: none"> • To obtain loans from IKEA or borrow in advance if there is demand. • To be supported by IKEA to build a business management system with high quality that meets the IKEA requirements and meets most of the quality requirements from other buyers. • To guarantee long-term orders (3-5 years).
Obligations	<ul style="list-style-type: none"> • To ensure stable and long-term consumption of all of the products manufactured by its suppliers. • To support the technical and management skills of its suppliers (through a third party). • To provide capital for its suppliers as required. • To monitor and audit its activities for its suppliers and sawmill systems in the supply chain. 	<ul style="list-style-type: none"> • To ensure the supply of FSC-certified products in the right quantity, species, quality, and time. • To ensure the increase of annual quantity by increasing manufacturing productivity without expanding its scale of production (e.g., no expansion of factories or labor force). • To ensure there is no fluctuation in product price.

Description...

IKEA Suppliers and Forest Plantation Households

	IKEA Supplier / Wood Processing Company	Forest Plantation Household
Rights	<ul style="list-style-type: none"> To maintain a stable source of timber materials that meet IKEA product requirements. Actively control the source of timber materials, to reduce dependence on imported timber materials. 	<ul style="list-style-type: none"> To access capital support with low- or zero- interest rates in order to prolong the growing cycle of planted forests To access new scientific and technological assistance in plantation forest development to increase forest productivity, minimize or eliminate negative impacts on people and the environment due to certain farming practices There is a stable output market for the timber harvest.

Description...

IKEA Suppliers and Forest Plantation Households

	IKEA Supplier / Wood Processing Company	Forest Plantation Household
Obligations	<ul style="list-style-type: none"> To support finance for the establishment and operation of household groups. To grant low- or zero-interest credit for households in the group in order to prolong the cycle of plantation forests. To advise on techniques for households to comply with FSC requirements. To sponsor the evaluation cost for certification. To commit to purchase timber at a price higher than the market price at the time of harvesting. 	<ul style="list-style-type: none"> To obey the technical requirements to ensure certified timber. To extend the cycle of trees in order to create large-diameter wood. To (preferably) sell timber to affiliated wood processing companies.

Description...

Support from Outside Organizations

- Quang Tri FSC groups: Swiss Agency for Development and Cooperation (SDC) and IKEA (via World Wildlife Fund--WWF)
- Yen Bai FSC groups: FAO through the Farmers Union
- Binh Dinh FSC groups: the World Bank via the WB3 project

Effectiveness of the linkage model – Economic (1)

For Suppliers: (1)

(+)	(-)
<ul style="list-style-type: none"> • Low net return (4-5%), but large order → Large total profit: <ul style="list-style-type: none"> • NAFOCO (2016) has orders valued \$32.5 mn → \$1.3-16 mn profit • Scansia Pacific (2016) has orders valued \$25 mn → \$1-1,25 mn profit • IKEA's orders are generally stable → stabilised and long term production plan • IKEA's products are simple and change little in terms of design → reduce enterprises' costs • IKEA's long-term commitment → helps ensure investment for FSC-certified raw material inputs 	<ul style="list-style-type: none"> • Only suitable for companies with large financial capacity and production scales • CoC requirements requires processors to pay more • Loosing binding agreement with smallholders: they decide when and to whom to sell timber to

Effectiveness... – Economic (2)

For plantation households: (1)

Model	FSC-certified Households in Quang Tri*		Non-FSC-certified Households in Yen Bai**	
Acacia cultivars	Australia Acacia mangium		Acacia Hybrid	
Plantation density	1,330-2,000 roots per ha		1,600-2,200 roots per ha	
Harvest cycle	10 years		7 years	
Indicator	Value (million VND/ha)	Note	Value (million VND/ha)	Note
Total revenue	167.5 – 201		96 - 127	
Total cost	50.3 – 60.3	Equivalent cost approx. 30%, including varieties, fertilizers, equipment, labor salary and harvest (outsourced), and transportation; excluding household labor and the FSC grant	32 – 42	Equivalent cost approx. 30%, including varieties, fertilizer, labor salary and harvest (outsourcing), and transportation; excluding household's labor salary
Total profit	117.2 – 140.7	Within 10 years	63 – 85	Within 7 years
Annual average profit	11.7 – 14.1		9 – 12.1	
Average profit per m ³ timber	0.84 – 0.94	140-150 m ³ includes the pruning volume, selling lumber and wood chips at the end of the 10-year cycle	0.7	90-120 m ³ includes the pruning volume, selling lumber and wood chips at the end of the 7-year cycle

Effectiveness... – Economic (3)

For plantation households: (2)

- Households get VND15-27 mn /ha/10 year when selling 10-18% higher than non-certified timber
- **Note: the following costs not yet calculated:**
 - (i) Costs for complying FSC requirement (soil preparation, planting, caring, protect, harvest;
 - (ii) Labour cost of the households;
 - (iii) Certification assessment (about \$28,000 USD / 5 years).

Effectiveness... – Economic (4)

For plantation households: (3)

Other additional factors affecting to profit of households:

- **Requirements for large-diameter timber:** Processing companies only buy large timber materials (small-ended diameter must be 14 cm or larger), and will not accept hollow logs
- **Long harvesting cycle:** 8 to 12 years, thus large capital needed
- **Difficulties in complying with FSC requirements:** 10 principles and 56 criteria; no intercrop; scattered small 1-3 ha plots mixed with non-certified areas
- **Diversity of plant cultivars** amongst the households

→ it is **unclear** whether the added value of the 10-18 percent selling price differential enables households to yield a higher profit

Effectiveness... – Social

(+)	(-)
<ul style="list-style-type: none"> • Mutual support → reduce outside pressures, increase competitiveness; invest more effectively; thereby enabling more sustainable economic development for society as a whole • Motivated the government to promote recognition of land tenure by granting land use certificates to households → reduce conflict within communities • Compliance with labor, hygiene, and health and safety laws in harvesting and manufacturing process → protect employees' health 	<ul style="list-style-type: none"> • Doubts of economic beneficial and sustainability, compliance of parties, land withdrawal, only buy large sized timber,...

Effectiveness... – Environmental

Compliance with the IKEA Way on Purchasing Products, Materials, and Services (IWAY) and FSC's FM/CoC, bring about positive impacts

- Timber source control → limit the loss or degradation of forests, water sources, and biodiversity
- No large clear harvesting and field clearing → reduced environmental pollution
- Better working and factory conditions

Discussions (1)

- Although the model is still in its inception phases, it has the potential to offer stable, long-term benefits for all parties involved, especially under the increasing demand of certified products in the global markets
- However, there are uncertainties and risks for the development of the linkage model
- 3 important conditions for strengthening the linkage model:
 - Having a focal organization that has the financial and technical capacity to establish, develop, and oversee the linkage model in a way that effectively responds to the interests of all involved.
 - The involved parties gain fair benefits
 - The linkage model itself is not an administrative organization, and stakeholders participate on a voluntary basis (under a “consent mechanism”).

Discussions... (2)

However, the model would not exist if:

- IKEA no longer requires FSC certified timber material
- Households have to cover certification associated costs
- Processing companies are not able to buy all the raw materials (owing to increased production area, better price of imported timber)

Potential risks:

- For processing companies: losing agreement (high risk of breaking the contract of households)
- For plantation households:
 - Profit from FSC timber < non-FSC timber
 - Companies only buy large sized and good quality timber
 - Financial and technical capacity of most of 1.4 mn households not enough

Discussions ... (3)

- *“Belief”* and *“fair share of benefits based on the responsibility of the involved parties”* were emphasized as foundational principles.
- The linkage model should be developed, BUT not necessarily FSC timber → **Linkage for non-FSC but legal timber**. Reasons:
 - Important role of households: contributing 60-70% of annual plantation timber
 - Help reduce import of timber, reduce risk of importing illegal timber
 - Overcome limitations of production and investment capacity

Discussions ... (4)

- **Policy recommendations (to local government):**

- Expand land access to more households, especially the poor and the land-shortage. Land sources: Commune People's Committees, State Forestry Companies
- Should not directly engage in linkage activities, nor issue administrative orders requiring households to participate
- Create and enforce mechanisms to improve business confidence, including stronger sanctions to minimize the risks when households break contract.
- Establish measures to ensure equitable economic, social, and environmental benefits, and prioritize mutual trust and fair benefit-sharing

Thanks for your kind attention!