Discussion paper

How to increase private investment in nature

November 2024

This discussion paper accompanies our briefing 'How to increase private investment in nature', also published in November 2024.

The role of the private sector in nature restoration

Benefits from nature are spread throughout the economy. In economic terms, some of these are classed as public goods, because everyone benefits from them and one person's enjoyment of them is not diminished by another person's use of them.

However, other benefits from nature can be classed as private goods, because the benefits accrue to the owner of the land or business and one person's use of them will reduce another person's ability to benefit.[1]

UK agricultural policy post-Brexit is based on the principle that public money should pay for public goods.[2] This means farming subsidies should be spent on delivery for public benefit, like clean air and water, rather than private goods, like food production. This is an important principle that ensures public money is used to support actions that everyone can benefit from and not to increase private profits.

However, the farming subsidy scheme in the England, called the Environmental Land Management Scheme (ELMS), also uses public money to pay for some private goods. For example, the new Sustainable Farming Incentive (SFI) pays for actions that improve soil quality, such as reduced till systems and planting cover crops, improving the resilience of supermarket and food manufacturers' supply chains.[3]

Previously some of these actions might have been covered by private sector payments, such as the Landscape Enterprise Network East of England project, where water companies, food manufacturers and the local county council pool their money to invest in nature-based solutions that improve food supply chain resilience and water quality.[4]

Furthermore, the distinction between public and private goods is not always clear cut, with some private goods like reduced flood risk providing benefits beyond the land on which they are created. The creation of public goods

from nature, such as cleaner air and more biodiverse habitats, also supports greater private sector profit, for example by improving workforce health and protecting assets from extreme weather events.

Therefore, the private sector has an important role to play in protecting and restoring nature, in the maintenance and creation of both private and public goods.

Mechanisms to increase private money for nature restoration

When designing policy for nature restoration it is vital to take the 'mitigation hierarchy' into account. The priority should always be to avoid harm to nature, and only if this is not possible should policy look to instead minimise damage and compensate for losses.[5]

We have identified five mechanisms for driving private finance into nature: supporting the development of voluntary markets, creating new compliance markets where companies are required to buy credits, charging a levy on businesses to account for their impact on nature and investing the returns in nature, charging fees for the provision of natural infrastructure and changing company incentives.

The first three change external incentives for companies, and mostly focus on the bottom of the mitigation hierarchy, to compensate for damage done. The latter option focuses on changing the internal incentives for company action, which focuses attention at the top of the mitigation hierarchy, on avoiding impacts in the first place. These are not either/or choices, mechanisms could be combined to create the most impact. These approaches and their pros and cons are explored below and summarised in the table.

Voluntary markets

The first option is to continue to support the development of voluntary markets for nature. These are markets where businesses are not required to invest in nature restoration but choose to. This could be because they recognise that nature delivers private goods and services that support their business and supply chains, such as preventing flood risk on farms that would impact the delivery of food to large food companies and supermarkets. For example, food manufacturers, water companies and a county council are jointly funding measures on farms in East Anglia to deliver benefits that will support their businesses operations in the region, including storing carbon, reducing flood risk, and improving water quality and the resilience of supply chains through the Landscape Enterprise Network model.[6]

Voluntary markets for carbon have existed for decades, with companies keen to offset emissions due to international and domestic pressure to reduce them. In 2022, it became mandatory for large companies to report on climate impacts and risks as set out in the recommendations of the Taskforce for Climate-related Financial Disclosures (TCFD) and to publish Transition Plans for how they will reduce them.[7] This has increased the motivation for companies to reduce emissions from their own operations and to look to offset remaining emissions through the voluntary carbon market.

It is currently voluntary to report on the equivalent nature related impacts and risks, in line with the recommendations of the Taskforce for Nature-related Financial Disclosures (TNFD).[8] Reporting under TNFD has important roles to play in generating data on nature impacts and raising awareness of business dependency on nature throughout supply chains. This should create incentives to invest in nature along supply chains to improve business resilience, but as most UK supply chains are overseas it is unlikely to drive significant investment in UK nature.

Making it mandatory to report on nature related impacts and risks in line with the recommendations of the TNFD is an important step in supporting the development of the nature markets, but it is not sufficient. Even businesses who would be interested in voluntarily investing in nature are currently nervous, without government policy that sets agreed standards and governance systems, that set out clearly what business can say about their investments, and without an agreed definition of what 'good' looks like.[9] The voluntary market for carbon has struggled with accusations of 'worthless' credits and greenwashing that have reduced investor confidence, contributing to low prices in the voluntary market.[10]

Compliance markets

The second option is to create markets for some public goods through regulation, known as 'compliance markets'. They place a requirement on businesses to mitigate some of their impact on nature by restoring it. For example, biodiversity net gain (BNG) places a requirement on developers to deliver at least a ten per cent increase in biodiversity as a result of their development, either on site where the houses are built, or if that isn't possible then off site.[11]

BNG has only been mandatory since February 2024 but is already generating significant interest from nature investors and land managers, as it delivers sensible pricing compared to other types of voluntary markets where value is set by the low voluntary carbon price. For example, Woodland Carbon Code credits fetch higher prices than the average voluntary carbon market price due to high standards, but are still only averaging £25 per tonne of carbon.[12]

For a single hectare, that carbon credit price could generate between £2,500 to £12,500.[13] Early market analysis on BNG credit prices suggest a range from £27,000 to £165,000 per unit depending on habitat distinctiveness, location and supply.[14] Landowners may be able to generate two to six units per hectare depending on habitat quality and type, suggesting a potential price of at least £50,000 per hectare for BNG.[15] In a review of 219 nature projects preparing to attract private finance across the UK, biodiversity credit sales were the most common revenue stream identified, in 66 per cent of projects, in anticipation of the potential for BNG in England and the introduction of further policy around biodiversity markets in future. Carbon credits were the second most popular revenue stream, identified by 60 per cent of projects.[16]

New compliance markets have the potential to drive a step change in private finance flows to nature, by making it mandatory, rather than leaving it to voluntary initiatives. Creating buyers in the market would enable investment due to greater certainty of returns and would allow farmers to plan their land management into the future. Good regulation can also be a strong driver of innovation in business, by creating the incentive for changes in practice that reduce impacts on nature in the first place.

Charge a levy

A third option is to charge businesses a levy in line with their impact on nature, which is then invested in nature.[17] This could take the form of a hypothecated tax, or it could be run as a pooled fund, administered by business or government.

If the levy was directed into a pooled fund, it could help support the development of the market, with the fund acting as a major buyer of nature credits from projects developing their business case through the Natural Environment Investment Readiness Fund, and projects in the Landscape Recovery element of the ELM scheme which are required to blend private finance with public investment. This would share the risk for businesses, enabling them to invest in new and innovative projects where outcomes are not guaranteed, as well as pooling the resilience benefits from these projects which can spillover beyond the land involved.

A pooled scheme of this type could be organised regionally, based on where businesses are operating and involve all relevant sectors. This would require business to have a strong understanding of nature impacts and dependencies, which could be supported by mandatory reporting against Taskforce on Nature-related Financial Disclosures (TNFD) requirements. Several voluntary mechanisms similar to this already exist, such as the Landscape Enterprise Networks model, pioneered by 3keel and Business Improvement Districts (BIDs), where local businesses pay a levy into a fund

to improve their local area.[18] Building on these successful approaches would be an effective way to drive businesses to invest in nature projects along their supply chains.

Changing company incentives

The previous three options described try to shape companies' activities by manipulating their incentives externally through tax or regulation. A fourth option is to internalise the harmful externalities businesses sometimes create so they voluntarily pursue more nature-positive corporate strategies.

This can be done in two ways. First, by giving them more 'skin in the game', whereby damaging nature in their supply chains directly affects their bottom line; and, second, by adapting the fiduciary duties of directors so investing in nature preservation becomes part of the purpose of the company. The advantage of the latter option is it affects the core operating incentives of a company. The disadvantage is that it would be complex to achieve and might encounter opposition from companies themselves.

Currently, there is a free rider problem whereby businesses can readily deplete nature and natural assets along their supply chains, and then move on to new suppliers once depleted. If businesses do not have ownership or rights over the land, there is little incentive for them to invest in restoring the natural assets they use, as it is someone else's problem. This is an example of the 'Tragedy of the Commons' where common resources are depleted as no-one is incentivised to protect and restore them. In fact, public money is currently used to protect and restore nature through ELMS with very few obligations on businesses to pay towards it.

One way to solve this would be radical changes in land ownership, so that businesses owned more of their supply chains and the land that underpins it. By having this stake, businesses would have a direct incentive to take care of the land as any damage incurred would be harming their own valuable asset. For example, a supermarket owning the land that produces the food it sells. However, this would be highly contentious politically and could also lead to monopolies if several large companies owned large areas of land for food production, creating additional problems in the food market. It is, therefore, not recommended.

Alternatively, organisations that already have property rights over large areas of land, such as the Crown Estate, The Church of England and the National Trust, or groups of small landowners working together, could charge users of their natural assets a fee to cover their maintenance. This could be based on the Regulated Asset Base (RAB) funding model, where the landowner invests in and manages natural infrastructure to maintain its

condition, paid for by fees charged to beneficiaries. The government could set up natural capital utility companies at a regional level to supervise the RAB, collate the information and levy the charges.[19]

This approach may be particularly well suited to the water sector, with users such as insurance companies who benefit from reduced flood risk across the catchment area. Working out which other businesses should be liable to contribute to these costs would require a detailed understanding of business dependencies on nature. Mandatory reporting under the TNFD would provide some high level data on business risks and dependencies, but more detailed data would be needed to provide spatially explicit information.

A second strategy, which would complement the first, is to reform principles of corporate governance, to oblige company directors to take more account of their business's impact on nature. There has been much recent discussion of ways to make companies pursue a wider range of goals besides profit maximisation which, when pursued in a very narrow sense, can be harmful to the environment as it elevates the financial interests of shareholders above all other stakeholders.

There are several possible remedies, but probably the most effective would be to widen the fiduciary duties of directors to include a responsibility to invest more in protecting nature. Under the Companies Act (2006) these duties are currently limited to acting in the interests of the company of which they are a director. But, in certain cases, they can be widened to include other stakeholders, such as employees and creditors. They could be widened further to include the interests of other parties affected by the company's activities, including nature. This would need to be accompanied by further reforms to ensure measures are accurately reported to boards and shareholders and are fully acted upon and justified to regulators.

Summary of pros and cons of mechanisms to drive private finance into nature

Mechanisms	How to implement	Pros	Cons
Develop voluntary markets	Make TNFD reporting and transition plans mandatory, create strong standards and governance for nature	TNFD will improve understanding and awareness of companies' impact on nature and their reliance on it through data gathered and published. Building up this data and expertise will enable new	Even if reporting is mandatory, investing in nature will be entirely voluntary and unlikely to deliver enough nature restoration at scale. Mirrors the voluntary carbon market, which has

	markets and set out the definition of 'good', nature positive, business	market creation based on nature impact. It will encourage investment in nature to improve companies' reputation with customers. TNFD could motivate investment if used by large institutional investors, eg pension funds, as criteria for investing in companies, but it is unlikely most of this will be in the UK.	suffered from low prices making it difficult to invest. Focuses effort at bottom of the mitigation hierarchy, offsetting damage rather than preventing it.
Create compliance markets	Expand existing markets, eg biodiversity net gain (BNG)	Broader environmental gain could be delivered and/or higher percentage of net gain.[20] Marine net gain would expand protections to marine environments. Encourage nature restoration close to the site of damage. Delivers predictable demand (subject to government policy).	Only covers existing sectors, so it is unlikely to drive much additional finance into nature. Focuses effort at bottom of the mitigation hierarchy, on repairing damage rather than preventing it. Not sufficient to meet nature restoration goals.
	Create new markets	Expands sectors required to invest in nature restoration, potentially delivering significant additional investment into nature. Compliance markets are delivering reliable and sensible pricing so far.	Hard to measure and enforce across international supply chains, eg in the food sector. Risks additional costs to business being passed onto consumers.

		Delivers predictable demand (subject to government policy). Enables business to innovate to meet requirements.	
Charge a levy	Charge businesses a levy in line with their impact on nature, then invest revenues in nature	Do not need to enforce actions in overseas supply chains. Additional revenue generation for nature. Potential for businesses to pool risk and resilience benefits.	Hard to define the level of levy (ie what measure of impact on nature is used). Cost to business rather than a market opportunity. Potential for costs to be passed onto consumers.
Changing company incentives	Expand fiduciary duties to include nature	Focuses effort at the top of the mitigation hierarchy, as businesses are incentivised to prevent damage rather than compensate for it.	Hard to come up with a legally watertight definition of directors' duties that forces them to act with due regard to nature restoration.
	Existing large landowners charge users of natural assets a fee, based on a Regulated Asset Base (RAB) model for utilities	Provides stable revenue for the maintenance of natural assets. Removes the 'free rider' problem.	Users would vary by catchment; detailed data on nature dependencies and impact would be needed. Users may see this as an additional cost to pass onto consumers.

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Endnotes

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