

<u>Wisnu Karya Putra International</u> Indonesia

Challenges and Opportunities in Implementing SVLK

Written by Ni Putu Sri Harta Mimba

Lecturer, Department of Accounting Faculty of Economics University of Udayana

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Introduction (WKPI)

Mr Wayan Diana, Director of Wisnu Karya Putra International Ltd Co. (WKPI), had just finished reviewing the latest economic report on business and industry in Bali. He noted that the export value of Balinese arts crafts timber for the period January to May 2012 had increased by 56% over that of last year for the same period, from US\$ 23.9 million to US\$ 37.3 million. He was certain that this increase was in no small way attributable to the implementation of the Indonesian Timber Legality Assurance System, also known as the *Sistem Verifikasi Legalitas Kayu* (*SVLK*). WKPI was one of the few timber enterprises in Bali that had already fulfilled the *SVLK* requirements. More than that, WKPI had played a central role in facilitating the implementation of the *SVLK* in other timber enterprises.

Wayan Diana sat back in his chair, privately savoring a sense of pride in the accomplishments of WKPI. He always wanted to be the first enterprise to provide onestop services for customer satisfaction. He personally recognized the importance of following international standards in order to be a player in the global market and he had made sure WKPI was compliant with these standards. As a result, WKPI had been able to export its products to all buyer economies. He was also aware of the impact of human resource management in increasing the knowledge and ability of WKPI's employees in complying with the *SVLK* requirements. Moreover, WKPI had also been involved in supporting other small and medium enterprises (SMEs) in the timber industry to obtain the *SVLK* certification through an incubation program. It had also proposed a *Warung Kayu* and *Gerai Kayu* to help other timber enterprises obtain legal raw materials and sell wood products.

While reflecting on these accomplishments, two questions entered his mind: What next steps would be needed to further make WKPI and other SMEs in the wooden handicraft and furniture products industry in Bali more competitive in an increasingly liberalized international market? And how could WKPI's human resource management systems and practices be further enhanced to fully support its business objective of becoming a significant player in the international market for wood products?

Wisnu Karya Putra International Ltd Co. (WKPI)

WKPI was a small-sized timber enterprise established on 10 October 1995 in Denpasar, Bali as a producer and exporter of wooden furniture, housing components, wooden house, furniture and handicraft as well as garden furniture. It started with 19 employees, with the Middle East region as its main target market. In 2007, WKPI expanded its target market to include Australia, the European Union and the United States. In 2012, WKPI's annual sales reached US\$2.52 million with about 30 regular employees, complemented by a number of part time employees hired only when the company received orders that could not be met by its regular workforce.

WKPI was one of the timber enterprises in Bali that had already fulfilled the *SVLK* requirements. Through the years, WKPI had built sufficient facilities (e.g., administration office, production rooms, packaging rooms, transportation facility, and warehouse) and fully equipped processing machines (e.g., planner, crosscut, circle saw and kiln dryer) for its products. This made WKPI the only timber enterprise in Bali that provided, at competitive prices, a one-stop service from wooden product processing and wooden packaging, to preparation of supporting shipping documents for cargo.

Wooden Products and Production Process

Puri Taru was the brand name for wooden products made by WKPI.¹ Every month, WKPI produced about 50-100 cubic meters of housing components, such as wooden floor. A similar capacity had been created for furniture. It also produced about 100-150 cubic meters of wooden packaging every month. (Figure 1 shows samples of wooden products.)

Figure 1: Samples of Wooden Products









Gazebo with curtain

Furniture

Handicraft

Moulding

The first step in the production process for wooden furniture was kiln drying of the sawn timber. Unfinished furniture from sub contractors had to first go to the kiln drying machine to undergo the phytosanitary process which secured the wooden materials from dangerous micro organism and fungi. The unfinished furniture was then brought to the assembly room, after which it was subjected to the sanding and coating process in another room. Finally, the furniture was brought to the packing room. Sawn timber had to go through a similar process, except that they had to go through the cut-rip room before they were brought to the assembly room.

In 2012, WKPI had three main wood suppliers and nine semi-finished wood product suppliers who also had to obtain *SVLK* certificates in order that WKPI could fulfill the requirement for legal compliance of raw materials and the legality of production. WKPI also had to keep all supporting documents related to raw materials and production process for auditing purposes related to *SVLK* (Figure 2).



¹In Balinese, *Puri* means house and *Taru* means wood.

Wooden Packaging

In addition to producing wooden products, WKPI also provided wooden packaging for international cargo (e.g., box pallet). For wood packaging and exported wood products, WKPI had to meet the *International Standard on Phytosanitary Measures* number 15 (ISPM #15)². This standard usually applied to pallet, dunnage, crate, drum, and skids. ISPM #15 required all enterprises to have the kiln dryer machine to perform the Phytosanitary function. To meet this standard, WKPI maintained a 2-chamber kiln dry machine with each chamber measuring 75 cubic meters. In addition, the certificate of ISPM #15 required the document on the origin of the raw material used in production. Figure 3 shows some processes in wooden packaging.

Figure 3: Wooden Packaging



Providing Supporting Documents and Shipping Services

As part of its services, WKPI provided other timber enterprises in Bali environmental related documents usually required in applying for related international standards and meeting the demands of the market. For instance, after checking the customers' raw materials documents, WKPI provided documents to fulfill a Chain of Custody (CoC) standard for raw material. The director of WKPI, Wayan Diana, was appointed by the Ministry of Forestry as the official publisher for timber invoice in Bali. He also held the technical certificate from the Production Forest Utilization Monitoring Center in 2007. In addition, Wayan Diana completed the Training of Trainers on CoC conducted by the World Bank Group in 2008, and the training on timber legality assurance system from the Multi-stakeholder Forestry Program (MFP), a collaboration program in forestry between the Indonesian Government and the British Government.

WKPI also provided shipping services and some of its employees were experts in custom clearance, handling and stuffing, as well as in managing containers.

Changing International Market Requirements

While market demand for environmentally friendly wood products had been increasing, international buyers had become more selective in buying wood products. To reduce the negative effects of free trade, some importing economies applied non-tariff barriers by requiring certain standards for wood products. They required many legal documentation

 $^{^{2}}$ This standard was developed by the International Plant Protection Convention (IPPC); it required exporting companies to treat wood materials of a thickness greater than 6 mm before shipping them to other economies to prevent the spread of irritant micro organism to destination economies.

regarding the company, raw material, handling of wood, production processes, and marketing. For instance, the European Union, through a Voluntary Partnership Agreement (VPA) with the Indonesian Government, required "legal" wood. In March 2013, the European Union (EU) would be requiring all timber export companies to have a certificate of timber verification legalization system.

Similarly, the United States through the implementation of the Lacey Act, required importers from the US to declare that they imported only legal wood. Besides, some importers required a certificate of Sustainable Forest Management for each wooden export product. The decision of some economies to purchase certified wood products was an attempt to reduce deforestation, and promote sustainability of forests in the future. In addition to the European Union and the United States, the application of this system was also observed by other importer economies, such as Australia and Japan. Japan required the certificate for legal wood through Green Konyuho or Goho Wood, a system to ensure that the government procurement used legal timber which came from legal sources.

In the future, only certified timber products would be accepted by international markets. The certifications covered raw material sourcing, processing and selling the wood products. For instance, the raw materials had to be supported by a Sustainable Forest Managed (SFM) certificate, while a product process had to follow a Forest Stewardship Council Chain of Custody system (FSC-CoC). (Figure 4.)



Response to Changing Market Requirements: The SVLK

The implementation of the CoC system in the timber industry was one of the requirements for obtaining the certificate of *SVLK*. The *SVLK* was also known as the Indonesian Timber Legality Assurance System (TLAS) which was issued by the Indonesian government to maintain the sustainability of its forest resources.

Based on the agreement between the European Union and the Indonesian Government as mentioned in the VPA, the timber legality certification (*SVLK*) requirement would be applied in 2013. All wood products and wood packaging that have fulfilled the *SVLK* requirements would receive the 'Vlegal' sign issued by the Indonesian Government through some accredited institutions.



The implementation of *SVLK* would have a significant effect on the Indonesian timber industry. *SVLK* aimed to stop illegal logging, illegal timber products and its associated trades. An *SVLK* certification was an assurance that an enterprise in the timber industry had fulfilled legal requirements in various aspects of its operations such as company status, raw materials used, production process and marketing. Having the SLVK certificate was a mandatory requirement to be acceptable to international buyers. With an *SVLK* certificate, an enterprise could export its wood products to all economies and did not have to be bothered by varying requirements of buyer economies. This, in effect, would increase the market access and increase the product share of companies that already obtained the *SVLK* certificates as well as enable them to get the premium price because of selling environment-friendly products.

Challenges in Fulfilling SVLK Requirements

The implementation of *SVLK* was urgently needed by the timber industry in Indonesia, especially in Bali which was not only famous as a tourist area, but was also a rich source of handicraft and furniture exports. Hence, the implementation of the timber legality system by buyer economies would significantly affect the timber industry in Bali since the industry in this island was dominated by SMEs.

The obligation to obtain the *SVLK* was especially difficult for the craftsmen, including those who mostly used wood waste. This was especially true in the case of Bali where most of the village craftsmen had limited capital. Many of these craftsmen managed their business as part of their traditional heritage. This might be the reason why they had limited knowledge of related regulations and the need for documentation and administration related processes.

Existing studies on the timber industry in Bali and the interview with Wayan Diana from WKPI and other entrepreneurs (e.g., Wayan Sudiksa from Bina Sarana Cipta Co. (BSC) and Made Witari from Tri Utami (TU) Company) indicated that the main challenges encountered by the timber industry in Bali were related to sourcing of raw materials, appropriate and sufficient documentation and production process and marketing.

Sourcing of Raw Materials

In Bali, the need for legal raw materials was very high. Most small and medium craft and wood enterprises found it difficult to obtain certified wood, thus limiting their production capacity. For example, on the average, a small to medium sized timber company in Bali produced only three to five units of wooden gazebo in a month. Since most of them had limited capital, they had difficulty in ordering a small volume of certified wood, say 6-10 cubic meters. This condition was aggravated by the fact that there were only a few wood suppliers in Bali who, quite often than not, were also without supporting documents. Hence, small wood enterprises in this island usually ordered the raw materials from other islands such as Kalimantan and Sulawesi Islands. However, the said wood suppliers who also had forest concessions, considered it inefficient to sell wood in small volume and preferred to sell legal wood in large quantities. On the other hand, many craft and wood enterprises in Bali had limited financial resources. Therefore, they could not afford to order large volume of wood, the cost of which could be very high, especially for certain types of wood such as Meranti, Teak and Merbau.

As a whole, most craft and wood enterprises in Bali faced difficulty in meeting the requirement to use raw materials from a sustainable and responsible forest management system as well as implement *SVLK* standards.

Appropriate and Sufficient Documentation

According to Wayan Diana, "... indeed, the actual number of exports could be increased if the craft and wood enterprises could overcome some export barriers, such as incomplete documents. For instance, an obstacle was faced either at the port of transit or destination port because the exported products had insufficient documents or lacked a certificate of origin to explain the source of wooden raw material."

This information was supported by Suarnatha, the head of Wisnu Foundation, an NGO involved in conserving the environment. He pointed out that most craftsmen and wood enterprises had done the right way, but failed to keep the documents they used for transactions or archive them properly. For example, most enterprises in Bali did not keep their sale and purchase receipts. This was especially true for transactions involving wood waste. There would probably be a need for the government to provide a statement letter to confirm the legality of such wood.

In addition, Wayan Diana suggested that to support the legality of waste wood, there must be a valid retrieval document, witnessed by a competent authority, to prove that the wood was sourced from a village. This could increase the utilization of waste wood products that could meet the legal requirement. Therefore, the international market could more easily absorb the waste wood products that meet the legality principle. Given this scenario, Suarnatha noted that "we should also anticipate the possibility of deliberately making certain type of wood as waste wood." For this reason, wood craftsmen in Bali, especially wood waste craftsmen, should archive all related documents on sourcing of raw materials, processing and selling the products.

Production Process and Marketing

Choosing the proper raw material, combining the product components according to the design and storing the scrap raw materials were some of the challenges faced in the production process. In case some aspects of raw material processing were distributed to other partners, the required systems or manner of doing the work had to be covered by a proper cooperation contract. For example, if the work was contracted out to sawmills, the requirements had to be part of the contract. Based on this contract, the sawmill should separate the order properly to clearly determine during the production process which wood came from WKPI, and which were sourced from other companies.

In marketing, one challenge faced by most timber enterprises was their lack of financial resources to expand the network. WKPI had limited human resources to improve the marketing aspects in the website of WKPI.

Implementing SVLK in Bali

The Role of WKPI to Support SVLK Implementation in Bali

Despite the challenges posed by the application of the timber legality verification system regulation (i.e., *SVLK*), Wayan Diana affirmed *SVLK*'s positive impact on the export

development of WKPI, as there was no longer a need to fulfill various different requirements from different importer economies. Convinced of the benefits of *SVLK* certification and desirous of extending these benefits to other timber companies in Bali, Wayan Diana, through WKPI, supported and initiated actions for a wider implementation of *SVLK*.

Supporting Business Incubator for Related SMEs

In the beginning of 2012, the Ministry of Cooperative and Small and Medium Enterprises activated business incubators³ in Indonesia, with full support from state and private universities.

With the support of Udayana University, the biggest university in Bali, WKPI stimulated the activation of the business incubator in the timber industry, the Udayana Business Incubator (UBI). The UBI was located in Denpasar municipality on a one-hectare area. This business incubator supported more than 30,000 small medium timber enterprises in Bali to stimulate *SVLK* implementation. Most of these enterprises lacked experience in business management and had insufficient knowledge of the importance of business legality and of production standards required by international markets.

The UBI developed and supported enterprises located outside (i.e., tenant out wall) and inside of the incubator area (i.e., tenant in wall). It had two tenants in wall and about 20 tenants out wall during the early stage. One of the tenants in wall was WKPI, which at that time had already obtained some national and international certificates in the timber industry. Because of WKPI's successful venture into the international markets, this company would serve as the benchmark for UBI tenant candidates, which would be recruited through the business incubation development program at the end of 2012.

WKPI assumed the role as the "anchor tenant" of the UBI in Bali. The anchor tenant was the leading tenant which could provide technical and non-technical support to other tenants. Technical support included sharing knowledge about design, production and the finishing process. Non-technical support included increasing skill in quality control, business management and administration.

WKPI arranged some business meetings (e.g., focus group discussion on *SVLK*, talk show and product expo) among financial institutions, tenants and other stakeholders in the timber industry. In addition, WKPI initiated the conduct of seminars and workshops to increase the knowledge and to develop the interpersonal skills of entrepreneurs, such as teamwork and collaboration. A workshop room and office supplies for the business incubator were mainly supported by WKPI.

Facilitating Raw Materials Sourcing through Warung Kayu and Gerai Kayu

Warung Kayu

As an alternative to overcome challenges in obtaining legal raw material, WKPI initiated the establishment of *Warung Kayu*⁴ which was expected to serve as a shop selling legal

³ A business incubator is an institution that provides supporting staff and facilities to stimulate small and medium enterprises to become self-supporting enterprises. The intensive support for tenants usually took two to three years (Dipta, 2003; Novel, 2001).

wood as raw material for the wood industry. The availability of certified wood would allow wood enterprises to have CoC certificate and thus increase the number of certified wood products serving the global markets (See Figure below).



The common raw materials used in the timber industry in Bali were Meranti, Kapur, Teak, Sonokeling, Coconut, Merbau, and Sengon, which were relatively expensive types of wood. Considering that it might be difficult to obtain legal wood in the future, WKPI was promoting the use of lesser known species of wood that had high economic value. There was however a need to know more about the exact structure and characteristics of these potential raw materials to achieve optimum result at minimum cost.

Gerai Kayu

Gerai Kayu was projected to be a one-stop shop for selling all types of certified finished wood products, and for providing information on the buying and processing of environmentally friendly wood products. The shop would also carry the Balinese touch in its interior and exterior design. In the future, it could be an alternative tourist destination that could provide information about the wood processing process and finished products. As of August 2012, the proposal for the establishment of *Gerai Kayu* was still waiting for funding institutions or the support from the provincial Government. Besides, WKPI could not yet find a strategic location with ample space for all activities and facilities planned for *Gerai Kayu*.

Developing Networks

Networking development activities aimed to increase production quantity and quality as well as enhance the international market share of WKPI. The company arranged various activities (e.g., workshop, trainings, seminars, technical consultations) to support the preparation of SMEs in the timber industry to fulfill the *SVLK* requirements. Most activities used the financial support from the MFP. Such funding was to be used only for non-investment activities and not for capital expenditures. For instance, WKPI facilitated *SVLK* socialization and training in Bali about (a) funding mechanism and the financial system; (b) the management of raw materials and standard systems of *SVLK*; and (c) the process of official purchase of raw materials. As explained by Wayan Diana, in order to decrease the problems of raw materials, other related SMEs had to know clearly (a) the sources of raw materials, (b) cooperation with other enterprises that had forest

⁴In Balinese language, *Warung* means a traditional shop which is familiar in the village, while *kayu* means wood.

concession, (c) a good raw material management system that could provide information about the appropriate time to order the raw materials, (d) a good documentation and record keeping system of raw materials kept in the warehouse, and (e) a concession contract with enterprises that had forest concession available for the sustainable supply of wood raw material.

From the point of view of WKPI, it was in WKPI's business interest to ensure that its potential suppliers in Bali were *SVLK* certified. In case the potential suppliers of WKPI had no *SVLK* certificate, the company could still order from the other islands but at a much higher cost. For this reason, it can be concluded that stimulating the business incubator for timber enterprises in Bali and proposing *Warung Kayu* and *Gerai Kayu* were essential components of WKPI's business strategy.

Human Resource Management Practices in WKPI

As the main director of WKPI, Wayan Diana emphasized the importance of human resource management (HRM). His strong attention to this issue emanated from his academic background and his understanding of various international requirements as an issuer and an examiner of molding fracture. He had a master's degree in accounting and was taking a course in the Professional Accounting Education at Udayana University.

The HRM System in WKPI had a significant role in enhancing the ability and knowledge of its employees, especially those related to *SVLK* requirements. Wayan Diana, the critical or key factor in minimizing the difficulties faced by WKPI and other timber entrepreneurs in implementing *SVLK* in Bali was a good HRM system. To support WKPI's regular activities and the business incubator, the company adopted and put in place various HRM practices as demonstrated in its human resource development, staffing, compensation, and health and wellness programs.

Human Resource Development

The human resource development implemented at WKPI consisted of training and performance management.

Training

To reduce some problems in the production process faced by WKPI (e.g., untraceable used materials), WKPI conducted some training activities, including training on behavior and technical skills. Skills training for employees was conducted regularly almost every year and covered the following areas:

- (a) Preparing systems and procedures with specific time duration, of the production process
- (b) Composing the reports of actual used material per day
- (c) Preparing required documents related to the production process procedure
- (d) Executing an intensive evaluation on the production process
- (e) Implementing the standard system of SVLK in the production process of WKPI

WKPI was a small company with only 30 employees (regular and temporary workers) and five divisions. Meanwhile, the production of wood products required high technologies and constant development of new technologies. Since WKPI did not have

sufficient resources to train their employees in-house regularly, the company mostly sent them to public training programs organized by the central and local governments. The central government provided support to increase skills related to *SVLK* and the local governments also had similar programs. Since, the central government cooperated with the British Government under the Multi-stakeholders Forestry Programs, funds for skill enhancement were also provided from international stakeholders. WKPI used these opportunities provided through its network of stakeholders to develop its workers at minimum cost.

WKPI also sent its selected loyal and potential employees to government academy and school to obtain specific certifications. For instance, in 2010, WKPI funded the training of its employee in Jakarta on customs certification. However, WKPI did not bind the employee to any written agreement with the company that would prevent him or her from leaving. Wayan Diana emphasized that the privilege granted to selected employees was based on trust. (WKPI did not provide formal trainings to its temporary or contractual workers but conducted informal orientation at the beginning of their employment). In addition to technical skills training, WKPI sometimes implemented training on organizational behavior for its division managers. This was intended to improve their communication skills in interacting with the staff in their own division and with other related divisions, as well as with external stakeholders. This kind of training also equipped the division managers to better understand various problems confronting their particular divisions.

Performance Management

Wayan Diana experienced difficulty in instilling discipline in workers attendance in order to meet production schedules. He noticed that the Balinese culture might have an influence on the discipline issue. Most Balinese people had a number of social responsibilities in their neighborhood. For instance, if their neighbor had *ngaben* (i.e., cremation ceremonial, as the ritual performed in Bali to purify the spirit of the dead to reach its highest state), they had to follow and attend the ceremonial which might take a couple of days. Although instilling discipline was hard to implement, Wayan Diana put a lot of effort on this aspect because the orders had to be finished on time. He had tried to change this cultural challenge into an opportunity.

The director encouraged good behavior and discipline among its employees through a system of rewards and punishment. The company, through its division managers, granted bonus to its employees who could finish orders on time (WKPI had five division managers, one each for cargo, export and import, production and management outsourcing, wooden packaging, and wood trading). On the other hand, WKPI issued reprimand letters to employees who did not work for three days without prior notice as a punishment mechanism.

Staffing

WKPI conducted a job analysis for each division which became the basis for developing the corresponding job description and job specification for each type of job. The job description indicated the responsibilities, related jobs, required skills, and expected outcomes, while the job specification defined the specific expertise required for a certain position. For instance, the manager of the cargo division had to know packaging, stuffing, and container operations, while the manager of export and import had to understand custom clearance and freight handling. Likewise, the manager of production and management outsourcing division had to be acquainted with quality, design and infrastructure.

In the recruitment process, WKPI selected applicants with specific knowledge for each position. Wayan Diana emphasized that although some of WKPI's employees were relatives of the owner, their employment with the company was mainly based, not on their special relations, but on their expertise, as shown by the results of written tests and interviews. Recruitment of employees was usually determined by the number of new employees proposed by each division manager, with an announcement in local mass media.

Compensation

WKPI compensated its employees based on their status. Fixed-term employees were paid a fixed salary based on the minimum regional salary defined by the local government. In case they met the target quantity defined by their division manager, they were also provided a bonus. Part-time employees were paid based on the number of days they worked.

Safety and Health Wellness

WKPI paid sufficient attention to Occupational Health and Safety, or what was known in Indonesia as *Keselamatan dan Kesehatan Kerja (K3)*. It also subscribed to the so-called *Jamsostek* insurance, the social insurance for private sector employers and their employees, which covered death, injury and health insurance, and an old age provident fund.

It was observed that some WKPI's employees were not yet familiar with the *Jamsostek* insurance and were not aware that it required the observance of safety at work conditions. Wearing safety tools during working hours was also not strictly observed as of yet by WKPI's employees, particularly those who cut logs in the sawmills.

Next Steps...

Wayan Diana roused himself from his musings. It was undeniable that WKPI had done a lot to accelerate the implementation of the *SVLK*. But he still had no answer to the two questions in his mind: What were the next steps needed to further make WKPI and other SMEs in the wooden handicraft and furniture products industry in Bali more competitive in an increasingly liberalized international market? And how could WKPI's human resource management systems and practices be further enhanced to fully support its business objective of becoming a significant player in the international market for wood products?

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