The role of private equity in international agriculture investment – balancing investment opportunities and sustainability criteria

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Fertile land is an finite resource while at the same demand for soft commodities is increasing driven by the rising world population, changing consumption pattern and the use of biofuels. In order to meet this increasing demand it is necessary to use the existing land more efficiently by increasing operational scale, use of latest agriculture technology, applying state of the art management techniques and improving gene material. This all requires significant amounts of financial resources.

Over the last couple of years one could observe that investments in the agricultural sector has risen significantly which in principle is a very positive development. At the same time fears have increased about the negative environmental and social impacts of such investments. This in turn has increased the call for regulation and voluntary initiatives to address sustainability issues in large scale agricultural investments.

If one looks at the capital flows there are currently two large groups of investors in this space: governments / sovereign wealth funds (SWFs) and private sector capital from institutional investors and private equity funds. The majority of private sector capital is currently invested in OECD countries which from a sustainability perspective is less problematic. But longer term even the private sector will look at investing in emerging economies. Today the majority of capital flowing into the agricultural sector in emerging markets –which are the countries where the largest challenges are – comes from governments and their SWFs.

For developing a framework to ensure sustainability of agricultural investments it is worthwhile to have a closer look at the developments in the timber and the oil & mining sector where challenges from a sustainability perspective are similar. In these sectors over the last two decades a number of voluntary commitments and certification schemes have emerged. While some of these initiatives are very general in nature others are very specific aiming at setting standards at the operator level and/or providing guidelines for the financial services sector as a very important intermediary.

The most significant global voluntary commitment is the UN Global Compact (UNGC). Set up by the United Nations in 2000 is the UNGC with today almost 5000 private sector signatories a widely accepted commitment. The ten principles cover all relevant environmental and social aspects. An annual reporting about implementation is mandatory and non-reporters are taken off the list of signatories. The challenge is that the principles are not specific enough and leave a lot of room to maneuver. Looking at the signatories' one can observe that only few private equity firms and SWFs have signed the UNGC so far.

More specific targeting the financial services sector are the UNEP FI and the Principles for Responsible Investments (PRI). While private equity investments in the agricultural sector are covered by these commitments their focus is still very much on listed equities. A good example from the financial services sector on how a voluntary commitment can develop into *an industry standard is the Equator Principles (EP) for project finance transactions. The EP relies on the IFC environmental and social guidelines and makes them mandatory for project finance transaction financed by EP banks. While public reporting is mandatory for all three examples enforcement of non-compliance and dispute mechanism are not well developed.*

In the timber sector the Forest Stewardship Council (FSC) has over the last 15 years developed to the most well known and highly regarded certification scheme for sustainable forest operations. With currently 100m hectares under management and a well known brand in many western consumers markets FSC is clearly a success story. Particularly since many voluntary initiatives refer to the FSC as best practice. But FSC can not avoid that there are players in the timber sector not even implementing minimal environmental standards.

The Roundtable on Sustainable Palm Oil (RSPO) is similar to the FSC targeting the palm oil sector. Very noteworthy is that RSPO is working very closely with producers and "consumers" und thus brings the most important stakeholder groups together. As a relatively new initiative it can already look back at a number of noteworthy success stories. But as with FSC RSPO is increasing the overall level of sustainability management in the sector but can not avoid that a small number of players continues operating with sub-standard practices.

Over the last five years the Extractive Industry Transparency initiative (EITI) has emerged. This initiative is trying to address the problem that the local communities did not really benefit from the oil or mineral assets in their regions. The EITI is an effort to make natural resources make benefit all by companies reporting what they pay to governments and governments publish what they receive. Therefore it is absolutely transparent how much money has been paid and where the money landed up with. The EITI brings the most important stakeholders together (private sector, governments, civil society) which is a key element for the long term success of this initiative. The EITI can –with some minor adjustments- easily be applied for agricultural investments as well and will thus be a good mitigation against opposition and social unrest one could recently observe in Madagascar.

What are the lessons learned out of these initiatives and developments in other sectors? While voluntary initiatives play a very important role in ensuring sustainability in natural resource investments, good local regulation and enforcement is also a key element. It is only regulation that can create a level playing field. But it is very important to stress that regulation on its own will also not be sufficient since it may be flawed or simply comes too late. Voluntary commitments are complementary to regulation they can close existing loopholes or act as safeguards in the absence of stringent or not enforceable regulation. Given that there are a number of well established voluntary initiatives in other sectors it may be worth to explore "best of breed" voluntary standards for agriculture investments. Such standards should be developed in concert with a number of relevant stakeholders including the World Bank Group and other multilateral banks. Especially the World Bank Group has in the past shown leadership in brokering such agreements (e.g. Equator Principles and Code of Conduct for SWFs). In the short and mid-term we need voluntary initiatives going hand in hand with regulation to ensure that the well need capital that flows in the agricultural sector is really creating sustainable value in the long run.

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