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Circular Economy and Waste Management: Policy Overview and Investment Opportunities

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The concept of the circular economy is not new, and it is here to stay – almost half of the world's top 100 companies have adopted the concept to increase the lifecycle of the materials they use. The circular economy is based on three principles:

1) design out waste and pollution
2) circulate products and materials for as long as possible
3) regenerate natural systems

Investing in the circular economy (CE) can help contribute to a business's corporate, social responsibility (CSR) and environment and social governance (ESG) strategy as well as increasing its competitiveness. This report details the key drivers investors should be aware of in a UK context. It will additionally consider waste management as one key part of transitioning to a circular economy.

Increasing energy efficiency and transitioning to renewable energy are widely accepted strategies for tackling the 55% of global greenhouse gas emissions that emerge from the energy sector. The circular economy addresses the remaining 45% of emissions in our products and food; organisations like the Ellen MacArthur Foundation are leading the way in researching how to take action on this 45%. MacArthur's thinking on the issue stems from experience sailing where, in her terms, 'what you have is all you have'. Broadly that means valuing finite resources by keeping them in the economy and out of the environment. Better waste management is therefore a key part of the challenge, particularly seeing beyond recycling and increasing the percentage of waste dealt with higher up the waste hierarchy pyramid. That pyramid places prevention and re-use above recyclate which is in turn prioritised over disposal and incineration.

Investors and the Circular Economy

Investors are increasingly viewing the circular economy as a value creation opportunity; a CE has a de-risking effect and drives superior risk-adjusted returns. For instance, analysis conducted on 222 European companies across 14 industries highlighted how the more circular a company is, the lower its risk of default on debt over both a one-year and five-year time horizon.[1] Other studies show how public equity funds with the circular economy as a sole or partial investment performed, on average, 5 percentage points better than their benchmarks in H1 2020.

Environmentally responsible, less risky, high returns: the advantages of the circular economy are becoming increasingly obvious. A Gartner study has shown that 70% of supply chain leaders are planning to invest in the circular economy in 2020-21 and that there has been a tenfold increase in the number of private market funds with a circular economy between 2016 and the first half of 2020.[2] It is further estimated that over half a million circular economy jobs could be created by 2030 in Britain alone in remanufacturing, recycling and resale.[3]

The waste management industry is also profiting from a post-pandemic focus on essential services, while investing in new technologies in this space is fulfilling 'building back better' criteria.[4] These services have the advantage of a guaranteed revenue stream, with opportunities for economies of scale to create incremental value. In addition to good ESG practice, waste management services also have attractive exit markets.

UK Policy Environment

The circular economy is important for the Government's environmental strategy as detailed in the 25 Year Environment Plan (2018), the Resources and Waste Strategy (2018), the Circular Economy Package (2020), the Net Zero Plan (2021) and the Environment Bill (2021).[5] After leaving the EU, Britain remains broadly aligned to commitments first signed up to in the transition period in the EU Circular Economy Action Plan (2018), restricting materials which can be landfilled or incinerated.

The Resources and Waste Strategy (RWS) is the most significant document, however, and the Government published an update to it in 2020.[6] In it, the Department for Environmental, Food and Rural Affairs highlighted both the need for an alternative to weight-based metrics for sustainability reporting (movement on this at COP26 and the institution of an International Sustainability Standards Board point to new directions here) along with the admission that the elimination of 'avoidable waste from household sources' continues to prove 'challenging'. For context, the UK's recycling rate has remained roughly stable over the five years up to 2019 at just over 45%. Key targets in the Resources and Waste Strategy are

- Ensuring all plastic packaging is reusable, recyclable or compostable by 2025
- Eliminating food waste to landfill by 2030
- Eliminate avoidable plastic waste by 2050
- Double resource productivity by 2050
- Eliminate avoidable waste of all kinds by 2050

While interesting smaller scale initiatives appear to be gaining ground around the UK, there is a perception that the Government is dragging its feet on the issue: the Net Zero plan published this year includes a delay of two years to the original target for separate mandatory food waste collections by councils (as set out in the Resources and Waste Strategy), and the institution of extended producer responsibility for packaging and a deposit return scheme appear will also be delayed to 2024 and 2026, respectively.[7] These delays indicate the complex, technical nature of implementing these two measures in particular, as well as their politically sensitive nature – despite broader public opinion being in favour of increased recycling and businesses being proactive in the net zero space. Their political sensitivity relates to the required buy-in from stakeholders, along with a high upfront cost of capital expenditure, difficulties reflected through these interim delays.

Positive shifts in the percentage of waste recycled to date have been driven by a combination of regulatory, financial and policy measures such as targets, taxes and directed financial support. However, opinion also remains divided about certain aspects of UK waste management/circular economy strategy (particularly in further investment in energy-from-waste capacity). It is clear – as the latest report from the National Infrastructure Commission details – that rising GHG emissions from the incineration of waste and stagnating recycling rates will stop the UK reaching its net zero 2050 targets.

Future trajectories

The Environment Bill, currently passing through Parliament, requires long-term legally binding environmental targets in four areas, one of which is resource efficiency and waste reduction, by October 2022.

- The 2020 update to the Resources and Waste Strategy sets out areas the government will be turning their attention to including improved sustainability metrics (moving from weight based to impact-based targets), improved sustainability labelling on products, exporting less waste abroad, a chemical management and reuse strategy, and upholding the 'pollutor pays' principle.
- Also being looked at are annual reporting on food surplus and waste, legal powers to introduce food waste, surplus food redistribution targets and a wider clampdown on waste-related crime.
- Waste management goals are set out in DEFRA's Waste Prevention and Waste Management Strategies (Jan 2021). These include ambitious targets like connecting waste incineration to district heat networks (Heat Networks Investment Project and Energy From Waste Projects) – this sector is looking for ambitious private sector investment currently – along with consultations on batteries, waste tracking and waste electrical and electronic equipment.
- Other interested stakeholders have pointed out areas in need of improvement that these wider Government future commitments conspicuously leave out: mandatory business waste collections and planning for the role of local authorities and local government in facilitating the introduction of circular economy principles through procurement. There are also arguments circulating for allowing local authorities the autonomy to determine and configure local waste collection policy.[8]

The circular economy more broadly is about a shift in perspective away from 'take, make, waste' and towards strategies that eliminate the production of waste in the first place. It is likely, however, that the UK's big 5 waste companies (Veolia, Viridor, Biffa, Suez and FCC) will continue to play a part in accelerating the circular economy.

It is also clear that finance will be a critical lever in actualising the circular economy's potential, and that investors are looking for new opportunities within this space that will not run the risk of stranded assets, as is looking likelier within the quickly changing plastics industry. The development of circularity measurement and accounting rules will soon harmonise the current patchwork network of non-financial metrics and reporting and the introduction of novel technology, changes to consumer behaviour and product design should begin to show social, environmental and financial benefits.

Resources

1. Ellen MacArthur Foundation with Universita Bocconi, *The Circular Economy as a de-risking strategy and driver of risk-adjusted returns*

2. Ellen MacArthur Foundation, *Financing the circular economy (2020)*, p. 26.

3. Levelling up through circular economy jobs

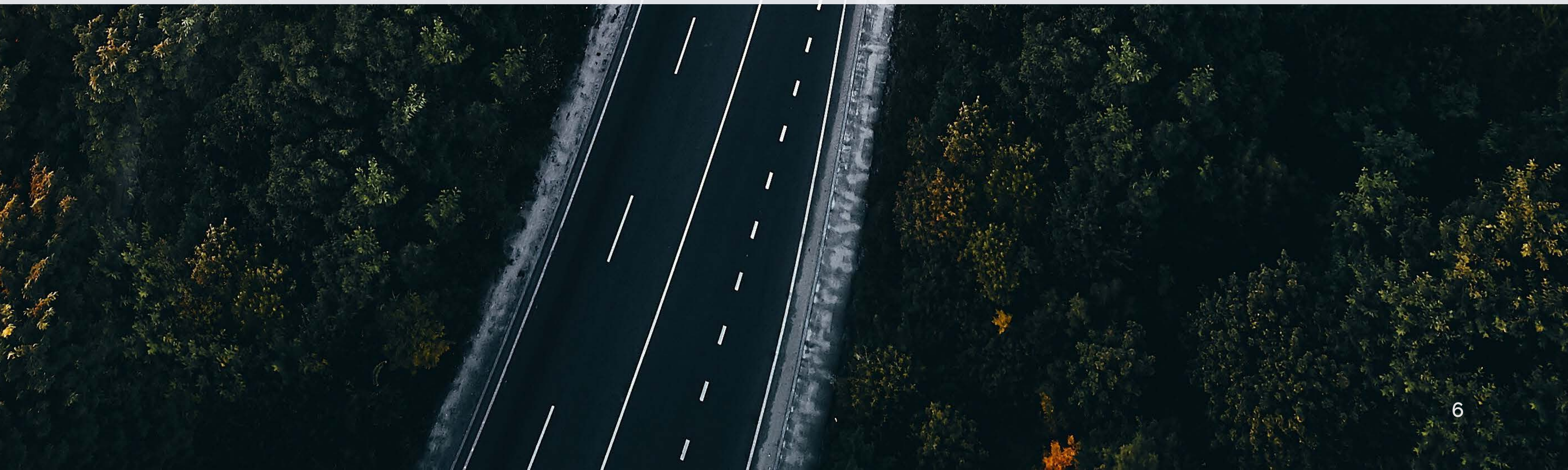
4. See (PE backed) Biffa's success in the waste-to-energy sector, an example of how companies investing in the circular economy end up increasing their medium to long-term competitiveness.

5. Waste policy is largely a devolved matter. The equivalent waste and circular economy strategies of the devolved nations are Beyond Recycling (Wales, 2021), Making Things Last (Scotland, 2016), Environment Strategy for Northern Ireland (NI, forthcoming).

6. DEFRA Resources and Waste Strategy Monitoring Progress

7. Examples of initiatives include Advance London, a circular economy programme offering business advice services to SMEs, and the London Waste and Recycling Board's running of circular economy pilots. For more see here

8. For more see a recent Houses, Communities and Local Government report on local government and the path to net zero.



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