Probioprise Project for EC DG Research

FIELDFARE International Ecological Development (FIED)

UK and Lower Danube Basin

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FIELDFARE International Ecological Development (FIED)[1]

Introduction

FIELDFARE International Ecological Development (FIED) is the manifestation of the desire of Paul Goriup and others to create a mechanism for bottom up rather than top down ecological stabilisation, restitution and development.

This was driven by Paul's frustrating experience of working with international technical assistance projects following the fall of Communism. However, unusually, Paul noted the growth of social / ethical investment funds, and realised that most could not invest in biodiversity because of the lack of suitable listed companies. It seemed that this was an interesting niche to explore in relation to the overall debate about sustainable development at the local level – an entrepreneurial insight that led to the creation of a new firm to fill this perceived gap, but one which would have from the outset both financial and environmental aims.

In 1996, Paul, his wife and others prepared a prospectus for FIED which described it as 'The Land Use Company for Ethical Investors', and launched the company with endorsement from the Ethical Investors Group.[2] This led to some initial interest and share subscriptions, but far short of what was needed to implement their ideas. Consequently development has proceeded rather more slowly than was initially hoped, with a focus on possible projects and partners in just the lower Danube region, particularly in Ukraine. This plays to the strengths and contacts of Paul's wife, Natasha, who is Ukrainian.

FIED is registered in England as a public limited company[3]. It has two employees in the UK, Paul and Natasha Goriup. It operates in Ukraine through a 94%-owned subsidiary, Salix Ltd, which is registered in the Odessa oblast. Salix has five full-time employees and up to six seasonal workers. This is an unusually sophisticated structure for such a small enterprise, whether ecologically focussed or not – but one that could be used as the basis for rapid expansion in other countries.

The Context

Between 1954 and 1960, the 'Virgin Lands' programme of the former USSR converted some 41 million hectares of dry steppe around the Black and Caspian Seas from traditional nomadic grazing land to cereal and sunflower fields production. This initiative, covering a vast area zone prone to drought, coupled with poor training for farm managers, led to widespread crop failures due to the inclement weather,

[1] This case was prepared by Professor David Watkins of Southampton Business School, SSU, UK and Tim Jones of DJEnvironmental on the basis of an extended visit to the business concerned and other materials provided by the firm. Additional input has been provided by other members of the Probioprise Project Team. Opinions expressed are those of the authors and do not necessarily represent the views of the firm or any other parties.

[2] See Annex 2

[3] The current Board of FIED is given at Annex 1

insufficient investment in irrigation systems, weak soil conservation measures, and poor harvesting and storage infrastructure.

At the same time, the populations of a wide variety of steppe plants, animals and birds diminished, some so much so that they are now recognised as endangered by both international conservation organisations and national governments. The principal cause was loss of habitat to farmland. In present day Ukraine, for example, over half the country was native steppe before 1940; today only 15 per cent of the land is permanent grassland and just 3 to 5 per cent is in a natural condition.

However, thanks to abandonment of arable farming in some of the marginal areas, tracts of land are now undergoing natural restoration and some rare species are recovering. Such areas are attractive for nature-lovers and therefore have potential for the development of rural tourism. Equally, there is also potential for low-input, sustainable agricultural management, such as grazing land for specialised breeds, honey production, and the exploitation of medicinal and horticultural plants. With appropriate investment, naturally recovering steppe and associated habitats provide considerable opportunities for sustainable long-term income-generation.

As a result of his experience in the early 1990s, especially in leading projects for IUCN/EBRD in Romania in the Danube Delta in 1991-1993, and for the IUCN/Dutch Government in Russia and Ukraine on sustainable agriculture in 1993-1995, Paul came to appreciate that traditional banking and agricultural extension services generally do not provide the small-scale investments, advice and support needed for sustainable land use at any part of the supply chain, be it land care training, to product identification and development, through to marketing.

Origins of FIELDFARE

It was to bridge this gap that FIELDFARE International Ecological Development (FIED) was formed in 1996 following discussions with and receiving endorsement from the UK Ethical Investors Group. The overall aim of FIED is to bring private investment to support ecologically sustainable development, but not only to become a biodiversity-oriented company whose shares are freely traded, but a beacon to others.

After achieving its initial capital target as a private firm, FIED became a public limited company in September 1999. At present, the company has 16 shareholders including the World Wide Fund for Nature. FIED’s Chairman is Adrian Darby OBE, former Chairman of the Royal Society for the Protection of Birds, and present Chairman of Plantlife.

In addition to private share capital, during its development phase the company attracted other income streams through the EU Tacis programme, consultancy contracts and in-kind support. Operating mainly in the Lower Danube region of Ukraine, it was involved in pre-investment studies for several potential ecological business projects. These included organic vegetable production, biofuel from reeds, sustainable fisheries and ecotourism. This has been successful to the extent that FIED’s investment studies have so far been developed largely without recourse to its own share capital.

Creation of the Salix Subsidiary

By October 2001 sufficient experience had been gained to consider a more focussed approach and to begin direct investment. The decision was taken to focus initially on environmentally friendly tourism. The rationale for this was that it would serve as a hub on which to hang other potential future projects. These investment activities are designed to accumulate local assets chiefly in the Lower Danube Region of Ukraine together with the cross-border areas of Romania and Moldova. This region was selected not only because of personal local knowledge – crucial as that is – but because it has the richest biodiversity in Central and Eastern Europe, together with a high density of internationally important protected areas and biosphere reserves.

In addition, the local and national authorities are developing cross-border sustainable development strategies, under the auspices of the Lower Danube Euroregion. Awareness of this are in Western Europe is low for historical reasons, but it is not only of crucial ecological significance but has great economic potential: the Danube River basin itself connects 17 countries with a combined basin population of over 81 million people. Of these, more than 16 million live in prosperous Austria and Germany. This provides a large prospective market for tourism in the Danube delta region since intending visitors from higher up the Danube want to see where ‘their’ river enters the Black Sea.

Thus here in the Lower Danube Basin, it was felt, a relatively modest environmental investment during the economic transition period could generate large benefits over and above the direct financial ones that would enable FIED to expand. These include: generation of income for local people; raised awareness of the value of local nature for attracting tourists; policy development and intervention to forestall intensive tourism development; and, knock-on benefits for the promotion of organic agriculture, nature management (especially of the wetlands) and energy efficiency.

FIED has therefore formed a joint stock company registered in Ukraine (TOV Salix Ltd), which is 97% owned by FIED. Through this subsidiary, FIED has established an office in Odessa and a sustainable business centre in Reni, which is a gateway to the Danube Delta of Ukraine. This centre will coordinate its investment activities in the Lower Danube region.

The first of these has been the purchase of a substantial building in Vilkovo to serve as an eco-tourism centre. This property was a former Turkish bath-house. The main building is being renovated to provide visitor amenities such as washrooms, a café, a souvenir shop, an activities booking office, and accommodation. The former boiler-house will be converted and assigned to a local NGO, EcoCentre Delta, as an information centre. Signalling commitment to the local economy through this kind of direct investment in refurbishing and modernising the local infrastructure, and particularly a manifest willingness to operate in partnership with local civil society, is important in demonstrating the incomers’ *bona fides*. However, despite FIED’s current profitability, the €400,000 required to complete the conversion is proving harder to raise than anticipated.

Operating in a Transition Economy

Even in developed economies it is difficult to find employees who are already suitably trained and ecologically aware. So it is no surprise that this is the case in a transition economy. Most training is provided on the job as few people in Ukraine have the skills needed. Employees are recruited through newspaper advertisements and personal contacts.

However, a major difference is that the rule of law cannot be taken for granted. Business and tax legislation is mendacious – or at least capricious - but since it applies to *all* companies, not just eco-friendly ones, in that sense it is equitable.

The 2004 Business Plan includes a standard SWOT analysis, but the nature of the threats identified are quite different to those which would be capture in a SWOT generated by a UK based firm operating in the UK rather than the Ukraine. Even in the rather dry and formal language of a business plan aimed at external investors this gives a flavour of the unique problems facing any SME operating in the Lower Danube Basin.

Specifically:

1. There is a risk of hostile official inspections in order to gain bribes. This can be avoided by keeping operations low-key and of course operating fully within the law.
2. The very small risk of attention from criminal organisations can be avoided by ensuring a good network of powerful local contacts and keeping operations low-key.
3. Abrupt legal changes, or changes in administration officials, can cause unexpected delays in project implementation.

However, in addition to the problems facing *any* business in the Lower Danube generally, environmental and biodiversity legislation is either poor or not adequately enforced, so FIED / Salix cannot exploit its competitive advantage in comparison with other companies who do not respect environmental protection and nature conservation.

FIELDFARE as a Learning Organisation

An acute sense of the value of time is a characteristic of all Entrepreneurs. So is learning from experience and modifying one’s behaviour accordingly. One does not have to spend more than a few minutes with Paul to realise that he is an ‘ideas’ man who is frustrated by how long everything is taking, so he gets frustrated by not being able to move on to each new, exciting project. Thus it is interesting that he and his directors made the effort to identify the learning from the initial phase of activity as a precursor to the second round investment phase discussed above.

Table 1: Lessons Learned by FIED in first period of operation

Need / Lesson	Explanation
Communication	The FIED approach is not conventional and much communication is required with local stakeholders to allay suspicions that the company has some hidden agenda that will, in due course, put partners at a disadvantage. Keeping investments relatively small, and engaging NGOs, is helpful in this regard.
Multi-sectoral approach	Linking investments to ecological benefits (e.g. wetland restoration) usually requires a multi-sectoral approach: for example, tourists need decent accommodation, clean food, transport, information, guiding, etc.
Multilateral investments	It is helpful to work with several partners to prevent investments being captured, to forestall corrupt practices, encourage competition and increase bargaining power, and allow redundancy if any one partner proves unsatisfactory.
Training and supervision	In the rural areas where FIED operates, there is a total absence of qualified personnel even if entrepreneurial talent is available. Engaging management staff, training them, and supervising their work are essential.
Delivering rapid results	It is expected that once a decision is made, results will flow rapidly. This may not always be possible, but at least some quick, visible achievements should be planned (e.g. FIED's purchase of a building in Vilkovo demonstrated intent more effectively than any documents).
Due diligence audits	This normal practice is vital in an economy in transition where accounting practices, valuation of assets and liabilities, depreciation and similar concepts are poorly developed, if at all.
Legal backup	The legal situation regarding land ownership, authorisations, investment and other matters is often unclear or contradictory. A similar situation exists with regard to accounting, tax planning and repatriating profits. Good professional advice is needed, preferably from several experts.
Anticipation of change	During the transition period, few political appointees remain in post for more than two years.

Source: Company Business Plan, 2004, revision 2

A new kind of SME Finance Gap…?

The question of whether or not there is a finance gap for SMEs has been a perennial issue in FIED's country of domicile, the UK. Numerous government reports have been published on the topic (Refs), and at different times gaps have been identified in the provision of both equity and loan finance. The essence of the problem – which is not unique to the UK – is that evaluation (and later, monitoring) costs are relatively independent of the size of an investment, so constituting a much greater proportion of the investment tranche for small sums than large. At some point the rates of return required to cover these enhanced costs will make all investments unviable. The problem is somewhat greater for equity than loan finance since the greater responsibilities of owners in most jurisdictions, even with limited liability, make the evaluations more onerous and thus more expensive. This is true of all classes of firm, but the situation is exacerbated if, in addition to the normal 'due diligence' costs, an environmental audit is also required. Thus, paradoxically, the costs of making small ethical investments are always likely to be higher than small 'non-ethical' ones, as well as large investments generally. In the absence of any subsidy, if the market seeks an equivalent return from all investments, interest rates for investments such as those promoting biodiversity will therefore be higher; similarly, without any subsidy, the expected rate of return sought from equity investments will be higher.

In its financial intermediary role this has two effects on FIED – one on the supply side and one on the demand side. *Ceteris paribus,* it is an attractive investment proposition only if its own investors are content with a financially sub-optimal return, or their due diligence costs are in part subsidised. However, in making pure investments its *own* evaluation costs are also higher. In the absence of subsidy[4], this increases the costs of capital to its own clients and / or further reduces rates of return to its investors.

None of this matters if there are investors who are prepared to value the environmental benefits to the extent that they are prepared to accept lower financial rates of return. Indeed, this may give us a way of 'pricing' biodiversity, so the situation of FIED is of particular interest. What then are FIED's experiences in raising capital?

On the basis of its revised 2004 business plan, FIED has attempted to raise second stage financing. This was to cover the costs of the Vilkovo conversion and to expand operations generally. Paul Goriup has kept a careful record of his experiences with a range of potential investors. These cover a mix of institutions including public and private sector investment agencies and NGOs. All have in the past expressed a desire to fund environmental or 'ethical' projects and to look sympathetically on them. The responses, which have been anonymised, indicate just how hard it is to raise funds to operate on anything like a commercial basis, even from essentially sympathetic investors.

Respondent One was an NGO investor in the first round of finance raised by FIED. However, its financial priorities had changed. It no longer supports projects which are

[4] Part of this subsidy might be indirect, such as knowledge gained from undertaking environmental or market evaluations for third parties – EU, governments, NGOs – on a consulting basis. Here the information asymmetry favouring FIED as an investor also serves the cause of biodiversity.

mainly eco-tourism driven unless these clearly contribute to local product diversification.

Respondent Two is an intergovernmental finance house. Its investment thresholds were far in excess of FIEDs current needs. It referred the Proposal to intermediaries it currently funds, but nothing more was heard.

Respondent Three was UK branch of an international bank, but would only support projects based in the UK.

Respondent Three was a Ukrainian affiliate of a western European development bank. It only invests in the Ukraine, but insists on rates of interest of ~15% on dollar denominated loans, in line with local market rates. It suggested raising finance in the UK…

Respondent Four only operates in the developing world, and does not include the transition economies in this category. Its focus is on Fair Trade ‘organic produce, but by way of normal trade credit not subsidy.

Respondent Five saw the Proposal as a real estate investment, and was not active in that sector in Ukraine.

Respondent Six is a commercial bank with international operations and an apparently genuine desire to invest in ‘green’ businesses. Its reply is worth quoting in full since it well expresses the difficulty faced by such institutions.

> “…first my apologies for the delayed answer. I am so awfully busy and if you cannot give someone an answer easily then it takes some time.....! I do not know if your plan is of any interest to XXXbank. Because, financing these kinds of investments is not 'standard' and in the eyes of 'traditional' bankers not promising a high ROI without risks..... I am still trying to develop new tools/instruments for financing these kinds of projects. I am involved in some initiatives (the European Task Force on Banking, Business and Biodiversity, the PAN Parks, a Green Investments Financing Scheme (EPE/EU), ECNC/Hungary) and I hope that one of them will succeed in 2006!! As you see in the heading of this e-mail I am forwarding/copying all your information and my reaction to my colleague {..the General Manager of our London branch} with the request to investigate the possibilities from the UK, because you mentioned that the loan will be taken by the British company through which the investment will be made in the Ukraine. I will call {him} about this one of these days. I hope (once) we can find solutions for financing these types of projects in the future..!”

In summary, the reasons for refusing investment include: sum requested below investment thresholds; difficulty of investing in one country for onward loans to another; insistence on market rates of return (with added risk of loans denominated in a third currency); changes in investment criteria; focus on non European development opportunities; internal difficulties in delivering on the bank’s investment rhetoric; no interest in specific sector, which it construed narrowly as ‘real estate’; awaiting action on a European / international level.

Issues facing FIELDFARE

Fieldfare is a brave attempt to create a vehicle which can mobilise resources from more developed economies to deliver biodiversity and other environmental gains *at a profit.* Its experience so far, despite achieving profitability, shows just how hard is this challenge.

Among the issues the case raises which have implications for the development of the Research Agenda are the following.

- It is difficult to raise funds in one country and deploy them in another. The situation is likely to be exacerbated by the fact that Ukraine is still in transition, but the limited evidence seems to suggest that the situation would not be entirely resolved if the firm were based in one EU country and its investments made in another Member State. Certainly the administrative processes of large potential investors are not yet geared to this for small scale investments in biodiversity, and possibly more generally, despite SEM rhetoric and cross border mergers.

- Minimum investment levels are a problem for SMEs generally. Many pro-biodiversity firms – even those with good long term potential for growth – are likely to need investment sums well below these thresholds initially, and therefore may never be funded.

- There is a potential role for EU and national government intervention in promoting the evaluation and monitoring of small scale pro-biodiversity investments. This could unlock a disproportionate volume of private sector funding by generating a well-researched and 'ethically certified' deal stream.

- International experience with SMEs generally has indicated a reluctance to support employee training for fear of poaching. The supply of labour with environmentally sensitive skills seems to be an issue in the Lower Danube as elsewhere. It would be worth investigating the potential for the EU vocational training programmes to take a cross national view of the strengths and weaknesses of the current national training regimes as they affect environmental sensitivity and specific skills required for establishing and developing environmentally oriented firms. Removing some of the financial risk of trained staff being poached by increasing the supply of trained labour could be one way ahead.

- This firm seeks to operate a mixture of business activities which synergise to protect and enhance biodiversity, with eco-tourism as the present 'hub'. It is unclear what investors expect a 'pro-biodiversity' business to look like, but it is often a complex mix of interacting activities. Taking too restrictive a definition – for example in framing legislation, eligibility criteria or codes of practice – could potentially eliminate (or fail to encourage) many worthwhile actions.

ANNEX 1: Directors of FIED

The chairman of the company is Adrian Darby, who was a tutor in economics at Keble College, Oxford from 1963-1985, and chairman of the Royal Society for the Protection of Birds (Europe's largest voluntary conservation body) from 1986-1993. At present, Mr Darby is chairman of the major plant conservation organisations Plantlife and Planta Europa.

The managing director of the company is Paul Goriup, who was formerly conservation director of Birdlife International (1982–1986) and who then founded and directed a successful environmental design and consultancy company, the Nature Conservation Bureau Ltd. Mr Goriup currently leads EU-funded projects in Ukraine, Moldova and Romania, and is a Fellow of the Institute of Ecology and Environmental Management.

Mrs Nataliya Sergeivna Goriup BSc (40). Ukrainian.
Trained as a botanist at the University of Odessa and joined the Southern Seas Research Institute of the National Academy of Sciences. From 1982 to 1994, she served as a field scientist for and later deputy director of the Danube Delta Nature Reserve, during which time she worked with Dutch consultants to develop a project worth $1.5 million for funding by the Global Environment Facility. The project is now being implemented. In 1989, she established (and still chairs) the Ecocentre "Delta" Vilkovo, the first environmental voluntary body in the region, which became a member of IUCN - The World Conservation Union in 1996. Since 1994, Nataliya has assisted Paul Goriup with projects in Abu Dhabi, Ukraine, Russia and Kazakhstan. She has extensive government and business contacts in the former USSR, is very familiar with local government procedures, and speaks Russian, Ukrainian and English.

Charles Rowney, BSc ACA (31). British.
Charles trained as an undergraduate in Applied Biology but in recent years he has developed skills in audit and accountancy and is a Chartered Accountant. Between 1989 and 1994 he was a financial auditor for KPMG, the global management consulting and accountancy firm. From 1994 to 1996 he was financial manager of the Nature Conservation Bureau, retiring for family reasons. He is now a self-employed consultant. Charles' career move to the Bureau and his Directorship of FILDFARE reflects his commitment to working with organisations whose objectives are primarily geared towards environmental conservation. Charles has experience of project work abroad having completed a research project in the Danum Valley, Sabah.

Hans Peter Kollar PhD (39). Austrian.
Trained as an ecologist at the University of Vienna, graduating with a doctorate in the behaviour of solitary bees. He is currently Director of the Institute of Behavioural Ecology, a privately funded body that undertakes commercial and charitable environmental research. Hans Peter is an expert in steppe habitat management (in particular designing areas for biodiversity in farmland), and has carried out human impact studies on landscapes (irrigation canal, waterway engineering, forestry). From 1994-1995, he prepared the International Action Plan for the Great Bustard on behalf of Birdlife International and maintains strong links with steppe habitat managers in Germany, Hungary and Czech Republic.

Annex 2: Original FIELDFARE Business Plan

(Restricted)