Implemented by :

UNFF 10, Istanbul, Turkey – Side Event

Good Business: Making Private Investment Work for Forests

Report

BACKGROUND

Financing for the forest sector comes from several different sources; public domestic and international funding as well as for-profit and not-for-profit private sources. But forest financing cannot be resolved by relying on one source only. Often public (inter)national funding is seen as frontier funding for high-risk investments or a funding source for global public goods. At the same time it is recognized that in order to scale up sustainable forest management, private financing will have to play a vital role. But this needs an enabling environment created by public sector action domestically and internationally.

In global discussions on forest financing, the role of the private sector has been repeatedly emphasized as potential key contributor to advancing SFM and forest and wood-based economic and social development. It is also widely agreed that responsible forest management could provide good returns to private investors. In several countries there are good examples where frontrunner investors and companies have successfully developed good forest business, showing the potential to go forward. A better understanding is needed of the impediments why this potential has not yet been fully captured and how to address these. There has been extensive work on general investment climate issues, but much less on forest specific issues.

OBJECTIVE

The objective of the side event was to provide a platform for exchanging information on successful cases of private sector engagement in financing SFM and the opportunities and challenges ahead to scale-up and replicate these successful endeavours; to share new insights on the current status and trends of different private actors in the SFM finance arena, alongside varied analysis of the key barriers, opportunities and lessons learned; and - finally - to better understand what policy measures are needed to enable profitable private sector investment while ensuring that social and environmental criteria are met, and community interests are protected. To advance in sustainable financing of SFM and to have sustainable forest outcomes it will be essential that each stakeholder group's role and comparative advantage are recognized.

The side event was jointly organized by World Bank/PROFOR, the Deutsche Gesellschaft für international Zusammenarbeit (GIZ) GmbH and Tropenbos International and chaired by Herbert Christ, GIZ. For the programme, see annex 1.

UNFF 10, ISTANBUL, TURKEY – SIDE EVENT

Date: Monday April 15, 2013

Organized by:

World Bank/PROFOR, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, Tropenbos International

Herbert Christ (GIZ), introduced the topic, pointing out that the private sector does not always get the mention it deserves within the UNFF because of emphasis on governments.

a) Presentations

Herman Savenije (Tropenbos International; herman.savenije(at)tropenbos.org; www.tropenbos.org**)** presented the main findings of the ETFRN Special Issue 54 entitled *Good Business: Making Private Investments Work for Tropical Forests (see* www.etfrn.org). The primary issue is the competitiveness of tropical forests as decisions and money flows against forests are much more powerful than those in favour. Private investment is already the largest source of investment in forests (9 times larger than those of governments and ODA) and this is likely to increase in the future. Private forestry business and finance too often misaligned with local and global public interests. The challenge is how to scale-up private financing and business and how to make these investments more sustainable.
There are currently several hurdles – weak investment climate, long-term nature of forests, single revenue streams, low profitability, unfamiliarity of forests to investors, lack of information, knowledge and expertise, and inadequate financial infrastructure. However, sustainable forestry business *is* possible and examples abound, although they need to be scaled up to achieve sufficient credibility. Further work is needed, such as trusting relations and pro-investment policies. SFM is a new future market and business opportunity; front runner investors see sustainability as a core corporate value and responsibility, a business asset, and effective risk mitigation strategy, and a license to operate. Certification is a must.

Planted forests are the most common forestry investment option in the tropics – markets are established, ecosystem services (e.g., carbon market) are still secondary outputs as they remain uncertain. Latin America and Southeast Asia remain priority investment areas. Institutional investors are still a largely unrealized potential given the perceived risk that remains and the opportunities that remain too few and far between. Small scale forest producers must not be overlooked. We need to improve our understanding of how SMFEs finance themselves to recognise their role and establish reciprocal relations.

Intermediaries are key in brokering the connection between investment and forestry worlds. There is a need to connect different worlds, particularly between the public and private sectors, between forests and the finance sector. To make money flow to sustainable businesses, the proper climate needs to be set up; multi-actor national forest financing strategies need to be developed; front runners need to be incentivized, coalitions and partnerships need to be facilitated, and forest financing facilities established at the national level.

The functions of the Facilitative Process are a good agenda but a more structural approach is needed for implementation. The international forest financing landscape needs to be better coordinated. Policy makers talk a lot *about* the private sector, but hardly ever *with* the private sector. Mr. Savenije concluded on the possibility of a Business-Policy-Led Initiative (BPLI).

Tuukka Castrén (PROFOR/World Bank; tcastren(at)worldbank.org; www.profor.org**)** presented preliminary findings from a study on private forest financing flows – constraints, challenges, opportunities and the way forward. Private investors look for return on their investment – the riskier the environment, the higher the returns expected (also referred to as *risk-adjusted returns*). Some risk factors can be modified by national governments. Data is actually readily available on FDI and plantation investments although much of it is not in the public domain. However, domestic sources of private investments are little known, as is sector-specific information. In addition, cross-country comparisons are indicative at best.

Private sector investments dwarf ODA, with most of it going into processing, then plantation establishment. Some 80% goes into Latin America, especially Brazil, the remainder going into Asia and Oceania. Africa gets a very small percentage. FDI flows used to go primarily to developed countries in 1990-2; today (2008-2010), the situation has changes and most financing goes developing countries (though a small number of countries is able to attract the bulk of the flow). However, the data is not always fully reliable, e.g. complex financial chains may lead to double counting of some flows and missing others.

The main constraints for forest sector investment are as follows: weak forest sector governance (opaque systems, corruption and weak legislation enforcement), red tape and bureaucracy (delays in permit systems, often linked to corruption), and inadequate information (only some 25 countries have frequently updated forestry inventories), tenure insecurity, perverse incentives, and lack of technical capacity.

Two case-studies from the study were presented, Brazil and Malawi. **Brazil** has been very successful in securing investment, thanks to its geography, but also incentives provided by the Government, creation and sharing of research knowledge by authorities, and existence of local demand and markets for these products. As for **Malawi**, the financial sector was liberalized in the late 2000s, enabling investment to pour in. But often financing is of short duration (0.5 to 3 years) making it infeasible for forest investments. One of the largest companies is the local tobacco company, which uses US$ 4 million for forestry operations (fuelwood) alone, which alone is worth four times the Forestry Department budget.

b) Panel

The following guests were invited to the panel in addition to the two presenters:

- **Dirk Walterspacher (ForestFinance Group**, Managing Director; dirk.walterspacher(at)co2ol.de; www.co2ol.de)
- **Emilio Mugo** (Senior Deputy Director Field Operations, **Kenya Forest Service**) enmugo(at)kenyaforestservice.org; www.kenyaforestservice.org)
- **Murat Gigin (ENAT** Industrial Tree Farming Company, Chairman; mgigin(at)tekfen.com.tr; www.tekfen.com.tr)

Murat Gigin: Regulations were in place in Turkey although they were not regularly practiced. As concerns for deforestation, forest cover has declined from 50% to 27% within the space of a generation. ENAT was established out of concern for the environment. It brings together several sectors of public life – Ministry of Forestry, academia, foundations (representing public conscience, the guardian of public interest), the "sinners" (users of pulp and paper industry), and investors (out of business interest or because of good corporate responsibility). ENAT is now 7 years old and its plantation is due to be harvested between years 16 and 20.

Challenges faced are identical to those already presented above. The public sector displays a lot of suspicion towards private companies. The Ministry of Forestry has established a very positive dialogue with ENAT. The primary goal, however, is making profit, like every actor in the private sector. Concerns are as follows: length of land lease (should be increased from 49 to 99 years); the size the land area (leases) that now are granted by the Ministry of Forestry to a company are often too small (for economy of scale and optimum cost of operation, 400 - 500 hectares of allocations would be more desirable); taxes: based on current regulations, the VAT (which is 18% at this time) that is paid is non-recoverable until the final harvest putting an additional fiscal burden on the Investor of the plantation. Finally, the mental barrier established by public sector civil servants again the private sector playing any significant role.

Dirk Walterspacher: The first reforestation projects of Forest Finance were established in 1994 with the idea of combining sustainability with money-making. Operations began in Panama, which turned out to be an excellent location. Now the company operates additionally in Vietnam, Colombia and Peru and is looking to work in Egypt too. There are 12,000 private investors and the overall investment volume has been approx. 80 Million USD so far. In 2013 Forest Finance expects an investment volume of 20 Million USD. The company employees over 150 people in total and operates either directly (in Panama) or through local partners. Return on investment does not take place every year. All reforestation operations in Panama are FSC certified and the operations in Vietnam and Colombia are undergoing the validation process. Additionally the operations in Panama are validated under the carbon standards CCBS and Gold Standard Transition Forestry approach. These certifications add value to the product and show investors that they are at the top of sustainability criteria. Pension funds and institutional investors are becoming more and more interested, although a rapid cash flow of return is expected, hence the expansion to models of fast and frequent return such as agroforestry (e.g., cocoa production) has performed. Also investments in secondary market opportunities like existing acacia or teak plantations are offered. In this case we follow a cap-of-profit approach: a part of the return after the first rotation is used to convert the plantation into a mixed species native forest. At the same time, the long-term perspective of plantations (25-30 years) is continuing.

There are different types of investors – some of them require lower return and focus on promoting sustainability, whereas other more "classical" investors are more focused on returns. In Africa, a new afforestation project is being implemented in arid lands in Egypt. Very few investors were willing to invest in such a political environment so early stage funding primarily comes from a PPP with GIZ. The advantage for the company is that this can then be a model to be scaled up to other arid or semi-arid regions such as the rest of the Middle East.

In terms of enabling environment, a long-term strategy for forests country-wide is an excellent sign of sustainability and risk reduction. A landscape approach is even more promising as it sets the rules not only for forests, but across different sectors.

Emilio Mugo: The Kenya Forest Service has existed for over a century and policies have not changed in decades, making private sector investment difficult. In the past 15 years, however, private sector involvement has been actively encouraged. Kenya is home to only 2 million ha forests. There is interest from both domestic and international investors, and in multiple uses of forest land.

c) Plenary Questions and discussion

- *Dambis Kaip (Papua New Guinea): It is understood that governments must take a lead. How does the private sector address the issue when land is owned by communities?*
  - Emilio Mugo: All plans in Kenya are shared with local communities as their involvement is expected.
- *Joseph Osiakwan (Ghana): What makes Latin America so attractive to investors?*
  - Tuukka Castrén: To set a premium on returns, an investor will look at the risk (including political risk) and the infrastructure and access to markets. In some countries the required risk adjusted returns expected are so high, it makes investment unviable. Brazil is a low risk country with many opportunities and good infrastructure, making investment there very attractive.
- *Thailand: It takes a long time for forests to grow and banks are usually unwilling to make a loan to investors in forests. What is the Bank doing in this area?*
  - Tuukka Castrén: This is one of the main challenges to forestry investments, even in short rotation plantations. One solution is to invest in existing plantations rather than new ones and diversify products invested in (e.g., agroforestry). The World Bank Group through IFC invests directly in private businesses, but also in intermediary organizations.
- *What about investing in wood processing? In Africa, returns on investment can reach 10-15%. We should start focusing on such aspects of investment in Africa rather than use sweeping statements on political risk in the 52 countries that the continent is home to.*
  - Herbert Christ: There is science showing that investment in Africa is thriving and in fact could be the next big boom.
- *How can markets for NTFPs and payments for ecosystem services be economically viable?*
  - Herman Savenije: There is evidence of the viability of NTFPs but these are relatively localized. PES and ecosystem service markets are not very lucrative at this time because of delays in setting up the enabling conditions that establish the rules for the market. In principle, these have

From left to right: Tuukka Castrén, Dirk Walterspacher, Murat Gigin, Emilio Mugo, Herman Savenije & Herbert Christ

prospects, but it will probably take time yet.

- Murat Gigin: Alternative activities were set up while waiting for returns on investments, notably by establishing almond orchards. The company has created an added value for local communities – by growing almond and walnut groves, beekeepers have benefited substantially from the pollen.
- Emilio Mugo: We need to ask who the customer is with PESs. In many cases, too many parties make PES difficult to implement, although the potential remains huge. Micro-financing institutions and organizations helping cooperatives build negotiation capacity have provided a helping hand, encouraging FDI (which generally avoids situations where these enabling conditions have yet to be established).
- Dirk Walterspacher: We set up a mixed model with a fast (starting after 5 years) and regular cash flow coming from cocoa, followed by a higher return once the timber cash comes in. In addition, under the Brand CO2OL we offer the sale of Carbon Credits from the forests under the Gold Standard Forest and Landuse Approach (returns can be expected 2-3 years after planting). Eco tourism provides extra revenues. Bird watchers have begun paying us money to visit our forests on a regular basis. Also more and more companies are shifting away from the carbon market towards forest landscape restoration and other themes. Together with a large international software developer we provide a specific software based solution to manage, communicate and distribute such CSR driven investments of large brands and companies.

This report has been compiled by Benjamin Singer of the UNFF Secretariat, Fabian Schmidt (GIZ), Tuukka Castrén (Profor/World Bank) and Herman Savenije (Tropenbos International).

Annex 1: Programme

Time:	Subject:	Speaker:
13.15 – 13.20 hrs.	Welcome & Introduction	***Herbert Christ**, GIZ;* *Chair of the meeting*
13.20 - 13.35hrs.	*Good Business: Making private Investment Work for Forest.* Main findings from ETFRN News 54	***Herman Savenije**,* *Tropenbos International*
13.35 - 13.50 hrs.	*Constraints to Private Financing Flows for Sustainable Forest Management, Wood Production and Primary Processing in Tropical and Other Developing Countries.* Preliminary findings from an on-going study	***Tuukka Castrén,*** *World Bank /PROFOR*
13.50 - 14.25 hrs.	**Business & Government panel: Scaling-up Private Business and Finance for Forests** - ***Murat Gigin***, ENAT Industrial Tree Farming Co. Inc., Chairman - ***Dirk Walterspacher***, ForestFinance Group, Managing Director - Carbon Business (CO2OL) - ***Emilio N. Mugo***, Kenya Forest Service, Senior Deputy Director Field Operations	
14.25 - 14.55 hrs.	**Interactive floor discussion**	
14.55 -15.00 hrs.	**Concluding remarks**	***Herbert Christ***