TERMS OF REFERENCE FOR THE

EAST AND SOUTHERN AFRICA KATOOMBA GROUP

Survey of the Potential of Private Sector in East Africa to engage in Markets and Payments for Ecosystem Services (PES)

Case Studies from Kenya (Tourism Industry),

Tanzania (Coffee Industry)

&

Uganda (Tea Industry),

INTRODUCTION

A survey of "How companies act on Global Trends" by the consultancy firm *McKinsey and Company* in April 2008[1] found that among fourteen global trends, "increasing constraints on supply or usage of natural resources" had risen from seventh to second place. Thirty-four percent of respondents now believe natural resource constraints are likely to have "a negative impact on profits over the next five years. Yet the survey also found that many companies lack the capacity to deal with natural resource constraints. Barely one-third of companies have taken actions to address this and other critical trends. Moreover, only seventeen percent report significant benefits from the actions they take.

A similar survey by the *East and Southern Africa Katoomba Group* carried out in Uganda in February 2007, also found that most companies were becoming aware of linkages between their core operations and critical ecosystem services on which they rely, but did not have systematic way of understanding the threats and opportunities stemming from this growing natural resource supply constraint. They also did not fully internalise what incentives arise from paying for ecosystem services—such as regulatory compliance, supply chain-related business benefits or positive community relations. Therefore, all businesses surveyed did not have any strategy in place for investing in the restoration and maintenance of ecosystems for reliable flows of ecosystem services. The companies called for further capacity building in this area, particularly assistance in developing such a strategy.

THE EAST AND SOUTHERN AFRICA KATOOMBA GROUP PRIVATE SECTOR ENGAGEMENT STRATEGY FOR 2009

Building on the 2007 survey in Uganda, the East and Southern Africa Katoomba Group (ESA KG) will work with companies to develop these strategies and is expanding its engagement with the private sector to Kenya and Tanzania.

The first phase of the 2009 strategy will be a survey similar to the one piloted in Uganda in 2007. The survey will also look at the business interface with the environment and explore the extent of business awareness of linkages between their core operations and critical ecosystem services on which they rely. The survey will also highlight opportunities for businesses to improve their bottom line by investing in the restoration and maintenance of ecosystems for reliable and flows of ecosystem services. The focus of the survey will be agriculture (tea and coffee sectors) in Uganda and Tanzania and tourism in Kenya. The selection is based on these sectors' importance to the national economies of the countries in question; and the opportunities that the sectors offer for businesses to engage in markets and payments for ecosystem services (PES). Another reason behind choosing these two sectors is that opportunities for PES in these sectors have so far not been widely studied. According to the *UN Food and Agricultural Organisation* (FAO), agriculture accounts for roughly 30 per cent of global green house gas (GHG) emissions[2], yet the agricultural sector has so far not tapped into the estimated

[1] How Companies Act on Global Trends: A McKinsey Global Survey; April 2008; http://www.mckinseyquarterly.com/how_companies_act_on_global_trends_a_mckinsey_global_survey_2130

[2] UN FAO Press Release; Oct. 2008;*http://www.un.org/apps/news/story.asp?NewsID=28746&Cr=climate&Cr1=change*

$15 billion on hand every year under the *UNFCCC Kyoto Protocol's Clean Development Mechanism* (CDM) to finance initiatives that help reduce GHG emissions. Traditional tilling and ploughing releases carbon dioxide stored in the land contributing to GHG build-up and climate change, but systems, that avoid this such as– drilling seeds directly into the soil – are much more climate friendly and can remove significant quantities of carbon dioxide from the atmosphere and store it in the soil. By pursuing "conservation friendly" agriculture, farmers can slow climate change, improve soil health and productivity, and also take advantage of the global carbon market by selling the offsets from the emissions.

The tourism sector is clearly highly dependent on the health of ecosystem services, - especially in Africa where most tourism is "ecotourism" – defined as "Environmentally responsible travel to natural areas, in order to enjoy and appreciate nature, promote conservation, and provide for beneficially active socio-economic involvement of local peoples. Africa's beautiful scenery, national parks and game reserves, (*the Masai Mara in Kenya, Bwindi Gorillas in Uganda, the lemurs of Madagascar, etc*) among others, are the main drivers of tourism. The World Tourism Organization's "*Tourism: 2020 Vision*", forecasts that tourism movement to Africa will increase to 47 Million arrivals by 2010. This represents an average annual growth rate of 5.5%in contrast to the global forecast rate of 4.1%. Africa's market share of global international tourism is projected to be 5% by 2020[3]. Another new factor in tourism is increasing demand for a hospitality industry that is environmentally friendly. Tourist operators and hotel managers in Africa, therefore, have a vested interest in ensuring that the ecosystems that their entire business depends on are maintained and restored, and their hotels promote a sound environmental code of conduct.

The second phase of the ESA KG private sector strategy will be to work with businesses that may be interested in taking the survey findings forward within their companies. Upon completion of Phase 1, The ESA KG will organise follow-up meetings with companies participating in the survey to explore if and how they may want to build on the findings of the survey.[4]. For example, following the Uganda survey, the ESA KG worked with a flower exporting company and a soft drink bottling company to develop a strategy for managing and costing its impacts on the environment. Activities to be pursued during this phase will be driven by the findings of the survey and interest among the businesses to take the work forward.

The Case Studies

1. <u>The Tourism Sector in Kenya</u>

Tourism accounts for 10 percent of Kenya's Gross Domestic Product (GDP), making it the third largest contributor to Kenya's GDP after agriculture and manufacturing, and Kenya's third largest foreign exchange earner after tea and horticulture. According to

[3] UN World Tourism Organisation Tourism Barometer; http://www.unwto.org/media/news/en/pdf/PR0801003en.pdf

[4] One useful capacity building tool that businesses could be assisted to explore and use is the World Resources Institute (www.wri.org) *Corporate Ecosystem Services Review (ESR)*[4] designed to help managers proactively develop strategies to manage business risks and opportunities arising from their company's dependence and impact on ecosystems. For more see www.wri.org/ecosystems/esr

Kenya's Ministry of Tourism website (www.tourism.go.ke), the tourism sector recorded approximately 2 million visitor arrivals in 2007, up from 1.6 million arrivals in 2006, reflecting a 12.5 percent growth. Consolidated tourism earnings expanded from US$ 670 million in 2006 to about US$ 842 million in 2007, reflecting an 11.6 percent growth. Tourism is now the leading economic sector in Kenya recording the highest growth in the economy at 13%. It contributes about 12% of the country's Gross Domestic Product and accounts for over 9% of total wage employment, and is also a major source of Government Revenue in the form of taxes, duties, licence fees, entry fees, etc[5]. The main tourist attractions include photo safaris through the 19 national parks and game reserves; the renowned scenery of the Great Rift Valley; and beaches along the Indian Ocean to mention a few.

There are various opportunities for PES in tourism that can be explored including paying premiums for environmentally friendly hotels and eco-lodges, offsetting carbon emissions for travel and so on. A survey of tourists visiting Kenya carried out in 2003 found 66% of respondents were willing to pay a higher rate for an environmentally friendly hotel.[6]

2. The Coffee Sector in Tanzania

Coffee is Tanzania's largest export crop. It contributes approximately US $115 million to export earnings, and provides employment to some 400,000 families.[7] Over 90% of Tanzanian coffee is grown on farms of smallholders on average holdings of 3 hectares. The remainder comes from co-operative and privately owned estates. There are many opportunities for PES in agriculture including markets and payments for "biodiversity friendly" commodities. Such commodities may be recognized through certification and they fetch a premium price. The demand for certified or 'sustainable' coffee is increasing worldwide (see table below) and in Tanzania. By end of 2005 a total of only 18 metric tones were purchased as "**Utz certified"**[8] from Tanzania; however, by mid 2007 the quantity increased to 27 metric tons[9]. The share of Tanzania's Utz certified coffee sales from African countries that export Utz certified coffee was only 0.7% in 2005. By mid-2007, it was 2.8%. All the coffee sales originated from certified coffee plantations that were certified in 2005 and the average premium was 5 US-ct. /lb of green coffee[10].

[5] Kenya's Ministry of Tourism website; www.tourism.go.ke

[6] 2003 P. Masau & B. Prideaux; Sustainable Tourism: A Role for Kenya's Hotel Industry; 1368-3500/03/03 0197-12 ©; Current Issues in Tourism Vol. 6, No. 3, 2003

[7] International Coffee Partners, Tanzania project profile; http://www.coffee-partners.org/project-profiles.html?file=tl_files/ICP-Toolbox/Projects/Project_Profiles/Tanzania+Project+Profile.pdf.

[8] **Utz Certified** coffee standard is a worldwide certification programme for 'responsible coffee'. Coffee producers certified by the Utz Foundation comply with the Utz Code of Conduct, which covers: good agricultural and business practices, social criteria based on the International Labor Organization Conventions, and environmental criteria.

[9] Evelyne A. Lazaro and Jeremiah A. Makindara (2008) Sustainable Coffee' Exports from Tanzania; Sokoine University of Agriculture, Tanzania; January 2008

10 ibid

Growth of Demand for Selected Certified Coffees (*Source: thecoffeeguide.org)*	
Type of certification	*Percent increase in 2006 over 2005*
Fair Trade	53
Utz Certified	25
Rainforest Alliance	106
Organic Coffee	15

A recent study by researchers at *Sokoine University of Agriculture*[11] identified sales to emerging, niche and value-added markets such as speciality, fair trade, organic, and Utz-certified coffee as a possible venue for increasing the value of coffee and other agricultural exports from Tanzania. However, the study also notes that there is currently no evidence that premiums paid on sustainable coffee justify investments for compliance. Producers that are not certified are yet to be convinced that these investments can offer them satisfactory returns. There is need to demonstrate that such niche markets do indeed pay-off [12].

3. The Tea Sector in Uganda

The Uganda Tea Association has identified 200,000 hectares of land as suitable for commercial tea production, however only 24,000 hectares of land is under tea production- which leaves alot of room for expansion. About 50,000 people are employed directly or indirectly in the industry. The smallholder tea sector produces about eight million kilos of made tea representing about 20 per cent of the country's total made tea production. In 2007, Uganda exported 41 million kg, earning about US $75 million. Volumes have been steadily increasing from 37,000 tonnes in 2003 to 45,000 tonnes in 2007. In 2006, there was a drop to 34,000 tonnes from 38,000 in 2005 because of poor weather. Volumes are expected to increase as more farmers put land under tea. About 70 per cent of Uganda's tea is sold by auction in Mombasa, and 20 per cent through direct sales, while the remainder is sold locally. The price is determined by brokers who test the quality of the made tea and then value it. On average, farmers earn about US$ $11 per kilogramme of green leaf. A hectare of tea plantation produces 6,000 kilos.

The Tea Industry is fully reliant on fuel wood and electricity for drying- which means the industry contributes significantly to carbon emissions. Uganda is set to benefit from the *Greening the Tea Industry in East Africa project* which aims to reduce the electrical energy in the tea processing industries in countries covered by the East African Tea Trade Association, while increasing power supply reliability and reducing greenhouse gas emissions.[13] A project feasibility study[14] found on average, two of the largest tea factories

[11] ibid

[12] ibid

[13] For more see http://greeningtea.unep.org

pay US$ 0.09 per kWh for every unit of electricity power drawn, and about US$ 0.35 for every unit produced by their diesel generators. About 6 kWh of thermal equivalent per kg of made tea are needed. About 1.2 tons of wood are required for every ton of made tea and the cost to each company amounts to about US$ 19 USD per ton of wood. The annual consumption of wood amounts to 5,500 tons. The aggregate electricity bill for both tea factories was found to amount to US$ 280,000 per year and in addition a diesel bill of about US$ 145,000. In total about 155 000 liters of fuel are consumed by the tea factories per year. The study proposes that if the greening tea industry project is successful, 465 tons of CO2 emissions can be avoided on an annual basis[15]. The two largest tea factories will be the focus of the Uganda survey.

For both the tea and coffee sectors surveys, there are several factors to consider. Businesses could, for example, add carbon credits where the alternative to conservation friendly coffee or tea may result in negative carbon impacts (e.g., less shade, more chemical inputs). In some situations and countries there may be an economic case for "double certification" – adding a carbon credit, which requires a certification process in the form of a validated or certified Project Design Document (PDD), to certified agricultural or forestry products. Forest Trends is investigating how to add carbon credits in such situations, for example, in FSC certified community forestry in Honduras, and for certified 'organic cocoa' from cooperatives in Costa Rica.

Also, if tea or coffee farmers are organised into producer cooperatives, there could be a strong basis for 'aggregation' and thus lower transaction costs for carbon credits. The best situation is where a carbon payment demonstrates additionality – for example where a carbon payment for certified tea or sustainable coffee could make the difference between a viable and non-viable land use; or where certification would not have happened without the carbon payment.

Another important factor to consider is the end buyers or processors of these products. Buyers such as *Cadbury* for coffee or *Twinings* for tea may very well be interested in supporting the certification of the plantations since (a) it helps assure sustainability of supply *(for example, in Ghana, Cadbury has raised concerns that cocoa production will begin to dry up with current more chemically-based production systems)*; and (b) companies can offset their carbon footprint and demonstrate themselves as "environmentally friendly". All these and other issues may be explored during the surveys.

ANNEX 1 : SEMI-STRUCTURED INTERVIEW GUIDE *(To be modified by consultants according to sector/country)*

[14] Greening the Tea Industry in East Africa Small Hydro Power Plant Pre-feasibility Study- *Nchwera and Warugo* Uganda; 15th March 2006; www.greeningtea.unep.org

[15] ibid

- Background Information on the Company/ Sector
- Company's interface points with the environment/broader trends anticipated – future shortages, climate change impacts, etc.
- Company approach to natural resource use – quantitative impacts
- Corporate strategy – forward looking opportunities for investment and improvement of the bottom line

1. Background Information on the Company

- Location, start date, employees, sales figures, sales outlook

2. Company's interface points with the environment:

- Tell me about how your company interfaces with the environment
    i. What resources do you rely on, as critical to the business?
    ii. What resources are indirectly important to the business?
    Ask for details related to why, how, and where.

- What is the current status of those resources, particularly in your country?
    i. Do you have any concerns about the availability of these resources over time?
        1. If yes – what?
        2. If no – move to next question.

- What is the anticipated future status of those resources on a 2, 5 or 10-year timeframe *if concerns stated, then:* how are you planning to address these challenges? *Is climate change, energy use or greenhouse gas emissions an issue, and if so, do you have a strategy to address it (e.g., have you thought about, or would you consider, carbon trading opportunities?)?

3. Company's current approach to natural resource use:

- How much of the natural resources/inputs identified above does your organization depend on per year? E.g: *acres of land, gallons of water, firewood, megawatts of electricity or other energy sources, fertilizer inputs, etc.*

- Who supplies the natural resources?
    i. Is it one supplier or are there various suppliers in the chain?
- How much do you spend for the resources (indicate rate and volume)?
    i. Is that a stable price or or does it fluctuate annually?
    ii. Is the structure problematic or OK?

- Do you experience any shortages / or has there been a sharp increase in price of the inputs or resources?
    i. If yes, what is the cause?
    ii. If no, do you anticipate any in the future – are there plans to expand?

3. Investments in the Environment/Natural Resources

- Does your company have a corporate environmental policy? – Provide details

- Does your organisation pay or contribute money or other resources to institutions or individuals in any way to ensure that:
  the amount and quality of natural resources (e.g the amount of land, water volume and quality, soil, etc.) is maintained;
  any loss in natural resources is compensated;
- If yes,
  i. What are the terms of payment?
  ii. Which institutions are paid?
- If no,
  i. What other investment programs and/or philanthropic programs do you have? (do you have a CSR policy?)
  ii. What drives decisions to invest in other natural resource programs? For example, has the company bottom line improved as a result of environmental investments (e.g., certification)? If not, do you anticipate making an environmental investment? Have you discussed your ideas with the government or other parties?

4. Corporate strategy – looking forward:

- When you look forward, what is the corporate strategy vis a vis natural resources in general - and particularly for those resources that your company depends on most?
- How is that strategy being implemented?
- What are you interested in doing/implementing that has proven difficult to date? (Why? How?)
- What assistance would you need to improve your corporate strategy towards the environment?

5. In-depth discussion of any PES opportunities identified in sections 3 or 4
[If time is limited, this discussion could be tabled for the follow up phase]

- If the discussions above identify a potentially attractive PES strategy (e.g., carbon trading, payment for watershed services provided by upstream communities, etc.), discuss the potential benefits and costs, challenges, constraints, etc., to establishing a PES mechanism (or linking in to a PES mechanism already operating in the country); this would involve an extended list of questions appropriate to the type of PES investment.

6. Other

- Is there anything that I haven't asked that would be useful for me to know or that you want to tell me?
- Is there anything else that you want to add?
- Do you have any questions for me?

ANNEX II: REPORT OUTLINE

EXECUTIVE SUMMARY (2-3 pages)

INTRODUCTION

Rationale for companies' interests in ecosystems / general opportunities for agriculture and tourism in PES; current trends of business/ecosystem interaction in Kenya/Tanzania/Uganda (*Desk Literature Review)*

CHAPTER 1:

Background information on the companies and sector *(sourced from both field interviews and literature)*

CHAPTER II:

Company interface points with the environment *(sourced from field interviews);* identification of key environmentally related constraints (e.g., increasing scarcity or cost of natural resource inputs; rising cost of treatment or mitigation measures (e.g., siltation problem))*;* anticipated future trends, e.g., future shortages, climate change impacts, etc. *(sourced from both field interviews and literature)*

CHAPTER III:

Company approaches to natural resource use – quantitative and qualitative investments and impacts – look at current responses to environmental problems and discuss potential responses, e.g., PES type solutions, regulatory or policy solutions, and their likely costs and benefits (could include corporate social responsibility or PR type benefits resulting from positive environmental and social externalities *(sourced from field interviews)*

CONCLUSIONS AND RECOMMENDATIONS

(a) Company or micro-level

(b) Sectoral or policy level implications (e.g., what needs to happen at the policy or regulatory level for potential PES solutions to happen? What can we learn from these company experiences and perspectives for the wider development of PES?)

REFERENCES/BIBLIOGRAPHY

APPENDIX 1: LIST OF RESPONDENTS INTERVIEWED – LOCATIONS AND DESIGNATIONS, CONTACT INFORMATION

APPENDIX II: ORIGINAL QUESTIONNAIRE RESPONSES