Natural Capital: what is it and why should you invest in it?

The past century has brought remarkable progress for humanity, but this success has come at a significant environmental cost – even though our economic prosperity depends entirely on nature.

By *Carl Atkin-House*

'Natural capital' refers to the natural resources that provide soft commodities and ecosystem services that provide value to society. It encompasses both the living and non-living aspects of ecosystems, such as forests, rivers, biodiversity, land, and minerals. Natural capital is a foundational element for economic, social, and environmental well-being.

Most of human history has been characterized by an extractive approach to natural capital management. Add to this the other unsustainable land management practices associated with poor agricultural practices, and the negative effects are startling: globally, food systems alone are not only the primary user of land, they are also the largest driver of nature loss, the largest single user of freshwater, and are responsible for 80% of deforestation and one-fifth of global greenhouse gas emissions.

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The legacy of industrial land management approaches is one of increasing production efficiency coupled with increasing degradation of biodiversity and soil fertility, posing challenges to the planet's ability to continue to produce food and fibre for a rapidly growing population, particularly in the face of increasing climate and weather volatility. It is now clear that a restorative and regenerative approach to land management is fundamental to ensure the economic and environmental resilience of future food and fibre systems, and contribute to solving the twin crisis.

The funding gap

To reverse the decline in biodiversity by 2030, analysis suggests that circa $ 711 billion needs to be spent each year over the next ten years. Mobilizing institutional allocations into natural capital is fundamental to reversing this decline and ensuring that natural capital plays its pivotal role in mitigating the negative effects of a changing environment. The sector is significantly underinvested: agriculture, forestry, and fisheries alone contribute 4.3% to global GDP, but less than 0.1% of institutional capital is focused on private natural capital assets.

Natural capital as an independent asset class

While natural capital investing dates back to some of the oldest forms of investing, it has evolved from the more conventional investments, such as farmland and forestry, which historically focus on income and capital appreciation, to a more balanced approach to achieving positive economic and environmental outcomes, while also including more nascent opportunities such as those that derive income from the provision of carbon credits, biodiversity credits, conservation easements and other ecosystem services. Investors tend to group disparate parts of capital markets together, creating an asset class framework, typically for analysis and allocation purposes. Those investors that are new to natural capital investing, without a dedicated natural capital allocation, often cite the similarities of natural capital strategies to those of infrastructure and real estate. As well as sharing the attributes of a real asset, natural capital assets are characterised by long duration, stable and predictable cashflows, while delivering potentially attractive risk-adjusted returns that are uncorrelated with the broader economic cycle.

From a portfolio perspective, natural capital strategies also demonstrate inflation hedging capabilities while delivering superior environmental upside when compared to more conventional real asset strategies. Sustainably managed natural capital assets contribute to portfolio decarbonization and aligning portfolios to the nature-positive transition.

New revenue streams from the monetization of impact

Markets that allow the monetization of natural capital services, such as carbon sequestration and biodiversity, are developing, as their value to the global economy becomes increasingly recognized. Some regions of the world have well established compliance carbon markets, notably Australia and New Zealand, whilst others have a patchwork of different voluntary markets with varying degrees of sophistication. Biodiversity and water markets are even more nascent, but it is promising to see that market standardization is progressing and helping to drive institutional engagement. Recently, the implementation of Article 6 of the Paris Agreement is creating a more unified framework for international carbon credit trading, reducing concerns around double counting and credit quality inconsistencies.

Managing natural capital assets in a regenerative way is accretive to returns and long-term value creation. It is not an either/or. Regenerating land makes food and fibre systems more resilient, reducing the need for input use, improving soil health and the water holding capacity of the soil, making production more stable. More resilient assets will become more valuable in the medium term, especially as degradation occurs in many traditional food and timber production regions of the world. Thus, managing assets to be climate and nature positive is not only the right thing to do, but also accretive and provides significant optionality to create additional income streams from impact.

As global resource dynamics shift, the investment case for natural capital is underpinned by powerful and measurable demand trends. The Food and Agriculture Organization (FAO) projects that global industrial roundwood demand will rise from approximately 1.9 billion cubic meters in 2020 to 2.4 billion cubic meters by 2030, driven by the expanding role of timber in construction, packaging, and climate mitigation. Simultaneously, the world's population is expected to grow by nearly a billion over the next two decades, with rising incomes fuelling a projected 50–70% increase in total food consumption by 2050. These converging trends signal a robust and growing market for nature-based commodities – positioning natural capital as a strategic, resilient, and scalable asset class for long-term investors.

Conclusion

Overall, we share the perspective that nature is now firmly on the agenda, with soft reporting regulations supporting the shifting investor awareness of how natural capital investment can benefit institutional portfolio outcomes. As economies rebound and investors acknowledge the need for nature-based solutions, we anticipate that natural capital will become a fundamental component of investors' portfolios. ■

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PHOTO: ARCHIVE HSBC ASSET MANAGEMENT

SUMMARY

Natural capital encompasses natural resources and ecosystem services that are essential to the economy and well-being.

Current land use leads to loss of biodiversity, deforestation and high CO_2 emissions.

Sustainable management is crucial for food security and climate resilience.

Every year, $ 711 billion is needed to combat biodiversity loss.

Natural capital offers stable returns, inflation protection and new income through CO_2 and biodiversity credits, among other things.

Natural capital is a strategic, future-proof asset class.