Transcript Episode 10, Lestari Capital
Michal Zrust, Founder and CEO
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Narrator: Green Invest Asia examines the role of finance and strong environmental, social and governance criteria (or ESG) to unlock land use investments that reduce climate impacts of agricultural and forestry commodities that we rely on for everyday life. We bring you the inside story on sustainable land use investments in Southeast Asia—what's working, what's not, and the green areas in between. This podcast is born out of a sustainable land use project by the same name funded by the United States Agency for International Development, or SAID, which works with investors to support agricultural and forestry companies in Southeast Asia reduce their carbon emissions through climate-smart operations.

Christy 0:04 Hi, I'm Christy Owen, Director of USAID Green Invest Asia and I will be your host for this episode. We are joined today by Michal Zrust, Founder and CEO of Lestari Capital, a conservation finance company founded five years ago and based in Southeast Asia. It develops nature based financial products that enables companies to deliver on their sustainability objectives. Welcome, Michal.

Michal 0:28 Hi, Christy. Nice to be here. Great.

Christy 0:30 So Michal, to start, can you break down for our listeners, just a little bit of the background of why your company was founded, and what makes it rather unique in this world of conservation finance?

Michal 0:42 Yeah, we'd love to, you know, Lestari Capital was started about five years ago. But the concept itself started even earlier than that in 2015. And what we were trying to do is really identify, you know, sources of market-based demand for conservation. And the reason for that is really just this, this constant issue within the world of conservation that projects are reliant on insufficient fickle, short-term grant financing. And I tried to identify what these, at that time, in a non-existent market=based demands were. I guess even the carbon market was still sort of relatively nascent. And it wasn't as big, as difficult to think about it now, that there was ever such a time given how, how much of a gold rush.

We identified, at the time, the Roundtable on Sustainable Palm Oil, had developed a compensation procedure. Within that compensation procedure, companies had to put money into conservation over the long term, minimum of 25 years. At scale, it was about $250 million at that-time. But they also had to support these projects and demonstrate on an annual basis that these projects were delivering impacts on the ground. And they would effectively be liable for those projects not delivering if they didn't deliver.

And so that sort of became kind of a hook for us to identify and structure that market-based demand, and really try to deliver it in a way that we can sort of demonstrate a best-in- class version of the impact that such a procedure could actually have.

As we progressed, and as the world also evolved a little bit, you know, in 2019, we went beyond that business line and developed what is now called the Rimba Collective. We came together with four leading partners, consumer goods manufacturers – Pepsi , Nestle, Procter and Gamble, and Unilever – a two-page concept of what a mechanism such as the Rimba Collective could look like. And really, the purpose of the mechanism was to address the key challenges that basically hinder progress in both the credible delivery of sustainability goals, but also in scaling, conservation and restoration and impact.

Christy 3:27 You mentioned the Rimba Collective which is, I think, a very unique model in the world of conservation finance, and that it was initiative funded by corporate buyers and processors of palm oil, many of whom are direct competitors. So how did you get them to agree on this financing model? And what's the benefit or incentive for them being a part of this collective?

Michal 3:58 Yeah, I mean, to explain a little bit and sort of slightly in an unfair way, I think, you know, if we were to really boil down what the Rimba Collective is, you know, it's a conservation outcome purchasing mechanism. And so companies in an aggregated form contribute towards a special purpose vehicle. The special purpose vehicle manages funds over the long term, and delivers them to the ground to a portfolio of conservation, livelihood restoration projects. Now those projects have been verified and ~~they~~ the impacts that are delivered [are] basically [demonstrated] on the ground. And it's only those impacts whether they be on hectares of conservation, hectares, the restoration, community benefits, biodiversity benefits, climate benefits. Those are effectively put into a registry once they are verified to have been to have been achieved. And the companies are then able to make sustainability claims simply on those impacts that have been delivered, which then aid their delivery of their own sustainability commitments.

The reason why I say it's a sort of slightly unfair characterization of it is because actually, the whole kind of operational mechanism around the Rimba Collective is so much more. We were looking at how can businesses go beyond the current sustainability commitments and actually deliver on these increasing expectations of our stakeholders whether they be on science-based targets or biodiversity or nature positive. The way, I think, that we wanted to do this was that companies could on one hand, deliver this long-term financing that allows the projects themselves ~~to,~~ to deliver and thrive. But on the other hand, through performance-based payment systems, actually deliver credible demonstrated, and the verified impacts on the ground to underpin those sustainability claims, as I said, and really, why would companies come together?

Well, actually, you know, to do this at scale, in terms of collective action, the way to actually have greater impact and impact at scale, which actually starts to demonstrate the positive role that businesses can play in tackling the global scale you need to be able to pull together and so the Rimba Collective also on one hand, you know, recognizes that there's multiple players within the palm oil supply chain, that there's multiple tiers, within that, that they all have different business cases, in joining something like this. This concept of shared responsibility for them to be able to do it in such a way that they are able to demonstrate their own kind of impact and their own fulfillment of their own commitments, whilst being part of something much bigger, which will achieve impact at a larger scale than going it alone is really valuable. And so the Rimba Collective accesses multiple impacts, where we call it environmental service outcomes. We're not just focusing on, you know, hectares of restoration, for example, we're focusing on multiple sustainability needs, whether they be on biodiversity, climate, livelihoods, and so on.

Christy 7:48 When you're considering a project for investment through the Rimba Collective, can you give us an idea of what makes for a good project? What makes you look twice at something? And, and tied to that, how much weight are you assigning to environmental and social benefits versus, you know, the traditional, you know, return on investment and profitability? Types of considerations?

Michal 8:23 Yeah, I mean, it's important, I think, to maybe make a nuance in the word investment and how people use it. We are not investing into the projects in the sort of a traditional financial institution kind of sense. We are off-taking the conservation outcomes. So the return on investment isn't financial, in this case, the return on investment is effectively the achievement of the impacts on the ground, which then the participating companies are able to demonstrate their own impact from so they are able to make claims on these outcomes. That's their ~~that's the~~ return that they are effectively purchasing those outcomes.

We are looking at a wide variety of projects, but all of these projects basically focus on conservation, restoration, climate, biodiversity and livelihoods in sort of different emphases. You know, some of the projects are closer to the supply chain or within supply bases of the palm oil world. And so they are more likely to be sort of restoration projects more likely to be focused on livelihood outcomes. And some projects are further away from the supply chain and so they're likely to have bigger emphasis on you know, forest protection for example, or biodiversity or in some cases even species reintroduction. Now you see many companies committing to science based targets.

Because I think on climate is really quite significant, but also focus on supply bases or supply chains is really significant. We wanted to create a balance within our portfolio, because it's just as important to be focusing on areas which are degraded, which are already in the supply chains. And we also have to focus on on protecting areas that are intact forest landscapes, where the community still have a choice, and the governments, of course, still have a choice of what will happen to those areas should we turn it into a production area.

And so what we would like to do with the collective, and this long-term financing for the projects is to start to demonstrate to the local communities and local governments that conservation can be self-sustaining, and there can be a business case for communities to earn financing through conservation, rather than just some destructive behavior. And so we're balancing that portfolio. And so, what makes us look twice, all of the projects undergo due diligence. Key red flags would be sort of demonstrated [unclear] agreements with local community, or, in fact, you know, even better projects that are actually run by the communities. But conservation is difficult, of course, and doing this through a portfolio approach allows us to de-risk it both financially and from that sort of practical aspect projects do fail. And we have built that into the model that some projects will not go through the full 25 years.

I think the key thing is looking at the capacity and technical capability, also of the project operators, and I think this is, you know, this is some something where, you know, other forms of financing at the early stage, whether it's kind of conceptual project stage, or sort of what we would call readiness stage where projects just need a little bit to get over the line, do the due diligence, you know, those kinds of financing mechanisms, other sort of forms of financing mechanisms to complement whatever the collective does, and sort of blended finance model, I guess, you know, is really important, such as the USAID Green Invest Asia and the support that you provide to early stage projects.

Christy 12:36 I think you've identified that not only do you have a pipeline, but you're actually funding that pipeline, you're getting those projects to be operational, which is quite unique about the Rimba Collective about Lestari Capital as well as I would say, the idea that you're placing your investment value really on environmental social outcomes, as opposed to other more kind of a traditional concept of investment. Other funds have struggled to reach this critical point. I'm going to shift a little bit from the criteria that you're using to evaluate projects to thinking about what you are seeking in terms of policy and regulatory frameworks to support this, this growing marketplace for nature-based solutions. And you alluded to that a little bit earlier. But if we could maybe unpack that a bit, and think about, from your perspective, what's needed in terms of policy and regulatory frameworks?

Michal 13:43 Yeah, I mean, you know, it's important to say that, you know, what we're talking about here is not something that's kind of conceptual or something that may or may not happen, the Rimba Collective is now operational. By the end of January, we will have over 100,000 hectares of projects within the portfolio, already being funded through the Rimba Collective. We hope that by the end of next year, we will be at 200,000 hectares, and we will continue to build towards that half a million which is our initial target. And we already see that there is enough demand that goes way above and beyond that half a million hectares for conservation projects.

You'll hear this in so many forums that the project pipeline, there is a bottleneck around this, right. And so, I mean, in terms of enabling environment Indonesia is actually relatively progressive in this way because they have a system of the *Hutan Desa* region added the traditional forests and community forest areas which are effectively licensed to operate for livelihoods and conservation, which are outside of the protected area network.

And that's a really interesting, and I think, really important tool that can be used to actually support communities and help conservation move along, move forward. We are very much aligned with the government. In other countries, the landing systems might be a little bit different. But of course, this is a clear kind of criteria, that there is an enabling environment in terms of the land tenure opportunities for conservation, where you can also then demonstrate additionality. Almost more so than regulatory frameworks. I think what is really important is that we start to support these early-stage project development initiatives because if we want to go above and beyond a half million hectares, then we need to start supporting conceptual stage projects right now, because in three years' time, they may be able to get over the due diligence.

And so for that, we need much greater capacity within the project developers and the project operators. We need technical capability. We need a mind mindset shift as well, I think, you know, because something like the Rimba Collective is sort of leading the in on this market- based demand delivery. However, you know, this will, there will be others, and it will be replicated, and there will be more demand of this kind of performance-based payment system. And what we really need to do is that we need to start to professionalize how these projects are actually developed and delivered, as well. And so for that, how do we do that at scale? We really need to start working on it, I think from the bottom up. I don't think that money is necessarily an issue, there seems to be quite a lot of money. So 20 years ago, everyone was talking about it. But there's no, there's no money for conservation. I think it's shifted. Now it's the other way round, it's actually the project supply in short supply, rather than the funding. But we need to also make sure that the funding is sort of delivered at the right scale, it's the right financing at the right scale.

Christy 17:34 And so we're going to be airing this episode, maybe about a month and a half or so after the most recent UN Conference of Parties, COP 27, that was held in Egypt. After every one of these gatherings, there's a drumroll of the renewal of governments' finance commitments to mitigate and adapt to climate change. The US government plans to double by 2020 its annual public climate finance to developing countries to around $11.4 billion. And these are huge numbers. And, you're saying money's not the issue. And I also hear that there's not enough money in the public sector to head off the worst climate change, and, and it can't happen without the private sector. So, is there really an issue of lack of funding? Or is it something else that's going on?

Michal 18:25 I think it's maybe from, from my perspective, it's a sort of an issue of, as I said, you know, the right financing at the right time at the right levels. And, I do have to admit, I despair a little bit when I listened to the pledges, and we're still constantly talking about hundreds of millions of dollars. We have half a billion and so on, you know, if you can't make it work, I think at the smallest scale, then I don't understand how you're going to be able to scale it up to something where half a billion would be in a short term, you know would be deliverable, and would create the impact that you're seeking. We sort of deliberately chose to start with something real on the ground, right? I mean, we need to identify the projects, okay, this project needs X amount of financing to get it through that, you know, and then we're building up from there. We were initially seeded as a company by the Partnership for Forests, which is a UK Government program, and because at that time, we would never have secured investment. We were just too different. We were just too, too out there in terms of what we were trying to do and this public financing for which I'm forever grateful, allowed us to, you know, to-set up the company and to take a little bit more risk on these kind of crazy, crazy concepts, although they don't seem so crazy now.

And you know, we multiply that 30-fold in terms of money that is committed and going to the ground right now. So imagine, you know, what could be done with small amounts of targeted financing for companies like Lestari Capital, looking at supporting projects on the ground? As we're progressing now, you know, we start with projects, some of these community projects are some 10,000 hectares, right. And so the question is, well, okay, but then how do you how do you get to the global sort of impact that you need in order to avoid, you know, the catastrophe that I think everyone sort of sees coming?

As you practice and progress, and you identify, you understand the issues on the ground, you can then start to see how to scale and so we are, just this last week, we were discussing about a project that was 400,000 hectares, and we can build on the small beginnings that we have to get to that, to get to that scale, and to get to perhaps over a million hectares, but you need to start something, you really need to understand the issues on the ground. And, and I fear that if we want to really achieve real impact, you know, our KPIs can't be millions of dollars raised, you know, our KPI has to actually be the impact on the ground that delivers for biodiversity, for local communities, for conservation.

Christy 21:35 Yeah, and I think that's super important. I mean, we talked about the need for all this money, but is it actually going to deliver the impacts that we as investors, whether we're public or private expect to see. And, you know, you alluded to the idea of, starting small, but you know, with small amounts of capital, you can create some big impacts. And, and even when we started Green Invest, Asia, we still heard all this time, this is a shortfall of climate finance, you know, we need more money, more money. But then there's this capital that's been raised and is sitting in funds, and it's not being committed, or at least not very quickly. And it is it because as you've mentioned earlier that perceived or actual lack of investable projects, or is it something more fundamental? And like, are the funding criteria unrealistic? Given the scale of the climate emergency and the small window we have to take corrective action? Is there something that's kind of embedded in this this conversation that that we haven't really pulled out sufficiently?

Michal 22:36 We do need to look at, you know, conservation and investments into conservation, project development, you know, from a slightly different angle, you know, this is not a, you know, it's not a coal mine, you can't just, you know, throw half a billion dollars, and expect a return within a couple of years, you know, conservation is difficult. There are many different challenges, there are issues of capacity and capability, and technical know-how, in terms of how to actually run and operate, operate the projects and deliver the outcomes that you need.

When we're talking with investors, and, you know, they're saying to us, well, you know, our minimum ticket size is $50 million. You know, it's, it's, it's tricky, then to be able to marry it with the reality of actually what we would potentially be able to use, you know, to get real impact on the ground in the near term. Yes. I mean, certainly, we need to get to that level, where the $50 million is potentially there to be able to invest into projects at a much larger scale.

But, you know, at the same time, we, in some ways, you know, we're receiving grant financing for projects to get them over the line, you know, of 20, $30,000. Right. And so, you know, how do we how do we marry those things. We, we need to do both, right, we can't just hope that, you know, that 50 million, 100 million dollars, if we just put the money into it is going to deliver the impact when there's quite a lot of projects that just need a small amount of financing, to get them over the line to start actually doing restoration conservation activities, supporting local communities. And, and to be able to do that in the long term.

We're sort of working on developing this half a million hectare portfolio and you know, starting with relatively small projects, but as we're progressing, as the opportunities are coming up, and as you know, as also project operators are starting to see that ‘oh, well, there is this different form of financing coming through the Rimba Collective, maybe what we could do is we could seek investment finance, you know, for one project that is, let's say 100,000 hectares, Rimba Collective can help fulfill, you know, the investment case, for us to be able to go back to the investor and say actually, this project is investable, even if it is a conservation project, because there is offtake, there is demand for what this project is going to be generating later on'.

And I think, you know, we started relatively small, but now we have projects coming to us that are 100,000, 400,000 hectares. And yes, those ones will start to need, you know, potentially X number of millions in order to go through feasibility, and to go to the project design stage and to the operational stage**.** But, you know, actually starting at being able to demonstrate something already working is really important, rather than just pledging financing.

Christy 25:52 Yeah, and it sounds like you're really working with the investors, with your partners to educate them and change their mindset about, you know, the matter, it's really a matter of prioritizing impact. It isn't necessarily about just raising money, but also about the spending and the deploying of it. Your model seems to recognize that there's a different way to help get this market moving. And, you know, as we, you know, at least when Green Invest Asia, part of our mandate was, you know, change business as usual, which is, is pretty high bar for a small project. But, you know, again, that kind of that small opportunities you can create some real big impacts as a result of that. I'm thinking about how we are trying to change business as usual within existing global financial structures, which remain incredibly risk adverse at a time when maybe we don't have time to be so cautious for the kinds of investment needed. So I'm wondering, you know, at what point do we accept that the risk of inaction is greater than the risk of action?

Michal 27:09 That's a really good question. And I think it's, it's something that, you know, I keep thinking about every day. I mean, you know, multi stakeholder bodies often spend, you know, an unreasonably long time actually trying to refine and perfect standards. And so I'm, you know, I'm looking at it slightly from the demand side angle now, you know, and companies actually moving on conservation, you know. Absolutely, we 100% want to support, you know, the building of robust standards, you know, from an ethical perspective, from an MRV perspective, and should make sure that everything that we're pushing for is robust, you know, that there is clear impact on the ground that needs to be demonstrated, that needs to be verified, and so on.

At the same time, I feel that, you know, sometimes these processes of developing new standards they take so long, that actually, it facilitates inaction. We know what to do, right? I mean, we actually know that we need to be protecting set aside areas within concessions, for example, if we're looking at the palm oil world, or if we're looking at the forestry world, or if we're looking at other agricultural commodities. We know that we should be supporting projects that are outside of the of the supply bases as well, because those areas are coming under threat, probably in not too distant future. You know, we know that we need to be supporting communities, we know how to we do know how to do it. And the problem is, we should just, we should start, right, and the fact that the standard isn't out there yet. And the fact that the standard isn't 100% completed, doesn't mean that we should be waiting for all of this clarity. And, and unfortunately, I hear from corporates, you know, that say, 'Well, you know, our CEO, said, You know, this, this guidance isn't developed yet. And so, therefore, we will wait, you know, to take action on it, right. And that's exactly the wrong thing, that is the wrong signal that the standards are actually starting to send, because it takes years and years and years to develop it.

You know, I was part of the compensation task force under the Roundtable on Sustainable Palm Oil. I was part of, you know, the way you could call compensation under the Forest Stewardship Council, you know, development. The real sort of focus on trying to close down every possible loophole, you know, to go around the system, and to make sure that we're counting the liability. I mean, it's very different. You know, this is a very separate case, but I'm just using it to illustrate the point, you know, these are standards of how to compensate how to calculate liability and the focus is so deep on calculating the liability, that, you know, you miss the opportunity that something like this could actually give, right, in terms of doing something positive, impactful on the ground, right? I mean, if under the RSPO, it's $250 million. I mean, imagine what could be done with that in terms of scale, supporting projects, and so on, you know, if we were focusing on the positive, on the impacts, you know, and just getting out there and doing it.

Are there going to be players that are going to try to, you know, go around the system, or the players that are going to try to find the loopholes? Yes, there are, but there's no reason why we can't do things, you know, concurrently, doing it also, whilst learning the lessons of how to actually do this, and we will be so much better for it. And there are companies, you know, that want to take positive action and so we don't want that business case to be undermined and allow the bad actors to be able to sit back, and just wait.

And so, you know, we need to be careful, and we need to send the right signals. I would hate to be in a situation where actors within agro industry, you know, are being disincentivized to support, you know, highly biodiverse, you know, probably last pristine areas in the world, because a standard is removing the business case for their management to do that, because they're pivoting to focus on now, the next big thing, right, and we, you know, we need to be thinking much more broadly, we need to be thinking creatively, we really just need to, you know, need to look at the bigger picture, I think on this.

Christy 32:08 Yeah. And I, I think that's all, like quite sobering but yet I hear these tinges of optimism in your response, which I actually really appreciate. Because I think we're both optimists in this space. I feel that you've just kind of have to be because the challenges are so big, but the risk of inaction is so potentially devastating. I just want for you to give our listeners that one takeaway from our conversation – what would that be, Michal?

Michal 32:52 We shouldn't be scared of going out there and trying something new, and really not being afraid of the failures that might come along the way, you know, I think quite a lot of people can think up new ideas, and they can think creatively. But you know, the difference between that, and, you know, real innovation is actually going out there and doing it and getting the impact done and trying things out. And all of these other aspects, you know, whether it's capacity building for the project operators, or, you know, it's sort of revisioning exactly how the investors can come into this market they will fall in place, it's just a matter of, going out there doing it, learning as we're going and really building the business case for others through demonstrating how it can be done and how it can be done well.

Christy 34:24 I want to thank you, Michal, so much for your thoughtful inputs, for your time, and explaining about Lestari capital, the Rimba Collective, and sharing your thoughts on how we move this all forward. Collectively. We have been talking to Lestari Capital's founder and CEO, Michal. To find out more about Lestari Capital, please check out their website at LestariCapital.com. And thank you all so much for listening. I will continue to bring more investment insights, niches and updates from Southeast Asia on climate-smart agriculture and forestry in coming episodes, so thank you all very much for listening.