



# A Case for Biodiversity Offsets in India: From Biodiversity Risk to Competitive Advantage

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*As the Indian economy is moving up the growth curve, the country's biodiversity is taking a beating. Even though legislation is in place to regulate and compensate for diversion of forests for non-forest uses, diversion and the resultant biodiversity loss continue unabated. The regulatory compensation regime has fallen woefully short of truly offsetting the biodiversity impact of economic development. The time is ripe for high-biodiversity-footprint businesses operating in India to explore the option of voluntary biodiversity offsets not only to manage reputational and financial risks by adequately compensating for their biodiversity impact but also to gain a competitive edge in the process.*

*"A good company delivers excellent products and services, and a great company does all that and strives to make the world a better place." ~ William Ford Jr., Chairman, Ford Motor Co.*

### **Business and Biodiversity Footprint**

The latest Global Biodiversity Outlook of the Convention on Biological Diversity lists habitat conversion driven by industrial expansion as one of the main drivers of biodiversity loss. This is especially true for industries such as mining, oil & gas and power that need access to biodiversity-rich areas either for extraction or for building infrastructure (Secretariat of the Convention on Biological Diversity, 2010).

Businesses in such high-biodiversity-footprint industries face a growing demand for accountability from governments, civil society and communities on one side, and from investors, insurers and financial institutions on the other. They are increasingly expected to take full responsibility of their biodiversity impact in lieu of a 'license to operate' in ecologically-sensitive areas (BBOP, 2007). Furthermore, 'the World Bank, the IFC, the export credit agencies, and even a wide array of private banks' increasingly take into consideration biodiversity risk while making lending and investing decisions as is evident from IFC's Performance Standard 6 and the Equator Principles (ten Kate, et al., 2004, p.40). Examples abound of companies who have incurred significant reputational and financial losses on failing to manage their biodiversity risk. (ten Kate, et al., 2004). London Stock Exchange-listed Vedanta Resources Plc. is a case in point.

### **Biodiversity Risk: Clear and Present Danger**

In what emerged as a textbook case of blatant disregard of biodiversity risk, Vedanta had its proposal to strip-mine a biodiversity-rich site shot down by the Indian Ministry of Environment and Forests (MOEF) in August 2010. Located in the Indian state of Orissa, the site called Niyamgiri Hills is a designated elephant reserve, an important corridor linking two wildlife sanctuaries and a proposed wildlife sanctuary in addition to being the sole habitat of the endangered and isolated primitive tribal group of Dongria Kondh, who hold the hills sacred (Saxena, et al., 2010). The fiasco in Orissa wasn't entirely unexpected given Vedanta's

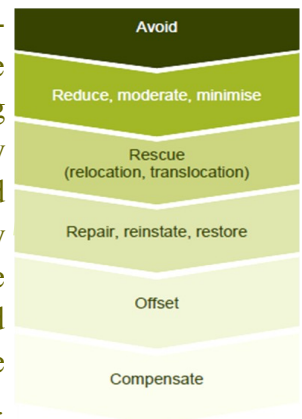
appalling track record of environmental misconduct (Reiner, 2010) and its image as an unacceptable reputational and financial risk among investors such as the Norwegian Government Pension Fund, which evicted the company from its investment portfolio due to pressure from groups campaigning against its Orissa project. Soon after, another investor PGGM Investments withdrew its stake from Vedanta which according to the Dutch Pensions Manager was ‘burdened with growing reputation risk, which may also translate into financial risks’ (Survival International, 2010). Over the past few years, a number of large investors including the Church of England and the Rowntree Trust have chosen to disinvest from Vedanta, sending its previously rising stock into a downward spiral (Krishnamurthy and Jalnawalla, 2010). The Local Authority Pension Fund Forum (LAPFF), a voluntary association of 53 local authority pension funds based in the UK, slammed Vedanta, saying that the stock price fall indicated ‘the financial risk inherent in poor management of social and environmental impact issues’ (LAPFF, 2010).

### Unpacking Biodiversity Offsets

The Vedanta case exemplifies that a company’s biodiversity breaches can engender significant regulatory, reputational and financial risks. On the other hand, by going beyond compliance and treating environmental expenditures as an ‘investment,’ companies can derive considerable reputational and financial mileage (Miles and Covin, 2000). Voluntary biodiversity offsets are one such investment.

The Business and Biodiversity Offsets Programme (BBOP), a partnership of over 40 companies, governments, financial institutions and conservation experts, defines biodiversity offsets as ‘measurable conservation outcomes resulting from actions designed to compensate for significant residual adverse biodiversity impacts arising from project development after appropriate prevention and mitigation measures have been taken’ (BBOP, 2009).

BBOP has developed ten principles that underlie the concept of biodiversity offsetting. The ‘adherence to the mitigation hierarchy’ principle positions biodiversity offsetting as the last-resort option for addressing biodiversity impact. Biodiversity offsetting must not be resorted to by businesses to circumvent their responsibility to avoid, minimize and mitigate biodiversity impact. Thus, biodiversity offsets cannot justify development in ‘no-go’ areas where impact must be avoided (as in the case of Vedanta’s Orissa project). Moreover, biodiversity offsets stand to provide reputational and financial gains only when developers have taken all reasonable efforts to adhere to the mitigation hierarchy i.e. when impacts have been avoided, minimized or addressed through restoration to the extent possible (ten Kate et al, 2004).



The Mitigation Hierarchy  
Source: PWC, 2010

## **Voluntary Biodiversity Offsets: The Business Case**

More than 30 countries already have legislations in place that require businesses to offset their biodiversity impact and many others mandate compensatory conservation in some form or the other. Notable examples include species mitigation and wetland mitigation in the USA, national system of tradable conservation units in Brazil and habitat compensation requirements in Australia, Canada and the EU. In countries where regulatory frameworks are absent or inadequate, voluntary offsets come into the picture and have a potentially strong business case. Undertaking biodiversity offsetting makes good business sense because it allows businesses to gain regulatory goodwill and a social license to operate. (ten Kate et al, 2004).

Another important factor that contributes to the business case for voluntary biodiversity offsets is enhanced access to capital. As already pointed out, lenders and investors are paying increasing attention to a company's environmental performance and biodiversity offsets are emerging as an important component of standards being used for measuring environmental performance. For example, IFC, World Bank's private sector arm that provides project finance for development projects in emerging economies, has stipulated eight Performance Standards on social and environmental sustainability that specify the requirements for companies to receive and retain IFC support. The 'Performance Standard 6: Biodiversity Conservation and Sustainable Natural Resource Management' deals specifically with biodiversity impact and requires companies to design mitigation measures including 'offset of losses through the creation of ecologically comparable area(s) that is managed for biodiversity' to achieve no net loss of biodiversity ( IFC, 2012, p.2). Based on the Performance Standards, IFC has also developed the Equator Principles which are 'a credit risk management framework' that allow financial institutions to assess the environmental and social risk of a project proposed for finance. Till date, 76 leading banks and financial institutions from around the world (collectively referred to as Equator Principles Financial Institutions or EPFIs) have adopted the Equator Principles and have committed not to finance a borrower unless it meets IFC's Performance Standards. These 76 EPFIs provide more than 70% of the international project finance in developing countries (Equator Principles, 2012). It is evident that biodiversity offsets are becoming an important criterion for project finance decisions and can offer companies a potential competitive advantage in vying for capital.

## **Compensatory Afforestation in India: Bringing a Knife to a Gunfight**

India's growth story has essentially been that of constant tradeoffs between development and conservation, with biodiversity almost always losing out. Forests have been recklessly diverted to make way for development projects.

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The Forest Conservation Act (FCA) legislated in 1980 lays down the framework for regulating indiscriminate diversion of forests for development projects and for offsetting the biodiversity impact of diversion. As per the FCA, companies that get a ‘forest clearance’ to divert forestland for a development project are required to pay the net present value of the land and the cost of compensatory afforestation (on an equivalent area) to the government, which in turn uses the money to carry out forestation and restoration activities (Kohli et al. 2009). Thus the existing regulatory compensation regime in India is based on mere transfer of funds rather than on concrete conservation outcomes (as required by the very definition of biodiversity offsets). More importantly, the very premise of the current legal regime has been challenged by none less than the parliament itself. According to a 2008 parliamentary standing committee report on compensatory afforestation, the current regulatory framework seems to legitimize monetary compensation for diversion of forestland, thus facilitating forest diversion rather than acting as a deterrent for it. ‘It is based on the assumption that collection of more and more monetary compensation and tree plantation is the answer to forest conservation. But this assumption proves to be totally false if seen in the light of pace of diversion of forest land for non-forest purposes which has gained momentum,’ observes the committee in its report (Rajya Sabha Secretariat, 2008). This is in direct violation of the mitigation hierarchy which gives ‘avoidance’ precedence over ‘compensation.’

It is evident that the present legal framework in India is not in conformance with the BBOP principles of biodiversity offsetting, which are fast gaining wide international acceptance. For one, the regulatory framework does not follow the ‘no net loss’ principle of biodiversity offsetting because mere afforestation of an equivalent area of land is hardly adequate compensation for loss of old-growth biodiversity-rich forests. Other conservation activities such as strengthening of ineffective protected areas, according protection to critical unprotected sites, establishing corridors and buffer zones, reintroduction of species, removal of invasives etc. (BBOP, 2011) that can reduce the shortfall between impact and compensation do not find a place in the present framework. The parliamentary committee concurs, ‘It takes hundreds of years to create green cover and compensation in terms of its compensatory mechanism over that period is never envisaged. The Committee is of the opinion that no amount of compensation, howsoever, hefty it may be is condign enough to compensate the irreparable loss caused to forests’ (Rajya Sabha Secretariat, 2008).

The ‘like-for-like or better’ principle (stipulated by BBOP) also fails to find a place in the present regulatory regime. This is because Compensatory Afforestation funds are utilized by the forest department for establishing commercial plantations including that of biofuels (Kohli, et al., 2009) rather than for establishing/restoring native ecosystems. Moreover, the law does not require the site for afforestation to be ecologically equivalent to or in close proximity to the diverted site. As per the regulation, the site for afforestation can be anywhere in the state and can be of a different habitat type (MOEF, 2004).

In addition, the present regulatory regime fails to allow companies to manage their reputational and financial risks. Businesses continue to generate bad press and the ministry is often under civil society pressure to shoot down project proposals. Moreover, mere compliance to the law does not afford competitive advantage in the form of enhanced access to capital. Although none of the Indian banks have espoused the Equator Principles, project finance from the IFC and EPFIs is extensively being used to fund development projects in India (Watchman et al, 2007). Thus, it makes very good business sense for companies operating in India to explore the option of voluntary biodiversity offsets in order to score over competition in gaining access to this capital.

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