Partnership for the Tropical Forest Margins

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POLICY BRIEF

# The Private Sector in the REDD+ Supply Chain: Trends, challenges and opportunities

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## Increasing Private Sector Involvement in REDD+

A key determinant of REDD+ success will be ensuring effective private sector engagement. Funding is a major concern in the implementation of REDD+ activities and involving the private sector will be absolutely critical to scale up investment in REDD+. The private sector can also make vital contributions to REDD+ initiatives through the range of its expertise and be part of the solution to mitigating climate change by addressing key drivers of deforestation under attractive conditions. Nevertheless, little has been done to identify who the key private sector players are, the roles they play and the sector's diversity in terms of scale, expertise, motivations and forms of involvement.

At the 17th Conference of the Parties, the willingness to diversify funding approaches for REDD+—including "public and private, bilateral and multilateral, and alternative sources" as well as the recognition of the possibility of developing "appropriate market-based approaches for REDD+"—were significant moves forward to help facilitate the mobilization of private finance for REDD+[1].

The ASB Partnership for the Tropical Forest Margins and the International Institute for Sustainable Development (IISD) explored the role of the private sector in REDD+ under a three-year REDD+ capacity-building initiative supported by the Norwegian Agency for Development Cooperation. Using the REDD+ supply chain as an analytical framework and drawing on information gathered through expert meetings and interviews with over 40 developing-country REDD+ decision-makers and implementers, the research examined:

[1] United Nations Framework Convention on Climate Change. (2011). *Outcome of the work of the Ad Hoc Working Group on Long-term Cooperative Action under the Convention*. Advance Unedited Version. Bonn, Germany: UN. See section II.C of the decision on REDD+ (UNFCCC/ AWGLCA/2011/L.4).



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- In the REDD+ supply chain, who are the private sector players and what are their motivations and types of interventions?
- What are the current challenges for private sector engagement in REDD+?
- How can private sector engagement in REDD+ be enhanced?

The intended outcome of the research is to increase the scope and scale of effective private sector involvement in REDD+. The complete analysis is available in the policy paper, *The Private Sector in the REDD+ Supply Chain: Trends, Challenges and Opportunities.*[2]

## The REDD+ Supply Chain

A supply chain is a system of organizations, people, technologies, activities, information and resources through which an initial set of inputs are transformed into the final product, to be purchased by customers or buyers on the demand side. If we consider the REDD+ supply chain, which revolves around the production and consumption of carbon sequestration as its key ecosystem service, the major business functions required for national and project-level REDD+ initiatives consist of: project investment, project development and implementation, technical expertise and capacity building, validation and certification, carbon credit trading and retailing, and carbon credit purchasing.

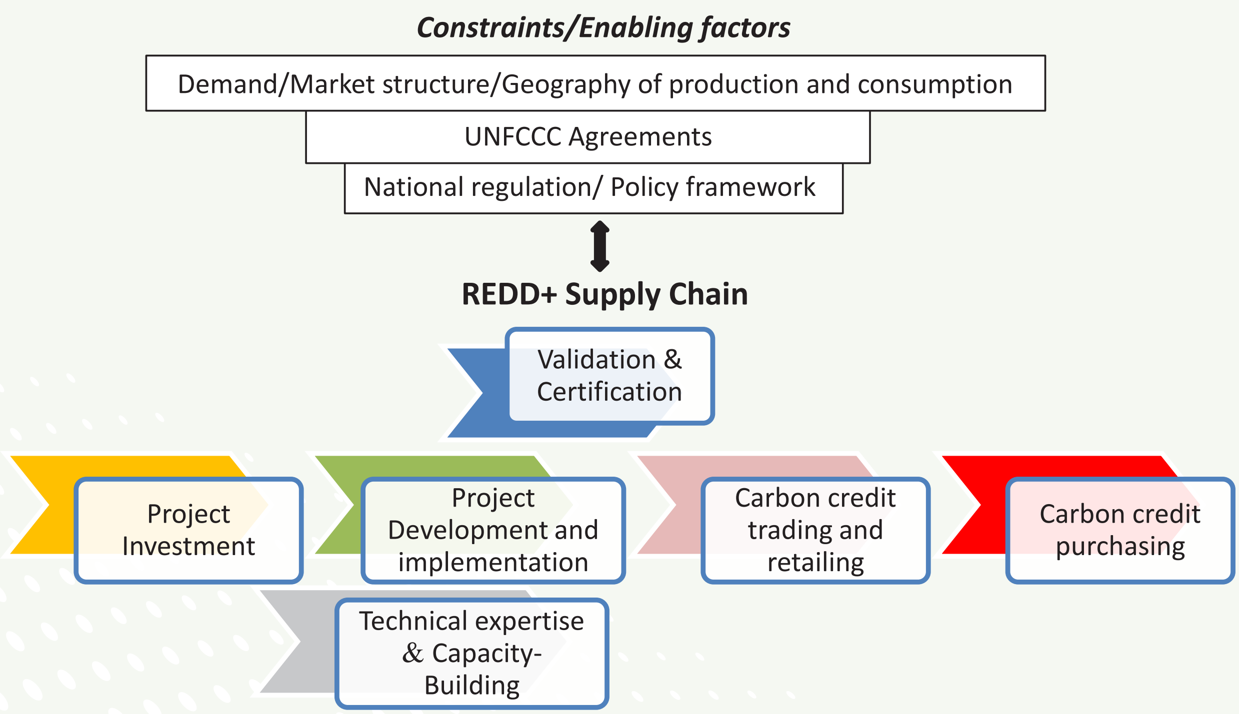


**FIGURE 1: THE REDD+ SUPPLY CHAIN CONCEPTUAL FRAMEWORK**

[2] See www.iisd.org/climate/land_use/redd for information on all project activities and the full policy paper on the *Private Sector in the REDD+ Supply Chain*

External, macro-level factors such as the international economic context, rules embedded in international climate change negotiations, and the overall national regulatory, institutional and policy environment all exhibit a formative influence on the REDD+ supply chain at the micro-level. As such, they can either enable or inhibit private sector involvement in REDD+ initiatives.

## *Private Sector Key Players, Trends and Motivations for REDD+*

Based on a comprehensive desk review of the literature on private sector engagement in REDD+, a review of selected projects dealing with REDD+ in Asia and Africa, as well as semi-structured interviews with key informants, the research identified several trends in the types of motivations, form and extent of private sector involvement along the REDD+ supply chain. As described below, the private sector can play a number of roles across the REDD+ supply chain, though business functions are not mutually exclusive and a private sector actor can wear several "hats" simultaneously.

### Investors through project investment

**Key players in the REDD+ investment arena include several pioneering investment banks seeking future investment opportunities**. In 2011 a number of new, multimillion dollar private REDD+ investment funds were established, including: Althelia (US$275 million target capitalization), Macquarie-International Finance Corporation (US$25 million) and Terra Global Capital (US$50 million) (Janson-Smith & Marsh, 2012). These funds and major private sector firms are strategically orienting themselves to take advantage of the growth in REDD+ credits on voluntary carbon markets, and are attempting to capture an early share of credits in anticipated REDD+ compliance markets. Other examples include BNP Paribas and Nedbank Group, which have taken stakes in REDD+ projects in order to explore and gain experience in developing REDD+ projects, and to sell the credits for a profit within voluntary, pre-compliance or compliance markets. Some of these deals take the form of direct investments, others of major carbon credit purchase agreements—although they often occur as a combination of the two (Diaz Hamilton & Johnson, 2011).

Significant investment also comes from emissions-intensive industries searching for large volumes of offset credits in order to become "carbon neutral." Several large multinational firms are also engaged in REDD+, investing through project grants. Many directly link these project activities to their corporate social responsibility (CSR) initiatives. These multinational firms often pursue projects that bring a triple benefit of climate change mitigation, community development and biodiversity conservation.

### Producers through project development and implementation

**Some medium- to large-sized private firms are leading the development of REDD+ projects, and serve as both investors and implementers**. This is the case of Wildlife Works—a leading private developer of REDD+ projects—with the Kasigau Corridor REDD+ project in Kenya. Currently, it is the world's leading REDD+ project development and management company, investing in projects in Kenya, the Congo Basin and Latin America. Other examples of leading private developers of REDD+ include Terra Global Capital and Infinite Earth.

A number of carbon offset firms are also involved directly at the project implementation and oversight levels. The core business and expertise of most of these firms is in creating innovative, climate friendly-solutions to deforestation and other environmental problems. Directly involving themselves in REDD+ projects can therefore be a good niche for these firms, many of whom are involved in selling the credits for a profit. One such example is South Pole Carbon Asset Management Ltd, which is co-financing select elements of the Kariba REDD+ project's workplan in Zimbabwe and is also responsible for its implementation.

**Some large multinational firms also leverage their existing technical expertise and technological capacity in addition to their investments, as part of their CSR policy**. This is almost exclusively performed in partnership with non-governmental organizations. Many of these large multinational firms are not dependent on forests in any way for their business, but rather see this as a means of "greening" their image. This can be seen in the case of the Toyota Motor Corporation, which is co-implementing activities in partnership with Conservation International by assisting in monitoring, reporting and verification (MRV) for the Penablañca reforestation project in the Philippines.

## Brokers through carbon credit trading and retailing

**Currently, most REDD+ credits are purchased directly from project implementers. But there are increasing numbers of buyers who purchase credits as intermediaries, with the intent to re-sell them for higher prices in the future** (Diaz et al., 2011). This creates a secondary market. Examples of companies trading/retailing REDD+ credits include the Carbon Neutral Group, ClimateCare and Camco.

Some financial firms that were initially providing direct investment in REDD+ projects are now securing purchase agreements that include upfront or immediate payments (such as Pre-Pay) for carbon credits with project developers, in order to re-sell them at a higher price. This allows project developers to deliver emission reductions without having to take on the risk of finding an end-buyer themselves. The emergence of secondary forest carbon markets is becoming a very important motivating factor in the marketplace, as California moves ever closer to its cap-and-trade scheme and the United Nations Framework Convention for Climate Change (UNFCCC) parties indicate further interest in using REDD+ in a post-Kyoto compliance scheme (Diaz et al., 2011).

## Advisors through technical expertise and capacity building

**There is a strong niche for private consulting firms to support capacity building and offer technical services to national, subnational authorities and third parties**. For example, there is often limited expertise and capacity for developing REDD+ Project Design Documents, establishing the Reference Levels and Reference Emission Levels or conducting MRV. The private sector has made some noteworthy scientific and technical capacity-building contributions at the national level. Examples include providing Geographic Information System (GIS), satellite imaging technology and innovative MRV technologies to participating REDD+ countries and research institutions. A number of private companies have also begun to offer financial support for capacity building and other readiness activities. However, larger resource input by private sector actors for capacity building is still rare.

## Auditors through validation and certification

**Another strategic niche for the private sector is the validation and certification of emissions reductions from REDD+ projects**. Validation is necessary for eligibility to generate carbon credits and for formal acceptance and registration under any given standard. Among other certification standards, Verified Carbon Standards (VCS) and Climate, Community and Biodiversity Standards (CCBS) are increasingly requested prior to the issuance of carbon credits for a REDD+ project. An example of a private auditor is Det Norske Veritas, which is a global independent provider of risk management services.

## End buyers through carbon credit purchasing

**In the primary market, carbon credit end-buyers can be classified into three groups** (Diaz et al., 2011, p. 57): (i) **Pure voluntary**—buyers purchase credits to offset their own greenhouse gas emissions on a voluntary basis; (ii) **Pre-compliance**—buyers purchase credits expecting to use them in a future compliance scheme; (iii) **Compliance**—buyers purchase credits for surrender under a regulatory emissions trading scheme. A large proportion of end-buyers voluntarily purchase offsets for CSR or public relations and branding purposes. These buyers are often in less emissions-intensive industries. Other corporate buyers' motivations included anticipation of direct regulation and a desire to "green" their supply chain. Compliance end-use remains a relatively small driver in the global marketplace, as most companies still have limited need or interest for forest carbon credits among current compliance schemes.

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# *Challenges Surrounding Private Sector Involvement*

Though a number of points of entry for the private sector can be identified in current trends, there are also a set of key challenges that can be identified through lessons learned and ongoing experiences. These challenges must be addressed if private sector engagement is to increase in scope and scale moving forward.

## A lack of policy certainty limits private sector participation and impacts the long-term demand for REDD+ credits

**Policy clarity and certainty are critical determinants of private sector involvement in REDD+, both internationally and nationally.** There is a need to create enabling conditions to support robust private sector involvement. Governments should clarify their intention to create and engage the private sector in future REDD+ compliance markets, and develop national legislation on REDD+ as well as national emission targets. REDD+ should also be integrated in sectoral planning. Private investors need to have a reasonable expectation for a risk-adjusted return on investment. Given that the REDD+ market is a policy-driven market, the UNFCCC should also play a central role in ensuring that the level of demand will attract private investment at scale (International Emissions Trading Association, 2012).

## Land tenure and carbon ownership remain key challenges to broader private sector engagement in REDD+ activities

**Clarification of land tenure and carbon ownership is a fundamental condition for involving the private sector and mobilizing private investment in REDD+ activities**. Private investors and project developers will not invest in REDD+ activities unless clear land and carbon ownership systems are in place. This requires clear understanding and consultation process with the communities regarding how this type of investment would impact their access to forest resources, and the development of clear benefit sharing mechanisms clarifying who has rights to benefits that flow from carbon and to what extent.

### Engaging the private sector in national-level REDD+ policy formulation processes is critical to shape an overall policy and legal framework that is win-win for all parties

**Stakeholder participation is crucial to ensuring effective and appropriate private sector involvement in REDD+.** Further consultations between private sector, governments and other affected stakeholders are needed to establish the legal framework for private sector investment and reduce regulatory risk and exposure by promoting the inclusion of flexible and cost-effective abatement options. This encompasses due diligence in the investment process, effective risk sharing and risk-mitigation mechanisms that create a more supportive investment environment for the private sector, appropriate dispute settlement arrangements, and clear and fair benefit-sharing mechanisms. Closer engagement is also needed in order to establish clear and consistent environmental and social safeguards for steering private sector involvement in REDD+. The private sector itself is most keen on implementing environmental and social safeguards because their adoption can help them avoid reputational and operational risk, and ensure that REDD+ projects will deliver emissions reductions with high social and environmental standards, which in turn increases the value of REDD+ carbon credits.

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## *Potential Strategies to Stimulate Private Sector Involvement in REDD+*

Several potential strategies and policies for addressing some of the above challenges and for attracting private sector participation and investment in REDD+ are promising.

### Enhancing investment through compliance carbon markets

**Compliance-driven demand for REDD+ credits from developed countries is needed to incentivize large-scale private investment in REDD+**, as demand and price levels in the voluntary market are not sufficient to drive private sector investment at scale and achieve a critical mass of emissions reductions from REDD+. Some new and emerging compliance markets could be looked at with interest, such as California and South Korea's cap-and-trade systems, Australia's new climate legislation and Japan's Bilateral Offset Credit Mechanism.

**An important trend lies in the REDD+ market's delivering greater quantities of carbon credits using VCS certified under CCBS**. These standards demonstrate how REDD+ projects can achieve internationally recognized social and environmental integrity, and increases the potential that these certified credits can be used as offsets in some compliance-based regimes.

### Enhancing investment through country-driven nested frameworks

**Allowing private stakeholders to receive direct performance-based payments while maintaining the environmental integrity of a national accounting framework through a nested crediting approach will greatly facilitate private sector involvement and investment**. The direct issuance of performance-based payments to the private sector secures their investment and makes the protection of forests financially competitive with conventional land-use options that lead to deforestation and forest degradation. With integrated jurisdiction-wide accounting frameworks, a nested framework reduces risk of intra-country leakage, which gives comfort to buyers in carbon markets.

## Involve the private sector in discussions and policies to address the drivers of deforestation

**The private sector players driving deforestation and those helping to conserve forests both need to be a part of REDD+ dialogues**. For instance, export-oriented agribusiness and extractive industries are important drivers of deforestation, but aside from CSR initiatives from select firms, they have largely lied outside the REDD+ supply chain. Engagement should move beyond CSR by better incorporating the extractive industry into the REDD+ supply chain. At a minimum, the extractive industries should be engaged in some sort of policy and regulatory process for addressing drivers of deforestation, in order to fully mitigate the negative impacts from their activities. Other private sector players already engaged in sustainable land-use activities also need to be engaged in the discussions.

## Stimulate demand in new sectors by developing targeted marketing strategies

**Whether the "currency" of REDD+ project outputs is tradable carbon credits or reputational returns, the private sector needs to see some sort of net benefit from its investment that can be measured and evaluated.** While marketing the REDD+ approach, it is therefore relevant to communicate the importance of both kinds of returns, in order to simultaneously attract compliance-driven and CSR-driven companies, as there are numerous aspects of REDD+ that make it attractive to both.

Large banks should be made aware of opportunities to provide long-term financing for REDD+ projects or offset their emissions and those of their clients. Involving insurance companies willing to take on the risks associated with REDD+ may also prove to be a promising area of exploration. REDD+ opportunities could also be brought to the attention of large companies with a CSR orientation, as well as customer sales, event management companies, hotels and individuals, among others interested in offsetting their carbon emissions.

## Disseminate lessons learned and best practices

**Promoting greater public-private collaboration could result in the identification of innovative and effective solutions for advancing sustainable REDD+ activities**. The various private sector actors should be involved as key partners of NGOs, inter-governmental organizations and governments in scaling up financing and innovation. Dialogue can be supported by groups not linked to the formal negotiating process, such as the series of REDD+ expert meetings held by IISD and the ASB Partnership for the Tropical Forest Margins with support from the Government of Norway. Country representatives, stakeholders and the private sector are often able to speak more frankly in less formal, non-negotiation sessions.

## Conclusion

Exploring the REDD+ supply chain provides helpful indications of the various types of private sector players and the trends of their current involvement in REDD+ initiatives. This is crucial for better targeting the private sector and increasing the scope of their participation in moving forward. The private sector encompasses a diverse set of players, including local REDD+ project developers, multinational companies, carbon regulated companies, local or specialist international investment banks, GIS service and technology providers, extractive industries, consulting firms, and many others, all of whom vary in terms of scale, geographic location, expertise, motivations, and degree of influence exercised on other links within the REDD+ supply chain.

Several strategies for enhancing private sector participation and investment in REDD+ are promising—in particular, increasing the demand for REDD+ credits in compliance markets, allowing private stakeholders to receive direct performance-based payments under a nested framework, and promoting greater collaboration between the public and private sectors—provided that an enabling policy and regulatory framework is put in place. Finding effective ways to incorporate extractive industries into the REDD+ supply chain is also critical.

Public multilateral and bilateral finance will still have a very important and complementary role to play, in order to ensure that developing countries with more challenging investment needs and environments are not left behind.

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IISD's vision is better living for all—sustainably; its mission is to champion innovation, enabling societies to live sustainably. IISD is registered as a charitable organization in Canada and has 501(c)(3) status in the United States. IISD receives core operating support from the Government of Canada, provided through the Canadian International Development Agency (CIDA), the International Development Research Centre (IDRC), and from the Province of Manitoba. The Institute receives project funding from numerous governments inside and outside Canada, United Nations agencies, foundations and the private sector.

## *About ASB Partnership for the Tropical Forest Margins*

Founded in 1994 as a program on Alternatives to Slash and Burn (ASB), the ASB Partnership for the Tropical Forest Margins has evolved into a global partnership that brings together local knowledge, policy perspectives and science to understand the tradeoffs associated with different land uses and the roles of markets, regulation, property rights and rewards. While ASB is coordinated by the World Agroforestry Centre (ICRAF), it is a global partnership of international and national-level research institutes, non-governmental organizations, universities, community organizations, farmers' groups and other local, national and international organizations. Our goal is to raise productivity and income of rural households in the humid tropics without increasing deforestation or undermining essential environmental services.



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