The Role of Private Sector Partnerships in Supporting Protected Areas

Patricia Moles Rivero
Venture Capital as a Financing Tool for Conservation Finance: lessons learned

Sustainable Finance Stream, World Parks Congress September 2003

Markets for biodiversity-related products & services

Private Equity/Venture capital investment models

Main Challenges for private equity/venture capital investments in protected areas

<table>
<thead>
<tr>
<th>Ecosystem</th>
<th>Goods</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agroecosystem</td>
<td>Food</td>
<td>Watershed protection</td>
</tr>
<tr>
<td></td>
<td>Fibers</td>
<td>Bird habitats</td>
</tr>
<tr>
<td></td>
<td>Genetic Resources</td>
<td>Carbon Sequestration</td>
</tr>
<tr>
<td>Forestry Ecosystem</td>
<td>Timber</td>
<td>Employment</td>
</tr>
<tr>
<td></td>
<td>Energy</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Water for Consumption &amp; Irrigation</td>
<td>Biodiversity Maintenance</td>
</tr>
<tr>
<td></td>
<td>Animal feed</td>
<td>Recreation &amp; Esthetics</td>
</tr>
<tr>
<td></td>
<td>Non-timber forest Products</td>
<td>Pollution control</td>
</tr>
<tr>
<td></td>
<td>Fauna</td>
<td>Carbon Sequestration</td>
</tr>
<tr>
<td>Fresh Water</td>
<td>Water for Irrigation</td>
<td>Water Flow control</td>
</tr>
<tr>
<td></td>
<td>Fish</td>
<td>Waste reduction &amp; elimination</td>
</tr>
<tr>
<td></td>
<td>Hydroelectricity</td>
<td>Nutrients recycling</td>
</tr>
<tr>
<td></td>
<td>Genetic Resources</td>
<td>Biodiversity conservation</td>
</tr>
</tbody>
</table>

Use Value of biodiversity being recognized by consumers/ regulators

Examples of products with “sustainable attributes”
- Agricultural products- organic / sustainable production
- Timber (low impact)
- Aquaculture
- Non-timber forest products
- Ecotourism

Examples of Services
- Carbon Sequestration
- Water
- Biodiversity
Emerging Markets: The sustainability “niches”

A. Innovative markets: appear as a response to increased (market-based) regulation:
   - Tradable permits (fishing, hunting, etc)
   - Carbon sequestration certificates
   - Conservation easements, wetland banks
   - Other environmental services

B. Niches within traditional goods & services markets responding to consumer demand:
   • Agribusiness: organic agriculture (low impact), low impact extraction of natural resources: timber & non timber forest products, fisheries, aquaculture
   • Tourism: hospitality & entertainment in natural habitats: nature tourism.
   • Energy: renewable energy (solar, wind, biomass etc)

Emerging Markets: The sustainability “niches”

Business Opportunity

- Real change in consumer patterns.
- Easier information flow (globalization)
- Motivated by concerns over Genetically Modified Organisms (GMOs)
- Promoted by a “back to natural” trend
- Fast Growth

Biodiversity Assets

Certification Organic / TSC

Products/Services $$$ Markets

Niche markets/products with high value added that offer an alternative to commodities.

SAI => from niche to “mainstream”

Sustainable Agriculture Initiative (SAI):

Nestlé 2001 US$ 52 Billion
Unilever 2001 US$ 46 Billion
Danone 2000 US$ 8 Billion
2004 + 10 (Kraft, General Mills, Coca Cola, ADM,...)

SAI: “A productive competitive and efficient way to produce agricultural raw material protecting and improving socio-economic conditions of local communities and their environment”
Markets for biodiversity-related products & services

Private Equity/Venture capital investment models

Main Challenges for private equity/venture capital investments in protected areas

- Private capital (family business)
- Private Investors (angel investors)
- Venture Capital
- Private equity. Third party investors for ongoing business.
- Quasi-equity instruments
- Convertible Debt (less risk)
- Issuance of shares in the market

SME Equity Financing Options

Risk
- Private capital (family business)
- Private Investors (angel investors)
- Venture Capital
- Private equity. Third party investors for ongoing business.
- Quasi-equity instruments
- Convertible Debt (less risk)
- Issuance of shares in the market

Liquidity

Private Equity Business Model

1. Acquisition of equity stake
2. Introduction of professional management
3. Capital Investment
4. Consolidate growth
5. Prepare exit
6. Sale to third parties/entrepreneurs

Value Creation

- Governance
- Audit
- Technical Assistance
- Human resources
- Co-financing
- Partnerships with NGO's

Where is the business opportunity?

a) Betting on selling the company at higher multiple

- Multiple based entry price
  - Ex: 5 x PROFIT

- Multiple based Exit price
  - Ex: 7 x PROFIT

b) And (or) on a very fast growth

- 5 x PROFIT on year 1
  - US$ 1 MM

- 5 x PROFIT on year 5
  - US$ 5 MM
**2002: Terra Capital four-year assessment**

- Portfolio was considered too risky, with no assurance of returns after 3 years
- Manager had to adopt a proactive attitude in problem deals, therefore increasing the risks to shareholders
- A development “type” work was required, but no structure had been foreseen to tackle this limitation.
- Steep learning curve (first two projects were bad investments)
- Very difficult operating environment (from a macroeconomic and regional basis), with most sectors suffering from informal competition
- Governance of the fund was jeopardized by small scale. Close monitoring of the board was not cost effective.

From 1999-2002 only 4 investments were made (US$5.5million). In 2002 investors suspended new investments and entered divestment phase.

**Investment in small sustainable businesses: Main Obstacles & Challenges**

- Little culture of venture capital in developing regions and innovative markets
- Low Management Capacity (even more critical in remote rural areas)
- Low Liquidity: difficult exits and capital recovery
- Growth over longer term will probably require patient capital
- Small scale of projects makes transaction costs relatively high
- Returns are lower than in traditional venture capital investments (technology etc).
- Local Regulations not necessarily enforced: companies that comply faced competition from informal activities.
Conclusions & Recommendations

Lessons learned on structure:
- Make it simple

• Lessons learned on Operations:
  - Create track record prior to setting up funds (do pilot projects, direct investment, etc)
  - Work on multilevel partnerships (state, municipal, communities, and commercial relations)
  - Allocate resources to training both managers and entrepreneurs
  - Be sure the risk profile of the activities is constantly aligned with expectations of key investors.
  - Act locally: sector specific investments
  - Be careful with tropicalizing “advanced” countries’ models. What works in the US probably does not work in Latin America