Timber Legality Verification Systems and furniture producers in Indonesia

Lessons from Jepara and Pasuruan, Indonesia

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Foto by Ahmad Dermawan/CIFOR.
Semi-processed furniture products in Jepara, Indonesia.

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1 Introduction

Global efforts to improve governance in the forestry sector have been underway through a variety of measures. From market to regulatory approaches, these measures aim at ensuring that forest products are legal and sustainable. Over the last decade, Indonesia has made significant strides to improve forest governance. The Government of Indonesia (GoI) has made curbing illegal logging a strategic goal within the Ministry of Forestry's long-term plan (MoF 2006). As part of its commitment to Forest Law Enforcement, Governance, and Trade (FLEGT), the GoI has also engaged in multi-agency operations and other measures to curb illegal logging across Indonesia (Luttrell et al. 2011).

One of the main milestones in improving forest governance in Indonesia was the signing of the Voluntary Partnership Agreement (VPA) with the European Union (EU) on 30 September 2013. Indonesia also became the first country to issue a FLEGT license, effective 15 November 2016. These are important steps for Indonesia and the EU to ensure that Indonesia's timber products comply with the Indonesian timber legality standards.

The GoI further developed the Indonesian timber legality assurance system, called *Sistem Verifikasi Legalitas Kayu* (SVLK), to meet the VPA requirements. SVLK enables timber to be traced along the supply chain to ensure its legality. Within the system, actors from smallholders, industry operators and traders in Indonesia are supposed to be registered and certified. SVLK regulations apply to all actors in the timber sector, both large and small.

One remaining issue requiring the attention of the GoI and other stakeholders revolves around the relationship of smallholders to SLVK. To what extent do they need to comply, both with SVLK and with a legality system for supplying domestic markets? There are concerns that small producers have less capacity to meet the conditions in SVLK regulations despite efforts to ease the processes through which they can become SVLK-compliant. Some small actors have become legally verified businesses and operate according to SVLK rules, but these cases are rare compared to the size of the small-scale timber business in the country.

This report attempts to assess the capacity of small-scale furniture producers to comply with the SVLK. It focuses on the furniture sector in Jepara and Pasuruan, which is dominated by small-scale producers. The Central Statistics Agency reported 160,000 furniture producers in Indonesia by 2018 (BPS 2019). Furniture is one major contributor to Indonesian exports, with USD 1.73 billion in 2019 (Bank Indonesia 2020). The study aims to describe the business characteristics of furniture production, including revenue and cost structure. More importantly, it will assess the extent to which furniture producers can comply with SVLK requirements in Jepara and Pasuruan.

2 Literature review

Micro, small and medium enterprises (MSMEs) play an important role in the Indonesian economy. First, they contribute to employment creation by absorbing a significant number of workers. In 2018, for example, the furniture industry absorbed around 400,000 workers, most of whom were informal (BPS 2019). Second, MSMEs play a role in entrepreneurship and business skill development, resulting in the 'upgrading' from micro-to-small and small-to-medium enterprises (Ascarya and Rahmawati 2015; Tambunan 2019).

MSMEs are generally informal, which is often reflected in lack of access to formal financing. This lack of financial access is partly due to lack of registration within the government system. They often operate without complete documentation, and sometimes have the owner is the only worker (IFC 2016). More than half of MSMEs in Indonesia are informal or semi-informal (IFC 2016). Approximately 76% of the micro and small industry uses self-generated capital (BPS 2019).

Attempts to formalize small-scale informal operators means changing at least some characteristics of the informal sector. Companies would need to change their operation to have more proper documentation. This includes records of workers' salaries, documentation of raw materials and production processes, and development of standard operating procedures (Chen 2007; Ascarya and Rahmawati 2015).

Simultaneously, the demands of global value chain configuration for trade in standardized and auditable goods and services may drive formalization. Certification was adopted to ensure the standardized production and trade of goods and services (Setyowati and McDermott 2017). Certification may take a form of legality verification, as in the case of Indonesia's SVLK. Legal verification has similarities with certification in that it drew on multistakeholder processes to establish legality standards. However, unlike certification, the final authority lies with Indonesia's government, particularly the Ministry of Environment and Forestry (MoEF).

Embracing SVLK would enable MSMEs to participate in global value chains. MSMEs with SVLK certificates will be able to address demands from international markets. However, the process of becoming legally verified has been challenging and costly for MSMEs. They must cover several certification costs to maintain their certificate and status as formal entities. The cost implications of SVLK compliance are high and, in some cases, lead to new power relations between large and small producers. For example, under this relationship, several small producers in Central Java and Yogyakarta benefit from access to export markets by using the certificate held by large producers or vice versa (Maryudi and Myers 2018; Acheampong and Maryudi 2020).

3 Method

APKJ and CIFOR surveyed furniture producers in Jepara (Central Java) and Kota Pasuruan (East Java, hereafter called Pasuruan) (Figure 1). The survey was from December 2019 to February 2020.

3.1 Source of data

In Jepara, the Office of Trade and Industry provided the list of furniture producers that either have exported their products or are interested in accessing international markets. The producers consist of several clusters based on geographical areas. Each cluster generally focuses on specific products. We selected 117 respondents (51%) from the list of 228 furniture producers provided (Table 1). Figure 1 shows the geographical distribution of the respondents.

Table 1. Sample selection in Jepara.

Subdistrict	Number of respondents
Batealit	11
Jepara	21
Mlonggo	25
Nalumsari	12
Tahunan	48
Total	117

Source: APKJ-CIFOR survey.

In Pasuruan, the Industry and Trade Office provided a list of 183 furniture producers. We also received the names of 38 producers from the Forum of Furniture and Handicraft Producers (*Forum Mebel, Kerajinan dan Seni* – Formekers) of Pasuruan. These two lists combined make a

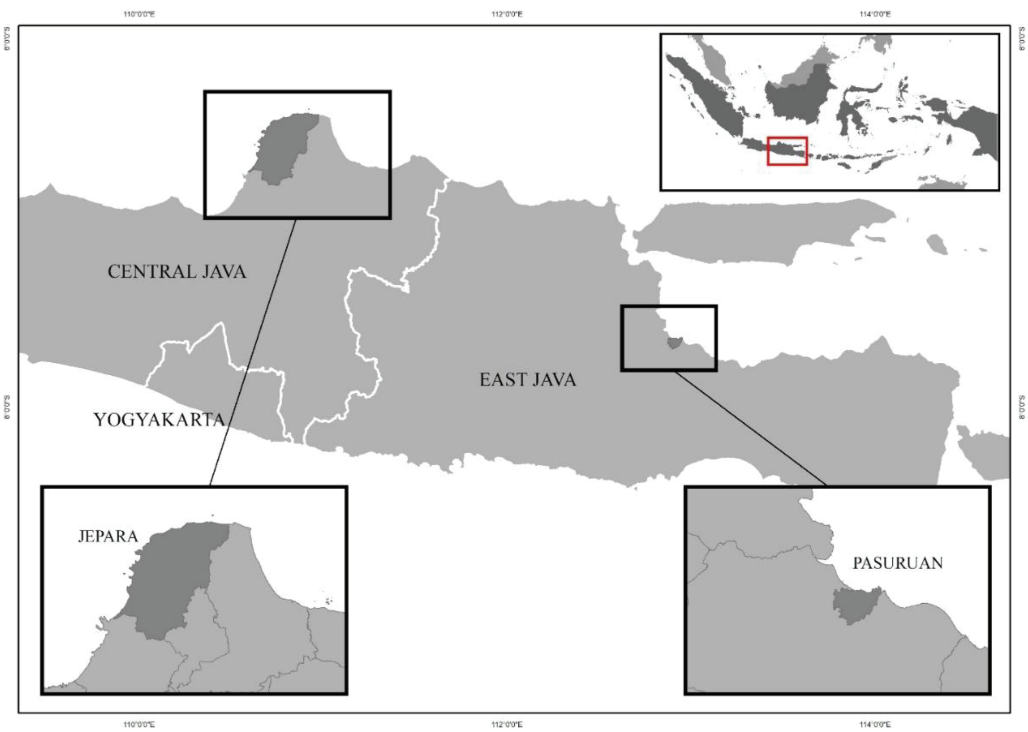

Figure 1. Location of Jepara district and Pasuruan municipality.

Source of data

total of 221 producers. We selected 122 producers (58%) based on respondents' availability (Table 2). Figure 2 shows the geographical distribution of the selected respondents.

We collected the data via a structured interview with respondents using digital questionnaires (Appendix 1). The structure of the survey is as follows:

1. Respondent and business characteristics: age, gender, education, position in the company, name of the company, address, length of operation, type of registration, business scale. (based on number of workers), permanent workers and their roles and salaries, and facilities
2. Timber source and destination of product sales: where the producers purchase the timber and where they sell the products.
3. Production, revenue and costs: product types, sales value and production cost.
4. Certification: timber-based certificates owned, and the financial and nonfinancial benefits.
5. Producers' practices in areas auditable for SVLK: there are several items to be verified if producers wish to have an SVLK certificate.

Table 2. Sample selection in Pasuruan.

Subdistrict	Number of respondents
Bugul Kidul	2
Gadingrejo	90
Panggungrejo	4
Purworejo	26
Total	122

Source: APKJ-CIFOR survey

The items build on the Director-General Regulation P.14/PHPL/SET/4/2016 Appendix 2.8. For each question, we provided an incremental option: (1) not at all; (2) a few items under question are available or carried out; (3) some items under question are available or carried out; (4) most items under question are available or conducted; (5) all items under question are available or implemented. The questions are in the areas of:

a. completeness of business documentation
b. sales and purchase contract records
c. raw material receipt records
d. timber import records

Figure 2. Geographical distribution of the respondents in Jepara.

e. supplier conformity declaration *(Deklarasi Kesesuaian Pemasok – DKP)*
f. DKP records
g. documents of timber from demolished buildings/waste *(kayu bongkaran/ sampah kayu)*
h. document of timber from industrial waste *(kayu limbah industri)*
i. production records
j. pasting of V-Legal mark/sticker
k. implementation of Occupational Health and Safety (OHS)
l. first aid kits
m. hiring of workers under the age of 18.

We developed the questionnaire using XLSForm, which we uploaded to the KoBo Toolbox server (a cloud database for collecting information). We installed ODK Collect on a tablet and connected it to the questionnaire in the KoBo Toolbox server. The application allowed data to be stored in the mobile phone when we conducted interviews — once connected to the Internet, the enumerator uploaded the questionnaire to the KoBo Toolbox server. The use of mobile applications reduced time required to enter the paper-based questionnaire into digital form before data analysis. The mobile app, which runs in the Android ecosystems, also allows for collecting geolocation and picture documentation.

We conducted a Focus Group Discussion (FGD) in each district, where preliminary analysis of the survey was presented and discussed. The FGD aimed to present preliminary survey results, receive feedback from key stakeholders in each location and obtain additional information on the benefits of obtaining SVLK and challenges to comply with it. In addition, we conducted a training on the principles of SVLK and its audit process. We also organized a session of sharing lessons from legally verified furniture producers about the process where we collected additional information about the benefits and challenges with SVLK.

3.2 Data analysis

We applied a descriptive analysis of the small furniture producers' performance and gaps with full SVLK compliance. Findings are presented on five topics: (1) producer and business characteristics; (2) origin of timber and destination of products; (3) production, revenue and cost; (4) certification; and (5) current practices against items auditable for the SVLK.

Figure 3. Distribution of the respondents in Pasuruan.

4 Results

4.1 Producer and business characteristics

The producers' average age is between 41 (in Pasuruan) and 46 (in Jepara). Most respondents were male. In Jepara, only two respondents were women (Table 3). Meanwhile, there were more women respondents in Pasuruan, although they represented only 13% of total respondents.

In terms of education, about 20% of respondents in Jepara and 26% in Pasuruan had university degrees. Almost half had a senior high school or equivalent degree.

Table 4 presents the business characteristics of the respondents in Jepara and Pasuruan. More than 80% in Jepara and more than 50% in Pasuruan were home-based industries. Only one respondent had a business entity in the form of a limited liability company (*Perseroan Terbatas*, PT).

Table 4 also shows the categorization of the business scale according to number of workers. Micro-scale businesses have a maximum of 5 workers, small businesses have between 6–20 workers, and medium companies have 20–100 workers (BPS 2019). Based on the criteria, 87% of respondents in Jepara fell under the micro and small business category, while the rest were medium-scale businesses. Concerning ownership of equipment, Table 4 shows most respondents had workshops. Approximately a third had showrooms, while only a few had a kiln and sawmills.

We asked furniture producers whether they had obtained timber-related certificates. Table 4 presents the certificate owner of the furniture producers in Jepara and Pasuruan. Only 11 respondents (9%) in Jepara and 2 (1%) in Pasuruan had the timber certificate. One of the 11 respondents in Jepara also had an FSC certificate. Meanwhile, the two respondents in Pasuruan had an SVLK certificate.

Table 3. Producer characteristics in Jepara and Pasuruan.

	Jepara		Pasuruan	
Average age (year)	46		41	
Sex				
• Male	115	98.3%	106	86.9%
• Female	2	1.7%	16	13.1%
Education				
• No schooling	1	0.9%	0	0.0%
• Elementary school	15	12.8%	21	17.2%
• Junior high school	28	23.9%	15	12.3%
• Senior high school	50	42.7%	54	44.3%
• University	23	19.7%	32	26.2%

Source: APKJ-CIFOR survey.

4.2 Origin of timber and destination of products

Table 5 shows the regions where furniture producers in Jepara and Pasuruan source their timber. It shows that most respondents sourced timber first from local markets and then from timber markets within the same province. Jepara shows more diversity, with some producers sourcing timber from Sumatra, Kalimantan and Sulawesi. Meanwhile, producers in Pasuruan only sourced timber from the local market and markets within East Java. However, this does not imply there are timber growers in both Jepara and Pasuruan.

Table 6 shows where furniture producers sell their products. In Jepara, producers sold their products to both domestic and export markets. In the domestic market, producers sold within the district, to Central Java and to other places

Table 4. Business characteristics.

	Jepara		Pasuruan	
Average year of operation	17		21	
Form of business				
• IRT*	96	82.1%	67	54.9%
• UD*	16	13.7%	45	36.9%
• CV*	5	4.3%	9	7.4%
• PT*	0	0.0%	1	0.8%
Scale				
• Micro	45 (1)**	38.5%	81	66.4%
• Small	57 (5)**	48.7%	39 (2)**	32.0%
• Medium	15 (5)**	12.8%	2	1.6%
Facilities				
• Workshop	114		104	
• Showroom	35		47	
• Sawmill	0		2	
• Kiln	10		0	

Note:

*IRT: *Industri Rumah Tangga* (household industry); UD: *Usaha Dagang* (trading business); CV: *Commanditaire Vennotschap* (joint venture); PT: *Perseroan Terbatas* (limited liability companies). Note that all are business entities, but PT is the only form of business that is also a legal entity.

** number in the parentheses represents the number of respondents with timber certificate (SVLK, Forest Stewardship Council).

Source: APKJ-CIFOR survey

Table 5. Sources of timber.

	Jepara		Pasuruan	
	Number of respondents	Percentage of total respondents	Number of respondents	Percentage of total respondents
Within the same district	94	80.3	113	92.6
Central Java	32	27.4	0	0.0
East Java	22	18.8	49	40.2
West Java	2	1.7	0	0.0
Sumatra	10	8.5	0	0.0
Kalimantan	0	0.0	0	0.0
Sulawesi	19	16.2	0	0.0
Others in Indonesia	1	0.9	0	0.0
Imports	0	0.0	0	0.0

Source: APKJ-CIFOR survey.

in Indonesia, mainly Yogyakarta. A considerable number exported their products. According to the certification status, certified producers in Jepara either served domestic or export markets, but not both. Meanwhile, most noncertified producers served the domestic market. However, noncertified producers also indirectly served export markets through sales of "export warehouse" (*gudang ekspor*), which is owned by companies that serve export markets.

Table 6. Destination of sales.

Destination	Jepara		Pasuruan	
	Number of respondents	Percentage of total respondents	Number of respondents	Percentage of total respondents
Within the same district	72	40.7	52	42.6
Central Java	10	5.6	0	0.0
East Java	8	4.5	83	68.0
West Java	3	1.7	0	0.0
Jakarta	15	8.5	4	3.3
Yogyakarta	2	1.1	0	0.0
Bali/Nusa Tenggara	14	7.9	11	9.0
Sumatera	6	3.4	0	0.0
Kalimantan	1	0.6	3	2.5
Sulawesi	5	2.8	2	1.6
Others in Indonesia	5	2.8	0	0.0
Export	24	13.6	1	0.8
Number of respondents with:				
	Noncertified	**Certified**	**Noncertified**	**Certified**
Only domestic market	80	3	90	1
Only export market	8	5	0	1
Both domestic and export	8	0	0	0
No response	10	3	30	0

Source: APKJ-CIFOR survey.

In Pasuruan, almost all producers sold their products within Pasuruan and the province. A certified producer served the domestic market, while the other served the export market.

4.3 Production, revenue and cos

Table 7 presents the production and financial performance of furniture producers in Jepara. Most producers were noncertified. For example, there is only 1 micro-scale certified producer compared to 44 noncertified companies. At the medium scale, where the difference was only five, there was less of a gap between the number of certified and noncertified producers. Average timber use within noncertified producers increased with the size of business. Conversely, timber use did not follow the same pattern within the certified group. Among certified producers, small-scale producers used less timber than did micro-scale producers.

Table 7 also summarizes the financial structure according to the business scale and certification ownership in Jepara. Gross profits increased with the size of business. Among noncertified producers, the gross profits of medium-scale producers were more than double those of small-scale producers and nearly six times those of micro-scale producers. Similarly, gross profits for certified medium-scale producers were about double those of small producers and nearly eight times more than the gross profit of small-scale producers. This difference may reflect value-added among producers, where middle-scale businesses produced higher value-added goods. The percentage of gross profits of small-scale producers was larger than those of micro- and middle-scale producers. In another interesting finding, the average gross profits of noncertified producers were higher than those of certified producers. The finding is consistent in each scale, although the difference was smaller among small-scale producers. The difference may reflect a lack of market opportunities for certified producers.

Table 8 presents the production and financial performance of furniture producers in Pasuruan.

Table 7. Average revenue, costs and profits, Jepara (million IDR per year).

	Jepara – noncertified			Jepara – certified		
	Micro	Small	Medium	Micro	Small	Medium
# of respondents	44	52	10	1	5	5
Timber use (m^3)	46.7	76.4	182.2	44.2	32.9	77.7
Revenue	356	652	3198	442	600	2396
Cost						
• Timber	158	230	1433	177	110	1185
• Worker	66	97	630	72	115	345
• Finishing	2	33	329	0	50	391
• Delivery	3	5	33	0	11	24
• Others	18	36	133	144	83	28
Gross profits	109	252	640	49	231	423
Gross profits (percentage of revenue)	30.46	38.68	20.03	11.09	38.53	17.66

Source: APKJ-CIFOR survey.

Table 8. Average revenue, costs, and profits, Pasuruan (million IDR per year).

	Pasuruan – noncertified			Pasuruan – certified
	Micro	Small	Medium	Small
# of respondents	81	37	2	2
Timber use (m^3)	60.8	80.5	64.5	358.4
Revenue	586	1126	1380	9294
Cost				
• Timber	303	356	318	2408
• Worker	129	128	189	621
• Finishing	45	94	0	1375
• Delivery	6	10	0	28
• Others	32	45	138	347
Gross profit	70	493	735	4.516
Gross profit (percentage of revenue)	12.03	43.73	53.28	48.59

Source: APKJ-CIFOR survey.

The numbers of certified producers were extremely small compared to noncertified producers, where only 2 of 122 total respondents had a certificate. Table 8 shows the difference in average timber volume across business scale was relatively low. For example, the timber volume gap between micro- and medium-scale producers was less than 4 m^3 (between 60.8 – 64.5 m^3). Small-scale producers used the highest amount of timber at 80.5 m^3.

Table 8 summarizes the financial structure according to business scale and certification ownership in Pasuruan. Gross profits increased along business scales. Among noncertified producers, gross profits of medium-scale producers at 735 million IDR were nearly 50% higher than those of small-scale producers and more than 10 times those of micro-scale producers. Moreover, certified producers in Pasuruan used 358.4 m^3 of timber — more than four times the amount used by noncertified producers at the same scale. Small producers in Pasuruan generated high gross profits. One reason could be related to using less labor, which is reflected in the lower proportion of workers to total cost. These companies may use high capital, which may significantly affect gross profits through asset depreciation.

4.4 Certification

We asked producers with certificates about the benefits of having them (Table 9). No producers responded to the benefits of the product's increased price or increased demand from existing markets. One producer in Pasuruan responded positively in terms of a demand from a new market.

Unlike the less positive response to the certification's financial benefits, producers responded positively about nonfinancial benefits. Respondents in Jepara noted improved management practices and enhanced business reputation as nonfinancial benefits. Meanwhile, respondents of Pasuruan noted enhanced business reputation, receipt of government support, involvement in local decision making and invitations to participate in exhibitions.

4.5 Current practices against items auditable for the SVLK

We asked producers about 13 points of individual producers' indicators to apply for the SVLK audits. Figure 4 presents producers' response in Jepara and Pasuruan to the degree to which they document their business.

Table 9. Benefits of having certificates.

	Number of respondents	
	Jepara	Pasuruan
Financial		
• Increased price	0	0
• Increased demand from existing markets	0	0
• Demand from new markets	0	1
Nonfinancial		
• Ease of applying for credit	2	0
• Enhanced business reputation	6	2
• Receipt of government support	2	2
• Involvement in local decision making	1	2
• Invitations to an exhibition	3	2
• Improved management	8	1

Source: APKJ-CIFOR survey.

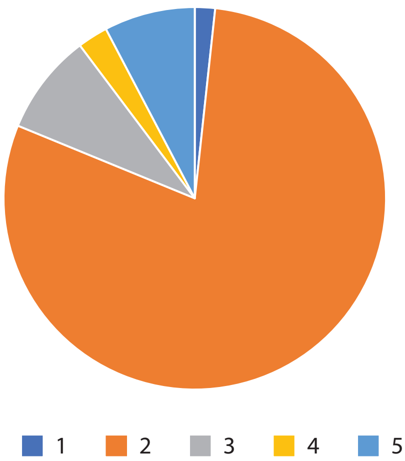

Figure 4a. Jepara

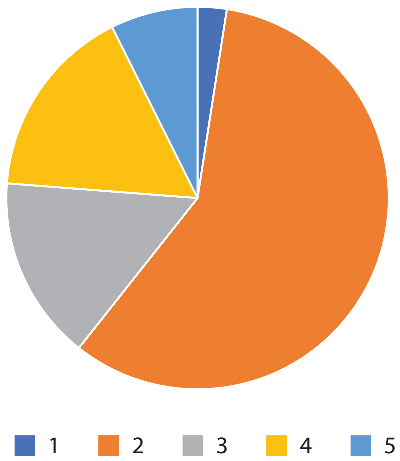

Figure 4b. Pasuruan

Figure 4. Completeness of business documentation.

Note: 1. No documents at all; 2. Only a few documents available; 3. Some documents available; 4. Almost all documents available; 5. All documents available.

Most respondents in Jepara and Pasuruan mentioned that only a few documents were available (Figure 4). More respondents in Pasuruan said that some documents were available. While all the producers had a business registry, other documentation was needed to apply for SVLK audits. This included a building permit, tax registry, environmental management efforts, and monitoring document (cf. Maryudi and Myers 2018). While respondents were aware of the GoI's Online Single Submission (OSS) program, the producers' inability to provide complete documents prevented them from applying. For example, some participants could not provide a building permit for their workshop.

Figure 5 shows the producers' responses in Jepara and Pasuruan about sales and purchase records. Half of respondents in Jepara stated they only recorded a few documents. A third of total respondents stated they did not keep records at all. Meanwhile, in Pasuruan, about two thirds of respondents answered they either "did not record" or "recorded only a few" sales and purchase records.

Figure 6 presents the respondents' answers about raw materials receipt records. More than 80% of respondents in each location said they either "did not keep records at all" or "only kept a few records" in this area. In Jepara, most participants responded with one of those two responses, while most

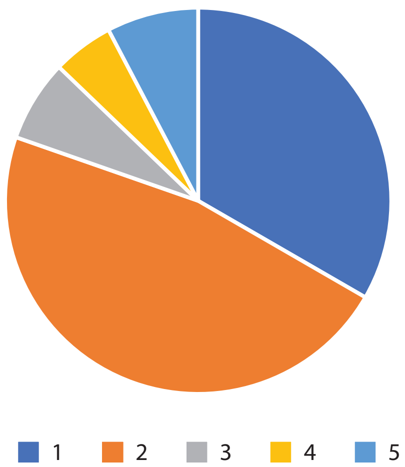

Figure 5a. Jepara

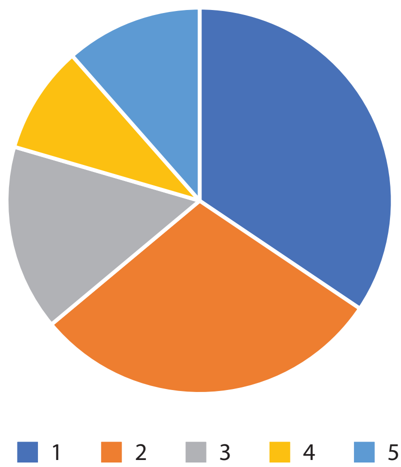

Figure 5b. Pasuruan

Figure 5. Sales and purchase contract records.

Note: 1. No documents at all; 2. Only a few documents available; 3. Some documents available; 4. Almost all documents available; 5. All documents available.

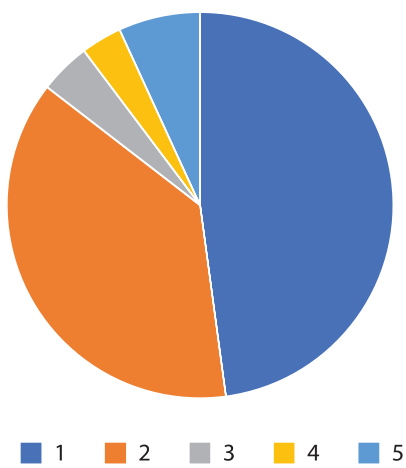

Figure 6a. Jepara

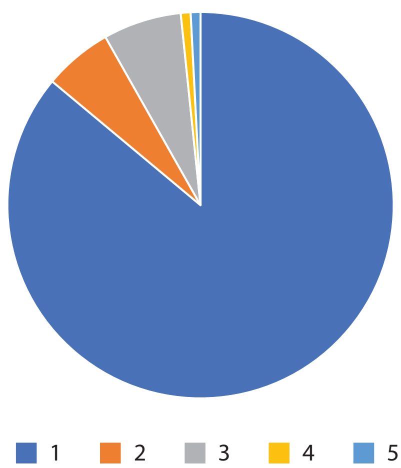

Figure 6b. Pasuruan

Figure 6. Raw materials receipt records.

Note: 1. No documents at all; 2. Only a few documents available; 3. Some documents available; 4. Almost all documents available; 5. All documents available.

respondents in Pasuruan answered they did not keep records at all.

Figure 7 presents the respondents' answer to whether they kept timber import records. Since Table 5 shows that no respondents imported timber, one might expect that all would answer that they did not record timber imports at all. However, some respondents in Jepara answered that they kept most or all records of imported timber. One explanation could be that some producers obtained SVLK or FSC certificates that had the order to produce furniture or handicraft with a specific type of timber. This practice does not seem to be widespread in both Jepara and Pasuruan.

Figures 8 and 9 present the respondents' answer about DKP. While most respondents answered they did not use DKP on all timber, some respondents in Jepara said they used DKP for their furniture. DKP relates to the supply from informal markets. In this sense, not using DKP could mean that either the producers bought timber from large-scale timber producers (such as timber from Perhutani) or bought the timber informally from smallholders without using DKP.

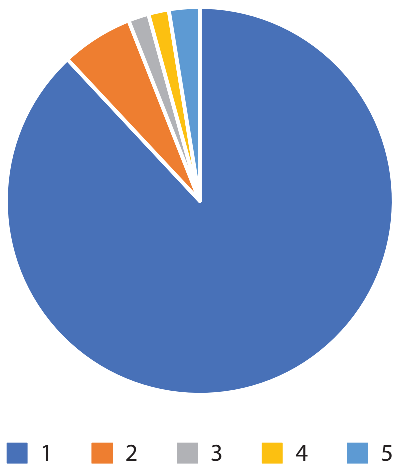

Figure 7a. Jepara

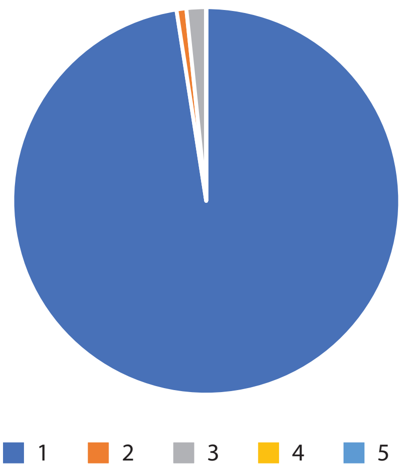

Figure 7b. Pasuruan

Figure 7. Timber import records.

Note: 1. No documents at all; 2. Only a few documents available; 3. Some documents available; 4. Almost all documents available; 5. All documents available.

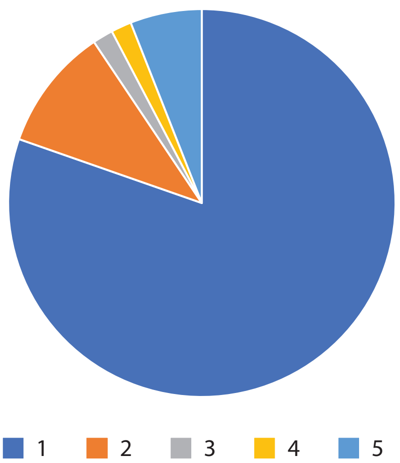

Figure 8a. Jepara

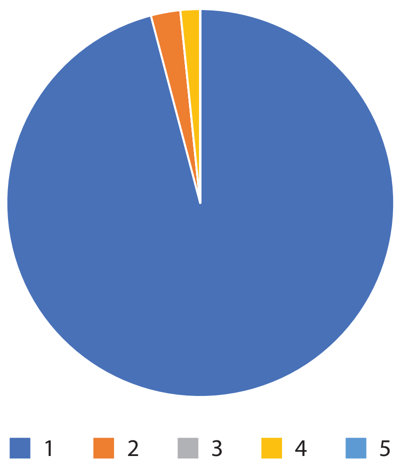

Figure 8b. Pasuruan

Figure 8. Supplier conformity declaration (DKP).

Note: No use of DKP on the timber; 2. Use DKP only on a small amount of timber; 3. Use DKP on some of the timber; 4. Use DKP on almost all timber; 5. Use DKP on all the timber.

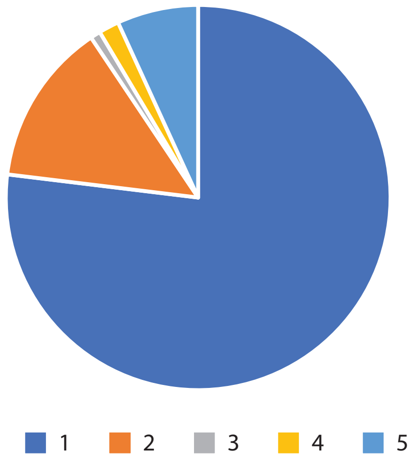

Figure 9a. Jepara

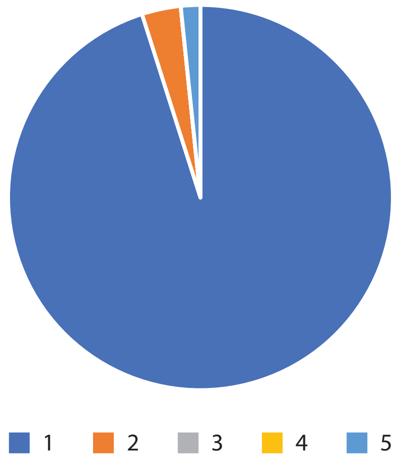

Figure 9b. Pasuruan

Figure 9. Keeping of the DKP record.

Note: 1. Not keeping DKP at all; 2. Keep only a small number of DKP; 3. Keep some of DKP; 4. Keep most of DKP; 5. Keep all of DKP.

Figure 10 presents the producers' response in Jepara and Pasuruan to keeping documents on timber from demolished buildings or waste (*kayu bongkaran atau limbah*). Arguably, all respondents in Pasuruan did not keep documents of such timber. Still, some producers in Jepara kept documents related to timber of demolished houses or waste. Figure 11 presents similar results on whether the producers in Jepara and Pasuruan kept timber documentation from industrial waste.

Figure 12 presents the response of producers in Jepara and Pasuruan to keeping production records. In Jepara, about half of respondents did not keep the production record at all. Another quarter of the respondents kept only a few documents. The remainder varied between keeping some of the production, almost all records and all records. Meanwhile, about half of the producers in Pasuruan said they either "kept production records" or "kept a few production records." About a quarter of respondents answered they kept almost all of the production records.

Figure 13 presents the respondents' answer to whether they paste the V-Legal mark on their products if they have it. As expected, since most producers did not have an SVLK certificate, most said they did not stamp the V-Legal mark on the products. We can expect that respondents who said they put on the V-Legal mark already had the SVLK certificate.

Figures 14 and 15 present the producers' response to Occupational and Health and Safety (OHS) and the availability of first aid kits. The distribution of responses to these questions was consistent among respondents in both Jepara and Pasuruan. About half of the producers in Jepara did not implement the OHS or provide first aid kits. About one-third of respondents in Jepara said they implemented only a few OHS programs and distributed a few first aid kits. In Pasuruan, more than three-quarters of respondents said they implemented ~~implemented~~ a "small number" or "some" OHS programs .

Figure 16 presents the respondents' answer to hiring workers below the age of 18. Almost all respondents stated their workers were all older than 18. Interestingly, some respondents in Jepara still stated that all their workers were younger than 18. This is the only area of compliance with SVLK. Figure 17 summarizes the average score of the current practices against the SVLK of Figure 4–16. Figure 17 shows that certified producers implemented better practices than noncertified producers in all areas. Area 13 (hiring workers above the age of 18) was the only one where producers in Jepara and Pasuruan showed the highest score with only a small difference between certified and noncertified producers. In several areas, Pasuruan producers showed higher scores, such as those related to OHS and preparing first aid kits, production records, business

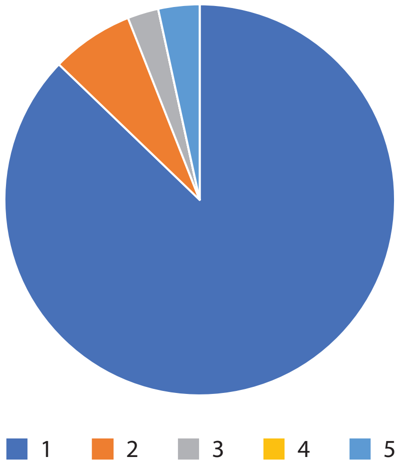

Figure 10a. Jepara

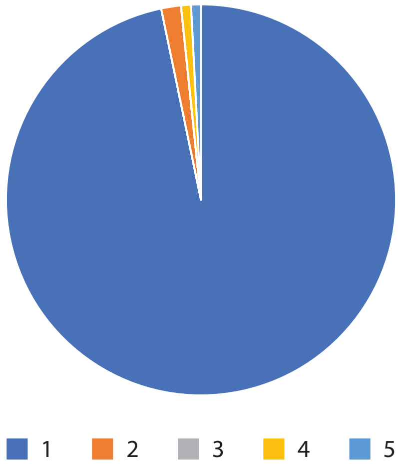

Figure 10b. Pasuruan

Figure 10. Documents of timber from demolished buildings/waste *(kayu bongkaran/sampah kayu)*.

Note: 1. Not recorded at all; 2. Only a few are recorded; 3. Some are recorded; 4. Almost all are recorded; 5. All are recorded.

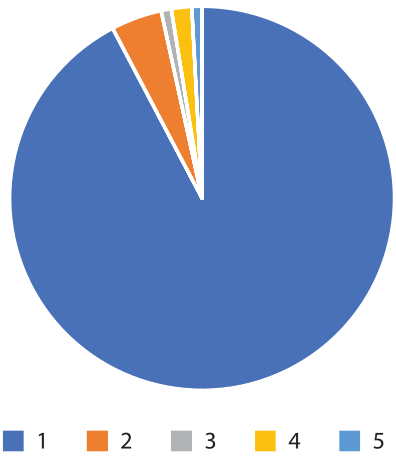

Figure 11a. Jepara

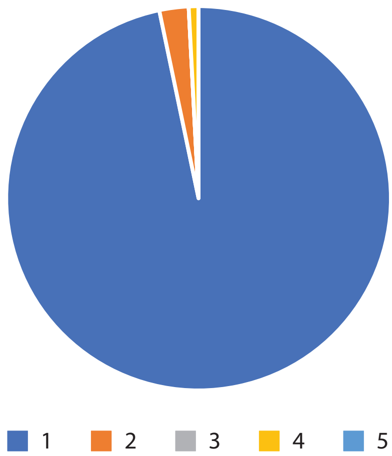

Figure 11b. Pasuruan

Figure 11. Document of timber from industrial waste *(kayu limbah industri)*.

Note: 1. Not recorded at all; 2. Only a few are recorded; 3. Some are recorded; 4. Almost all are recorded; 5. All are recorded.

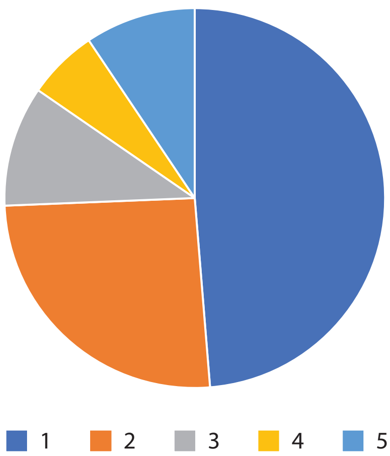

Figure 12a. Jepara

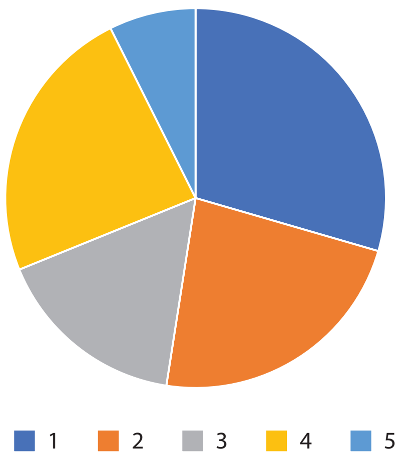

Figure 12b. Pasuruan

Figure 12. Production records.

Note: 1. Not recorded at all; 2. Only a few are recorded; 3. Some are recorded; 4. Almost all are recorded; 5. All are recorded.

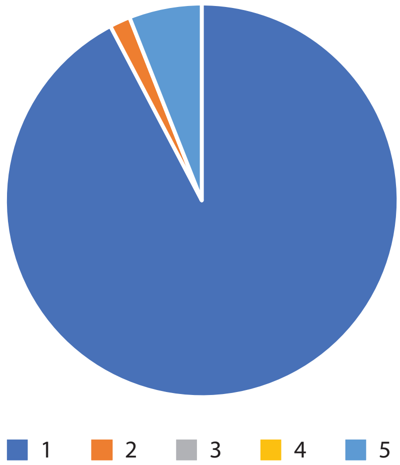

Figure 13a. Jepara

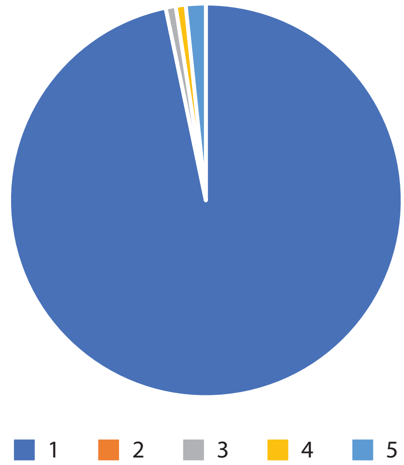

Figure 13b. Pasuruan

Figure 13. Putting on the V-Legal sticker.

Note: 1. Do not put on the V-Legal mark on all products; 2. Put the V-Legal mark only on a small number of products; 3. Put the V-Legal mark only on some of the products; 4. Put the V-Legal mark on almost all of the products; 5. Put the V-Legal mark on all of the products.

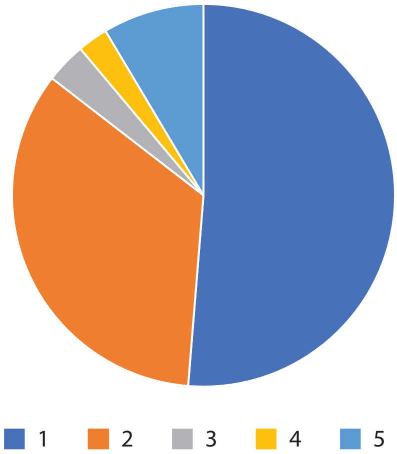

Figure 14a. Jepara

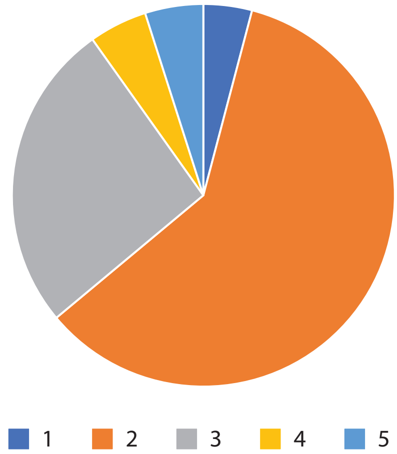

Figure 14b. Pasuruan

Figure 14. Implementation of Occupational Health and Safety (OHS).

Note: 1. Do not implement OHS programs at all; 2. Implement only a small number of OHS programs; 3. Implement only some OHS programs; 4. Implement most OHS programs; 5. Implement all OHS programs.

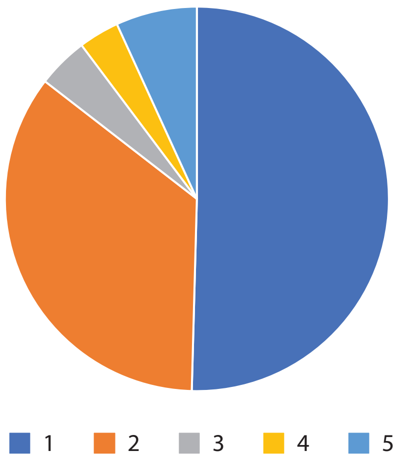

Figure 15a. Jepara

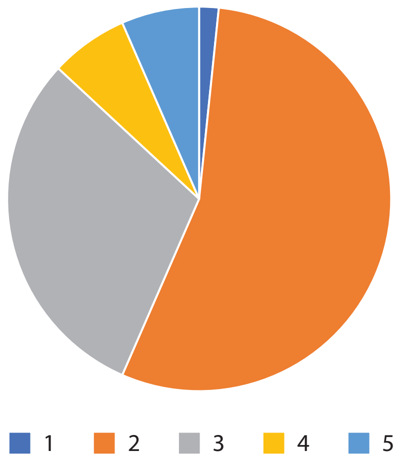

Figure 15b. Pasuruan

Figure 15. First aid kits.

Note: 1. No first aid kit is available; 2. Only a few first aid kits are available; 3. Some first aid kits are available; 4. Almost all first aid kits are available; 5. All first aid kits are available.

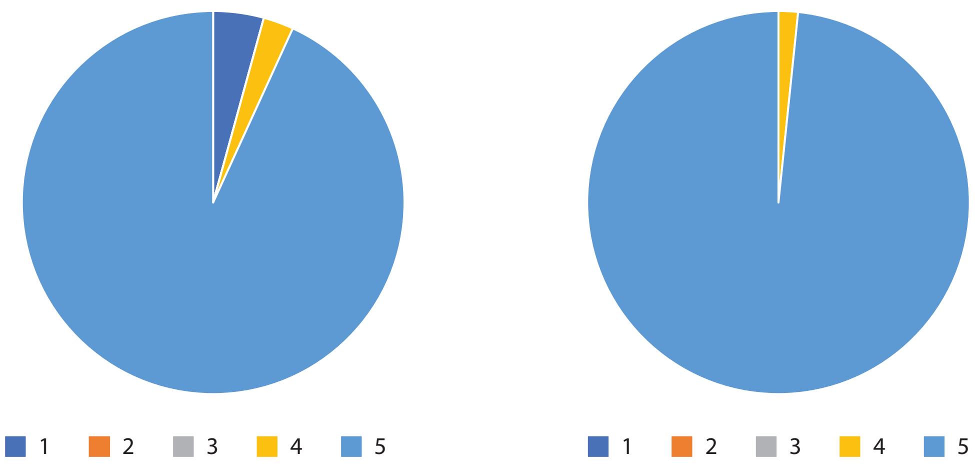

Figure 16a. Jepara

Figure 16b. Pasuruan

Figure 16. The hiring of workers under the age of 18.

Note: 1. All workers are under 18 years of age; 2. Almost all workers are under 18 years of age; 3. Some workers are under 18 years of age; 4. Only a few workers are under 18 years of age; 5. No workers are under 18 years of age.

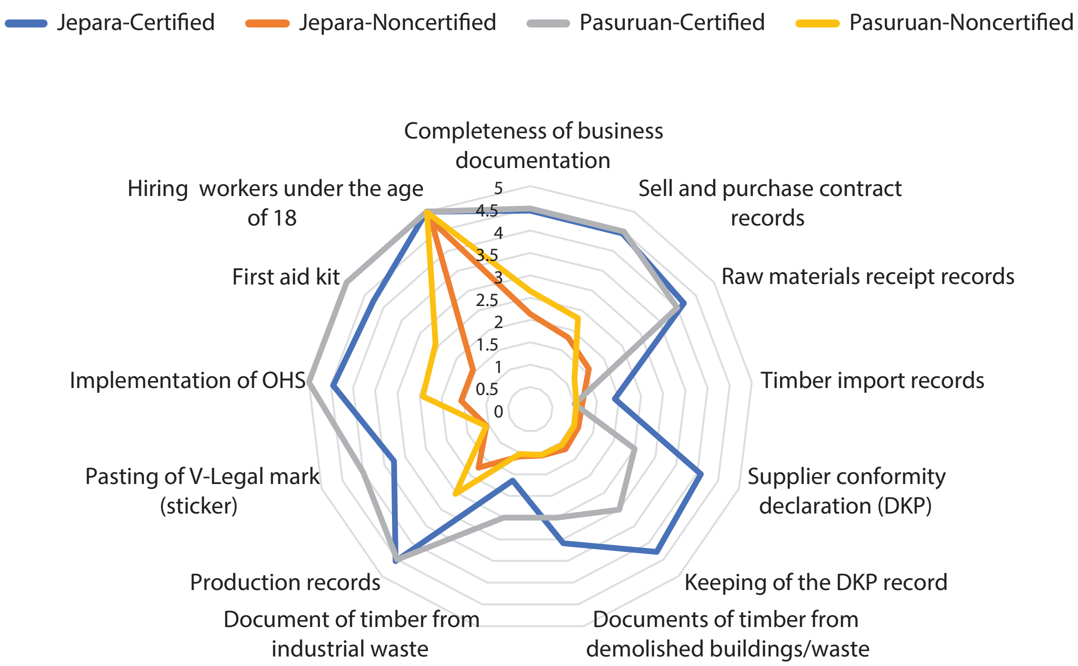

Figure 17. Average score of indicators of SVLK compliance areas.

Note: better practices are presented as farther from the center.

documentation completeness, and sales and purchase records. Jepara producers showed higher scores only on raw materials receipt records and the DKP record. However, other than hiring workers above the age of 18, other areas need attention as average scores were lower than three. In terms of priorities, areas four, seven and eight are arguably less pressing because only a small number of producers used imported timber and used timber from waste. Similarly, the average score of area 10 will be low (producers must get an SVLK certificate before they can put the V-Legal sticker on their products). Only a few respondents had the SVLK certificate.

5 Discussion

Some findings indicate the furniture industry in both Jepara and Pasuruan showed positive gross profits. Positive profits provided an opportunity for growth. At the same time, they faced challenges in terms of market conditions, particularly with the rising COVID-19 pandemic. We highlighted several areas from the findings that showed opportunities and challenges facing the industry. The first relates to the inclusiveness of SVLK for formal business entities and its cost implications. The second area is about the gaps between the producers' current and fully SVLK-compliant practices. The third area discusses the relations between certified and noncertified companies. The fourth is about the roles of central and subnational governments in closing the gaps. These areas, discussed in more detail below, highlight the key insights about SVLK as an instrument to legalize timber and move the timber business toward a formalized sector.

5.1 Business registration and certification

Earlier studies show that SVLK drives formalization, where informal actors register for a formal business license before they can apply for SVLK certificates (Obidzinski et al. 2014; Putzel et al. 2015; Setyowati and McDermott 2017). It is encouraging that SVLK does not restrict business registration types that can have a legal certificate. Producers in Jepara and Pasuruan can apply for SVLK regardless of business registration types. The only respondent with SVLK certification in Pasuruan is PT, while those in Jepara are not PT. Establishing a PT would require registration with the Ministry of Law and Human Rights Affairs. The shareholder/owner must deposit a minimum IDR 50 million of initial capital. This finding means that SVLK is inclusive of small producer participation. More important than the type of business registration is implementation of good business administration practices, one of which is to manage and record transactions properly. The nonfinancial benefit expressed by most respondents, in fact, is better management practices.

As an additional issue that would require better management practice, the cost of SVLK audit and its subsequent surveillances are not reflected in the products' price, at least directly. The respondents did not see the financial benefits of having certificates, which participants of the FGD in Jepara and Pasuruan corroborated. This finding is especially concerning for producers that run micro-scale businesses, where additional costs for preparation, audit and surveillance can reduce profits. For them, the only feasible response is to apply for group certification. Meanwhile, medium-scale companies or companies that produce high profits may still be able to apply for SVLK individually without compromising their financial structures.

5.2 Major gaps toward compliance to SVLK

Earlier studies (e.g. Obidzinski et al. 2014; Maryudi and Myers 2018; Acheampong and Maryudi 2020) show the various challenges for MSMEs to prepare and follow through with the audit and surveillance to maintain the certificate. Our survey found that respondents could meet almost all 13 areas if they were about to move ahead with the SVLK audit. For example, most producers hired workers above 18 years of age, but some other areas might be less relevant to them, such as use of timber from a demolished house, or industrial waste, or timber from imports.

Producers who wish to comply with the SVLK need to pay attention to the following areas: (1) keep the record of business documents; (2) keep the record of sales and purchase of timber; (3) keep the record of the production; and

(4) procure first aid kits and implement OHS. These are areas where small producers would need to improve. Changing behavior may take a long time; consistent facilitation by the government and nongovernmental organizations (NGOs) is necessary. Quick fixes such as hiring a consultant to fix the problems come at exorbitant costs (Maryudi and Myers 2018; Acheampong and Maryudi 2020).

Producers could begin to fill the gap as best they can. For example, procuring and maintaining first aid kits is something that producers can do for their benefit. Some actions would require training, such as the recording of timber purchase and product sales.

5.3 "Renting legality" and the relation between large companies and MSMEs

The survey and the workshops found another issue that corroborates earlier studies about challenges stemming from the SVLK certificate. In Jepara, several noncertified producers sold to export markets. In one workshop, we learned that a company can "rent" the certificate from another, a practice that Maryudi and Myers (2018) call "renting legality." The authors explain this practice is driven not only by the survival needs of MSMEs, but also by the desire of large-scale enterprises to accumulate more financial benefits and control of markets. It is also driven by the market conditions and inability of an MSME to meet demand from international buyers or the products in which quality standards require mechanization.

5.4 The role of government and other stakeholders

During the FGDs, participants highlighted the central and subnational governments' important role in enabling producers to become SVLK-compliant. Participants appreciated that the MoEF covered the cost of the first round of certification audits. Recently, the MoEF also made funds available for surveillance audits. Jepara is among the few districts with a District Regulation (*Peraturan Daerah*) to protect, foster and facilitate the furniture industry. However, it requires implementing regulations before a district government can make a budget allocation. District Regulation 2 of 2014 was the first district-level regulation to protect the furniture industry in Indonesia. The regulation has several objectives: (1) to strengthen the furniture industry to become resilient self-sufficient and sustainable; (2) to improve the capacity of the furniture industry to run its business; (3) to improve capacity to become competitive; and (4) to improve capacity to grow the business to a larger scale. To protect the furniture industry (Chapter III), the regulation mandates the district government to protect the furniture industry in the following areas (Article 5): infrastructure, business certainty, furniture price and insurance coverage. The government needs to empower the furniture industry (Chapter IV) in the following areas (Article 17): education and training, extension and facilitation, quality standards, marketing system and infrastructure, partnership schemes, financing, access to knowledge and institutional strengthening through technology.

Participants in Jepara and Pasuruan highlighted the difficulty in meeting environmental management efforts and monitoring (*Upaya Pengelolaan Lingkungan – Upaya Pemantauan Lingkungan*, UKL-UPL). At the same time, without obtaining the UKL-UPL document, they cannot apply through OSS. Training and facilitation from the district government or other stakeholders in this area are important. As elaborated by Maryudi and Myers (2018), preparation sometimes requires a consultant with certain qualifications. Jepara has made progress in the UKL-UPL through issuance of District Head Regulation (*Peraturan Bupati*) 4 of 2020. The regulation stipulates the UKL-UPL applies only to companies with an investment of IDR 1 billion or a building size of more than 1000 m^2, an annual production capacity of 2000 m^3 (for furniture) or more than 100 workers (for handicrafts). This regulation means that companies with a scale smaller than those mentioned above would not have to apply for the UKL-UPL.

Another area raised by participants in Pasuruan is the building permit required when the producer rents the land for its workshop. Changing the building permit from its initial purpose (for example, residential) to a workshop would require coordination between central and local governments. These governments would need to verify the kind of building and status of land ownership or land control. As in the case of the

UKL-UPL, producers cannot submit a registration through the OSS without the building permit.

Participants also requested assistance from the local government in several other areas. In Jepara, as one important focus, national and district governments should consider balancing or aligning sectoral development. Jepara has become a host to an influx of investments by companies moving from the western part of Java. These companies note that Jepara has a lower minimum labor wage than Jakarta, West Java or Banten. New investment in this sector has shifted from labor in traditional furniture sector to the new sectors. It also changes the workers' wage structure from being paid by the order (typical in the furniture sector) to becoming salaried workers. Having salary and insurance benefits attracted current workers and newly graduated students. The outcome is that several furniture producers found it challenging to find workers. Simultaneously, furniture producers found it difficult to keep up with the large companies' payment systems that provide monthly salaries and benefits.

Central and subnational governments could drive the demand for SVLK-certified products in the domestic market through public procurement. The discussion about including SVLK-certified products in public procurement has lasted for several years. However, the public procurement agency only included the stipulation in early 2020 with the circular letter 16 of 2020. The agency decided that SVLK-certified timber was among several green products in the public procurement systems.

6 Conclusion and Recommendation

The report aims to present the furniture-making industry's situation in two districts of Indonesia: Jepara, and Pasuruan. It also aims to assess the gaps between current practices and what it takes to comply with the SVLK. The finding shows some promising aspects, namely the industry's profitability and the ability to apply for SVLK regardless of the type of business license. Simultaneously, there are challenges to change the furniture sector's current practices toward those compliant with SVLK. While SVLK is about timber legality verification, the policy's scope goes beyond forestry or industry domains. Indeed, the challenges with MSME compliance to SVLK are arguably like those in all economic sectors. Cross-sectoral partnership is, therefore, required to address challenges and seize opportunities.

The study finds that MSMEs have more flexibility in the formalization process, despite having to register. At least in Jepara, MSMEs are excluded from having to prepare the UKL-UPL document. Despite these opportunities, MSMEs in the furniture sector face challenges in processing other documents before applying for the certification. Jepara's government has a legal basis for protecting the furniture industry and has issued an implementing policy that is more friendly toward MSMEs. If the Government of Pasuruan sees the need to issue a District Regulation or an implementing regulation that would facilitate the furniture industry, Jepara could provide a learning experience.

One major issue is the need to change current practices of the furniture MSMEs to narrow the gap with the compliance of SVLK. Relevant offices at the government level, such as District Manpower Office, District Cooperative and MSME Office, and District Industry Office, should establish and revitalize the SVLK clinic or related programs. NGOs can also provide clinics. However, emphasis should be put on assisting MSMEs in improving their business administration practices and focusing on the SVLK audit's technicalities. Meanwhile, the MoEF could continue facilitation to cover the first audit costs and support group certification.

Producers, both individually and as a group, can address several gaps, but the government's role remains important. First, central and district governments should make SVLK more accessible for producers. Second, by creating an environment that promotes the furniture sector's investment and maintenance, both governments can help reduce "renting legality" practices. Third, the central government can help create demand in domestic markets through public procurement. Meanwhile, business associations and NGOs can build producers' capacity to improve their practices and minimize the gap with SVLK compliance.

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Indonesia's Timber Legality Verification System (SVLK) has been in effect for more than a decade, with some degree of success. One area that needs attention, however, is how small-scale producers would achieve and maintain compliance. This study aims to assess the furniture industry's performance and the gaps between the producers' current practices and the principles and criteria of SVLK compliance. Through a survey of 239 furniture producers in Jepara and Pasuruan, the study finds that nearly 90% of the respondents are in micro- and small-scale businesses. Most producers purchase timber and sell their products at the domestic market. However, 14% of producers in Jepara also participate in export markets. The study also finds that average gross profits of noncertified producers are higher than those of certified producers. In addition, it finds that furniture producers should improve their practices in several areas, such as registering their companies; properly recording their business process; and implementing occupational health and safety. The Ministry of Forestry plays an important role by providing funding to enable producers to obtain an SVLK certificate. The local government should coordinate the furniture sector's development, align with other sectoral development and provide facilities to market furniture products.

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