
Long-Term Stewardship Funding and Mitigation Industry Sustainability

By applying general industry life-cycle concepts to the wetlands mitigation banking industry, the authors provide insights into the development and future sustainability of the compensatory mitigation industry.

BY GREG DEYOUNG AND STEVE MOORE

All industries have a life cycle.¹ The stages in the life cycle are infancy (sometimes called introduction), growth, maturity, and often—though not inevitably—decline. The priorities and perspectives of industries change as they enter these different stages. We see this same type of progression in the mitigation industry. A pertinent manifestation of this is the industry's evolving emphasis on long-term stewardship funding. This paper applies the industry life-cycle theory to the mitigation industry and, specifically, the role that long-term stewardship funding plays in the development of a sustainable, rather than a declining, industry.

The mitigation industry's beginnings were identifiable a quarter century ago when mitigation providers were a loose consortium of biology consultants, engineers, and landscape contractors. As concepts of mitigation banking and full-delivery mitigation projects took hold, the mitigation industry began to coalesce. Tangible evidence of this includes the 2008 Mitigation Rule, with its support for third-party mitigation approaches, and the National Mitigation Banking Association, formed in 1998.

INFANCY

Industries in their infancy offer new and unique products. Companies are typically small at this stage and profits are usually negative. Revenues need to be reinvested, as it costs money to create new product offerings, develop and test prototypes, and market the products. The reinvestment is to solidify its position and help fund continued growth.

Mitigation banking exhibited these characteristics on the East and West coasts in the mid-1990s. With regard to long-term management funding, the perspective was short-term and there was a tendency to resist these extra costs in the face of low revenues and high risk. The results were very small endowments—or none at all—coupled with poor management of funds by endowment holders.² For example, one early conservation bank in California

had a total endowment on the order of \$70,000. At this level, an endowment could not regularly yield more than approximately \$2,500 per year based on modern endowment fund estimation practices. This is not enough funding to visit a site and write an annual monitoring report, much less to fund actual physical management of a property. Without adequate funding, mitigation sites were often not managed.

GROWTH

The next stage of an industry is growth. Significant capital is still needed at this stage to facilitate the growth required by the market demands. Perhaps in part because of the need for capital, firms tend to be larger. In addition, there tend to be more new entrants to the industry eager to take part in the growth. Industries in this stage see more product standardization, economies of scale, and production efficiencies. Profits in this stage are now positive, though there is still a significant need for research and development funds for refinements of the products and services.

Mitigation banking in the leading regions was in this stage at the turn of the century and through the first decade of the 21st century, including the formative stages and early implementation of the 2008 Mitigation Rule. At this time, change was welcome, as long as it was not the type of disruptive “technological discontinuity” that can eliminate companies.³ The results in mitigation banking were viable endowments, though with inconsistency on how funds are estimated, invested, and spent. How much is enough? Are endowments' charitable funds owned by the nonprofit? Or, are they trust accounts for the land, with permitting authorities serving as trustees? How are they to be invested along the safe versus sound continuum? There were examples of requirements that the funds be entirely in bonds or federally insured accounts, a requirement that guarantees ultimate depletion of the funds. How are they spent? Can you spend in a down economic year? If not,

what happens when critical management needs go unmet? Many of the questions are still debated in different forums, including different U.S. Army Corps of Engineer districts.

We also saw turbulence among endowment holders as real money began to flow into the funds. In one case, this even played out in the California legislative arena, with one bill passed (SB 436), then scrapped for another that allowed more types of governmental and nonprofit organizations to hold endowments than codified in the original law (SB 1094).

MATURITY

At maturity, industries expect slowing growth. The rate of sales expansion is typically equal to the growth rate of the economy. There may be fewer, larger firms and these firms will compete on quality or on cost. There are fewer innovations by industries at this stage.

The mitigation industry, as represented by mitigation banking, just turned 21; we are just entering the maturity phase. Will firms at this stage focus on higher quality or compete on cost? A competitive strategy based on quality will only be viable if competitive differentiation between banks exists. If competition based on quality is to work, consistent high standards, supported by the rules and the regulatory agency representatives, must exist. In the context of long-term stewardship funding, all forms of mitigation, and all mitigation banks within a region, will have to pay for comparable and adequate long-term stewardship. For most banks or other large mitigation projects, endowments of \$70,000 will no longer suffice; funds of \$100,000 or even \$200,000 are likely to be insufficient for long-term stewardship and will also weaken the competitiveness of higher quality projects that include larger, more viable endowments.

DECLINE OR SUSTAINABILITY?

Ironically, the fate of the mitigation industry may rest on the sustainability of our projects—and thus on the adequacy of our endowments. In life-cycle models for traditional product-based industries, the trajectory includes an accelerating drop in sales, large shakeouts with failing firms, and mergers and consolidations. However, there is a new industry life-cycle model, pertinent to our changing economy, in which services combined with products create new life for companies.¹ This has been seen in the automotive and software industries.

In mitigation, some regions are likely to see a declining need for compensation as urban areas begin to reach build-out. We are already seeing this in some metropolitan areas in California. And there may be unforeseen changes that also

dampen demand for mitigation credits. This is where the product/services model becomes particularly relevant.

We have seen more need for services as agency rules and technical demands become more complex. It is no longer sufficient to just throw an easement on proverbial “Uncle Bob’s Farm.” Substantial endowments, with all of their attendant investment and distribution requirements, will need to be created. The need to hold and manage these funds will most likely be met by nonprofits or the public sector. On the other side, this will also create a market for stewardship services. Private firms can provide essential land-management services, funded by the annual endowment distributions. This may help firms address the decline phase that historically has been the fate of product producers.

The 2008 Mitigation Rule sets the stage for this further alignment of natural resource goals and the long-term industry persistence. As it matures, the mitigation industry will benefit from larger, better-managed endowments within all of the nation’s Corps districts. Requirements by the regulatory agencies for adequate long-term land stewardship funding will allow mitigation providers to compete based on quality, rather than just cost, while furthering species recovery and no-net-loss of aquatic resources. This heightened quality will then validate and bolster the important role that compensatory mitigation plays in resource management. One hallmark of compensatory mitigation under the 2008 Mitigation Rule is that stewardship funding is paired with habitat restoration, a pairing not always seen with restoration performed under other programs.

CONCLUSION

Looking forward, we see large, managed preserves that fulfill the benefits of third-party mitigation cited in the 2008 Rule; they are large intact areas, appropriately placed within the landscape and the watershed, and funded for ongoing long-term management. We see a sustaining mitigation industry that authentically serves the species and aquatic resource needs of the nation. ■

ENDNOTES

1. *Industry Lifecycle*. Inc.com, at <http://www.inc.com/encyclopedia/industry-lifecycle.html>.
2. Teresa. Sherry, *The Demise of the Environmental Trust*, ECOSYSTEM MARKETPLACE (2006), available at https://www.eli.org/sites/default/files/docs/events/6.3.13%20ILF%20Webinar/The_Demise_of_The_Environmental_Trust.pdf.
3. Cusumano, Michael et al., *Product, Process, and Service: A New Industry Lifecycle Model* (2007), available at <http://web.mit.edu/sis07/www/cusumano.pdf>.
4. *Id.*