GCF insight #21

Enhancing private sector investment in tackling climate change through the Green Climate Fund

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Contents

GCF insight #21

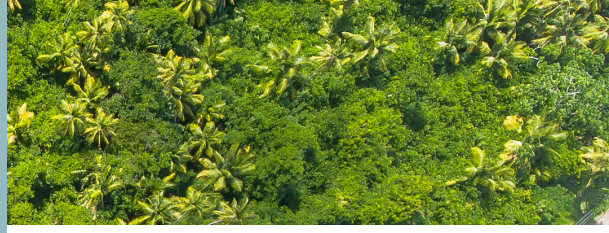
GCF insight seeks to understand what's working - and what's not working – in Green Climate Fund (GCF) project development. These surveys and reports spotlight the most topical GCF issues. This twenty first edition explores stakeholder views on enhancing private sector investment in tacking climate change through the Green Climate Fund.

About E Co.

We specialise in designing low-carbon, climate-resilient projects and programmes. For over 22 years, we've been providing technical expertise to help our clients solve climate adaptation and mitigation challenges and access project funding. We assess markets, develop strategies and formulate projects to provide long-lasting solutions for vulnerable populations worldwide.


OVER HERE!
ALMOST THERE
THIS WAY

The importance of the private sector in tackling climate change



To address the climate crisis, we cannot rely on the resources of public institutions alone. Today, the private sector manages more than USD 210 trillion in assets but only a small part of this is dedicated to climate-related investments.

As more governments put in place targeted policies and incentives to achieve their climate change and green growth ambitions, the private sector has an unparalleled opportunity to deliver the investment needed to spur innovation and create thriving markets for climate, spanning across clean energy, sustainable transport, green infrastructure or climate-resilient agriculture.

The Green Climate Fund (GCF) was established to play a pivotal role in shifting and catalysing financial flows managed by the private sector into low-emission and climate-resilient investments in developing countries. Moreover, the global reputation of the GCF could help de-risk private investments in tackling climate change. The support of the Fund adds weight and may encourage private investors to invest in climate-related activities.

Developing countries will need USD 300 billion annually by 2030 to avert catastrophic climate change and mobilising private capital at scale is critical to meeting this financing need.[1] This figure is expected to rise USD 500 billion by 2050 if mitigation targets are not met. The GCF, as the world's largest multilateral climate fund with over 200 accredited entities and delivery partners, is well positioned to make a substantial contribution to this effort.

The GCF's Private Sector Facility (PSF) aims to address barriers to private sector investment in adaptation and mitigation activities and help catalyse climate finance at scale in the most vulnerable countries. While the number of private sector projects is increasing, they still lag behind public sector projects. Therefore, there is a significant opportunity for the GCF to mobilise private sector finance. The GCF recognises this and recently updated their Private Sector Strategy[2]. Nonetheless, private sector projects still pale in comparison to public sector projects within the GCF and are a tiny fraction of what is required to address climate change risks.

At the time of writing, the private sector accounts for[3]:

42 projects out of 200 total GCF projects (21%)

USD 3.7 billion in GCF total financing (35%) out of 10.8 billion committed

USD 16.9 billion in total portfolio value (GCF financing plus co-financing) out of 40.2 billion total portfolio value

As private sector investment into climate change solutions is far from what is required, many in the private sector perceive such investments to be high risk. This may be due to unproven technologies or markets and geographies that are less suitable, and therefore attractive to traditional investors. Others struggle to see how such investments could yield attractive returns.

1.United Nations Conference on Trade and Development. 2021. Scaling up adaptation finance.
2.GCF. 2022. Private Sector Strategy. Available at https://www.greenclimate.fund/sites/default/files/document/private-sector-strategy.pdf
3.GCF. 2022. GCF in Brief: Private Sector Financing. Available at https://www.greenclimate.fund/sites/default/files/document/20220720-psf-2pager.pdf

GCF insight

GCF insight seeks to understand what's working – and what's not working – in Green Climate Fund (GCF) project development. This report, and the surveys and interviews that have informed it, highlight the most topical GCF issues. This twenty-first edition discusses the challenges faced by the private sector when working with the GCF.

What we found

In brief, here's what we found from our study:

- Accessing the Fund remains a challenge, especially for smaller private companies and those private sector companies with limited knowledge and experience of the GCF.
- Respondents welcomed the newly approved project-specific accreditation. The majority believe it will make the private sector more likely to approach the GCF for funding.
- Better communication of the Private Sector Strategy will allow the private sector to understand both how to approach the Fund and the benefits the GCF offers compared to other financial institutions.

Methodology

This study was conducted in September 2022 and consisted of survey questions and semi-structured interviews. The survey received 37 responses and 3 stakeholders were interviewed, each with experience of working on private sector projects submitted to the GCF.

The goal of this study is to build upon our 19th *GCF insight report*, which also focused on the private sector. In the earlier edition, stakeholders told us about multiple hurdles relating to them working with the GCF. This included limited access to the Fund, especially for small and medium-sized enterprises (SMEs), lengthy timelines compared to other sources of funding, and the difficulty associated with accreditation. This edition explores perceptions of how each of these challenges can be overcome, including reactions to changes the GCF has already made relating to the Private Sector Facility. By understanding how such changes are received by the private sector, we can begin to see whether more private sector companies are likely to pursue the GCF as an opportunity for climate finance.

The answers provided by survey respondents can be placed within three categories: risks, access and communication.

Risks

A recurring theme in this edition as well as the previous *GCF insight* on the private sector is the risk of investing in climate solutions. Investing in tackling climate change is still in its relative infancy and many private actors are wary of the risks these investments carry. For example, the political risks associated with investing in certain countries, or the technological risks associated with new innovations may be unattractive. Moreover, the private sector often struggles to see how investments in relatively new and unproven markets, or countries that are not typically popular for investing, can provide attractive returns. This is often the case for adaptation especially. The World Bank highlights three key risks faced by the private sector for adaptation investments[4]: Firstly, accurate climate data can be difficult to obtain in some regions which makes it difficult for the private sector to assess costs and benefits of specific actions. Secondly, there may be a lack of effective governance or climate planning in vulnerable countries. Unlike mitigation, there is also a lack of common metrics for defining success in adaptation projects. Lastly, adaptation projects can be difficult to structure and are often not easily monetisable. For example, it is much easier to assess possible returns for an investment into a revenue-generating, emissions-reduction technology than it is for investments into seawalls or mangroves, yet both types of projects are needed.

This is a key reason why some private actors consider attracting GCF or other public sector climate funding because the financial support of the Fund as well as its reputation can help ease worries about existing investment risks. This may enable the mobilisation and flow of financial resources.

We asked respondents how the GCF could limit the risks for the private sector. One interviewee said, “Provide de-risking for private sector, such as first loss guarantees. Also, many institutional investors don’t have a risk appetite for investments in countries the GCF provides finance to. Blended capital approaches that de-risk investments are key for private sector investment.” Another told us that the Fund should seek to “issue guarantees and blended financing to de-risk the climate projects. Make adaptation proposals attractive by providing grants and first loss funding or results-based payments.” It is important to note that the Fund already aims to implement these suggestions. This perhaps shows that GCF approaches may not be well known or understood by the private sector and the sector could benefit from better communication – a topic discussed later in this report.

Others noted it is difficult for the GCF to successfully de-risk private sector investments, with one person noting that is “very challenging to find the right balance. There is a real risk that the GCF either invests in private sector projects that are not really viable (due to political pressure) and hence should not be funded, or that the GCF invests in private sector projects that do not need “cheap” money from the GCF, thereby giving private investors, family offices, etc. an extra financial benefit.”

4.World Bank. 2021. Enabling private investment in climate adaptation and resilience

Access

As in *GCF insight #19*, accessing the Fund by the private sector remains a difficulty. Respondents believe it is especially a challenge for smaller companies. The overall feeling is that many SMEs do not have the capacity and financial resources to access the GCF. The processes require either enormous internal time requirements or hiring external experts to navigate the GCF process–the complexity and expense of which is discouraging. An interviewee said that, "The process is difficult and cumbersome enough for larger institutions with capacity, it must be nearly impossible for those without it." Others feel that it is unclear what has a realistic chance of gaining GCF support from a private sector perspective and it can often require a large investment of resources, both time and money, into the proposal process before there is any clarity. Respondents suggested it would be beneficial to know as early as possible whether the type of project they have in mind stands a chance at receiving funding to avoid wasting time and money.

This also gives rise to the question of what types of smaller companies should be able to access this funding. Currently, very small and grassroots level companies in developing countries realistically do not have the capacity to navigate GCF processes. However, many existing GCF projects and programmes provide funding include components that will see SMEs receiving funding, although indirectly. One respondent said, "There is little that can be done. SMEs must be reached through aggregators, direct funding from a multilateral fund is a pipedream."

However, others, including an interviewee, suggested the GCF consider opening a special financial line for SME proposals. "More emphasis needs to be placed on micro and small enterprises and a dedicated window set up for them. These enterprises also need to develop the capacity, perhaps through training, to submit concept notes and Funding Proposals consistent with the GCF business model" another said.

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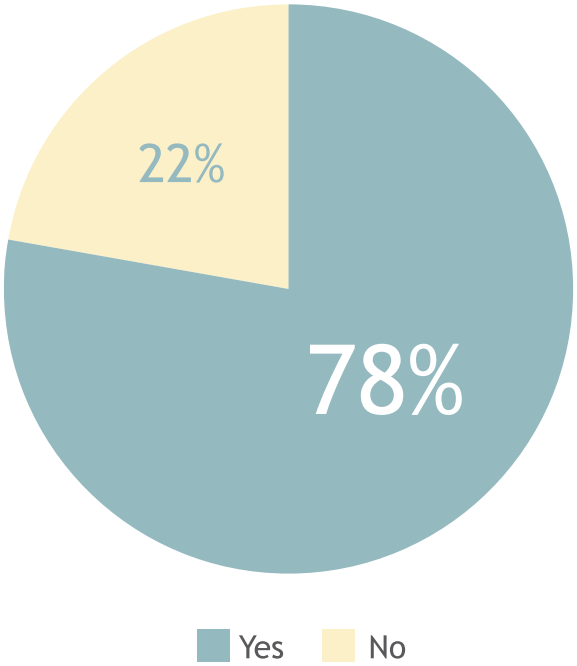
SMEs can help integrate climate solutions on the ground and account for the vast majority of businesses in regions where the GCF operates. For example, in Africa, approximately 90% of all businesses are SMEs. Therefore, it makes sense to enable them to participate in obtaining funding without being constrained by requirements or capacity.

Respondents and interviewees suggested that there is a general level of incompatibility between the Fund and the private sector. This is largely due to much longer timelines than the sector is willing to accept. Many private sector companies can access a loan from a financial institution far quicker than the GCF which makes the heavy requirements of the Fund even more frustrating to navigate. As discussed in detail in *GCF insight #19*, the complex processes of the Fund can lead to private companies not pursuing the GCF for funding. Equally, specific GCF terminology that is fundamental to successful proposals is not typical for the sector, making the process more challenging.

Private companies often feel as though the GCF does not understand the sector's needs. For example, private sector projects may include future investments that are yet to be identified. Rather than presenting detailed investment criteria and the process that will be used to identify future investments, the Fund wants information on precise investments which is not possible at the proposal stage. One respondent summarised this by saying, "Timelines are too long for the private sector. Private sector GCF projects with blind investments, to be identified later, need to have a comprehensive operations manual. This will go through a rigorous review process by the Secretariat and iTAP but then can still face many challenges at board approval."

Others noted that even those major private sector actors with access to the GCF through accreditation are not using the Fund. One interviewee pointed to the fact that many of the largest banks and financial institutions globally are accredited with the GCF but have no projects with the Fund. This suggests, they said, that the transaction costs associated with the GCF are much higher than the private sector world is used to or willing to accept.

Will the newly approved project specific accreditation make it more likely for the private sector to go throught the GCF process?



Having said that, changes to the GCF relating to accessing the Fund appear to be well-received by respondents. In particular, the recent approval by the Board of project-specific accreditation will, in theory, limit the complexity and lengthy timelines associated with gaining accreditation to the Fund. Entities can therefore become accredited for a single project or programme rather than for multiple.

We asked whether this new accreditation option would make it more likely for the private sector to go through the GCF process. Seventy-eight percent of respondents said yes. However, one interviewee told us that they "cannot see the private sector chomping at the bit to approach the GCF because the word is already out that it is difficult to access finance." They added that while they hope this new approach is successful, they worry that it may have taken too long to be introduced.

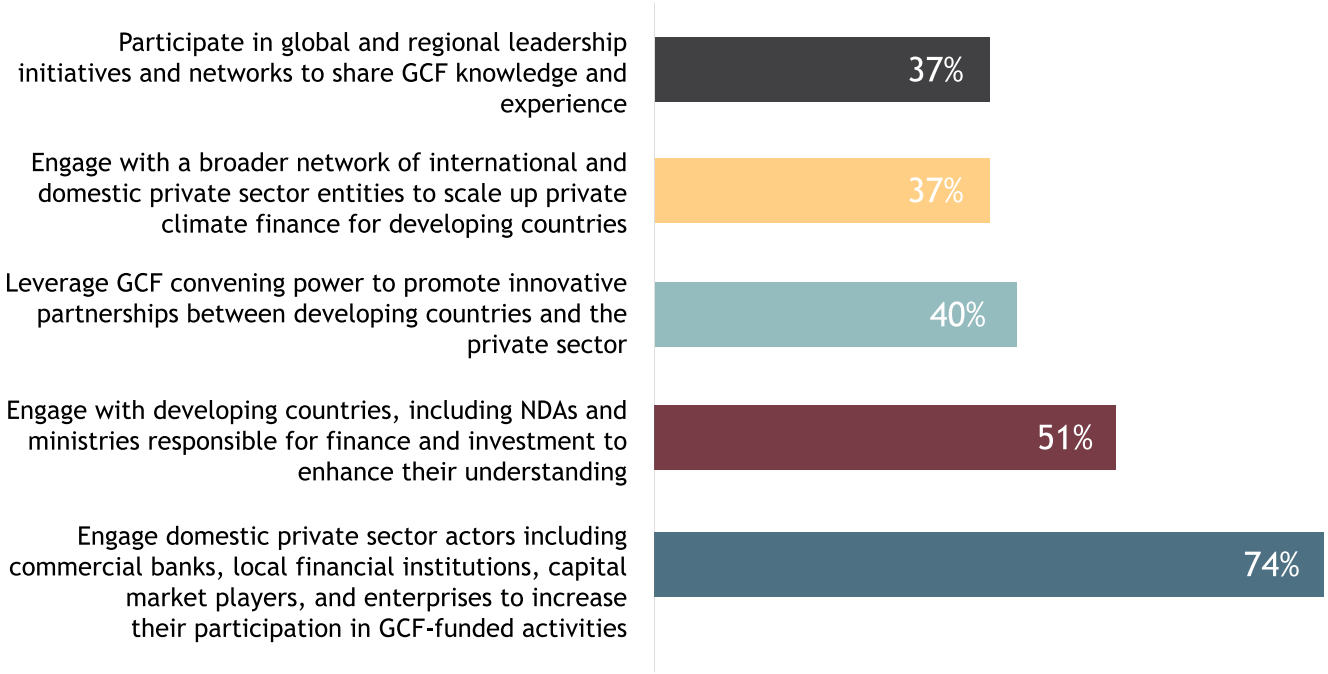
Communication

In our previous edition of *GCF insight* focusing on the private sector, we identified the fact that the private sector often felt out of the loop in terms of what the GCF expects and is looking for which, in turn, led to disenchantment of the whole process. This causes an access barrier as described above, but a portion of this appears to be down to GCF's communication practices. In recent months the GCF introduced an updated Private Sector Strategy. Part of the ongoing challenge in engaging the private sector is effectively communicating this strategy to the most relevant stakeholders. The GCF identified five ways to engage stakeholders:

1. Engage domestic private sector actors including commercial banks, local financial institutions, capital market players, and enterprises to increase their participation in GCF-funded activities.
2. Engage with developing countries, including NDAs and ministries responsible for finance and investment to enhance their understanding.
3. Leverage GCF convening power to promote innovative partnerships between developing countries and the private sector.
4. Engage with a broader network of international and domestic private sector entities to scale up private climate finance for developing countries.
5. Participate in global and regional leadership initiatives and networks to share GCF knowledge and experience.

Respondents were asked to choose which option(s) from those identified by the GCF would be most effective. Chart 2 below presents the results. Approximately 74% of respondents chose engaging domestic private sector actors, 51% chose engaging at the country level, and 41% chose leveraging GCF convening power to promote partnerships.

Which is the most effective way to engage private sector stakeholders?



The more detailed responses show that the communication of GCF processes as well as the advantages of the Fund compared to other sources of financing remain an issue. For example, one interviewee said that "The main obstacle is still the private sector's lack of information about GCF and its goals. Or at least a lack of awareness." Many private companies lack the knowledge of the GCF and climate investing in general and are more likely to approach traditional financial institutions, such as banks, if and when they need funding.

Another told us that "GCF processes do not align well with private sector practice. Often, it might be easier to get concessional finance from development banks." Greater engagement from the GCF with the sector, especially on presenting the new Private Sector Strategy, could help private companies understand exactly what the GCF stands for and why the sector should seek funding from them.

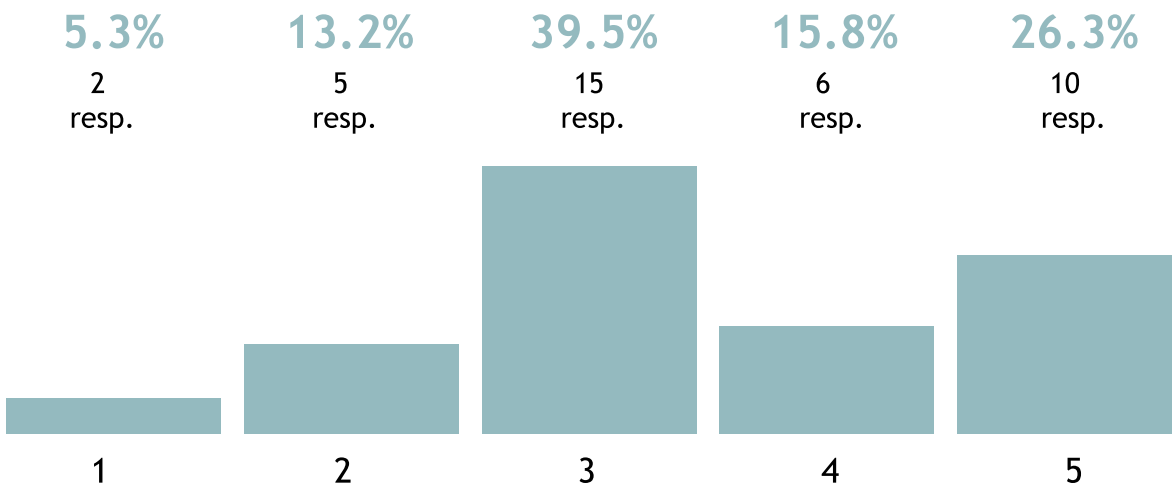
Engagement could also help in other areas that this report has discussed. For example, an interviewee told us that "More and more engagement will reduce the perceived risks associated with the GCF. The private sector companies' objectives should be aligned with social goals to ensure the risks associated with private sector investment in tackling climate change are re-focused." Therefore, this approach could help tackle two obstacles in one.

One interviewee highlighted the vastly different macroeconomic environment across the countries the GCF works in. They pointed to the Private Sector Strategy being a helpful start but noted that to realistically engage private investors at the necessary scale would require individualised strategies aiming to overcome country-specific barriers. They suggested the GCF could expand the readiness offering to help produce these individual strategies or work with in-country consultants to map the private finance landscape and how best to engage key players.

The interviewee also discussed the need for the GCF to help mobilise domestic funding. In many developing countries and small island developing states (SIDS), levels of debt are too high to be attractive to international financiers. Debt burdens have grown significantly in recent years as a result of the pandemic, which essentially shuts the door on opportunities of international money. Rather, the interviewee said, they should look to attract money from domestic private sector actors – an opportunity the GCF could assist in.

Looking ahead

To gauge an overall perception of how the private sector views the Private Sector Facility, we asked respondents to rate the usefulness of the Facility out of 5, with 1 being not useful and 5 being very useful. The average score was 3.4, with 40% giving it a score of 3, 16% a score of 4 and 26% a score of 5. This is a slight increase compared to *GCF insight #19*, where the average score was 3.2. In the previous edition, 12% scored the Private Sector Facility 1 out of 5 compared with 5% currently, and 15% scored it 2 out of 5 compared with 13% now.



This report has identified a number of sticking points for the private sector. In particular, the risks associated with investing in combatting climate change and the difficulty accessing the Fund are major challenges.

However, the recent update to the Private Sector Facility is a positive step. It highlights four specific areas of focus that will enable the mobilisation of private investment at the required scale. We asked survey respondents to rank the four areas in order of which is likely to be most effective in addressing climate change from the private sector perspective. Results varied but the clear winner was to promote a conducive investment environment for combined climate and economic growth activities. The remaining three areas of focus received very similar scores.

#1 Promote a conducive investment environment for combined climate and economic growth activities

#2 Accelerate innovation for business models, financial instruments and climate technologies

#3 De-risk market-creating investments to crowd in the private sector

#4 Strengthen domestic and regional financial institutions to scale up private climate finance

Moreover, the introduction of project specific accreditation shows that the Fund understands that current processes were not working as best as possible. This change will hopefully lighten the burden associated with applying for accreditation and shorten the timelines from initial concept to Board approval. Given that speed is attractive to the private sector, this mechanism, if it functions as expected, has high potential.

As the flagship climate fund, the GCF must do everything they can to ensure the financing gap between public and private sectors is addressed and to make the flow of finance between the private sector as seamless as possible. With another Conference of the Parties on the horizon, "The time to choose our future is now. It is a matter of both environmental urgency and economic common sense.These challenges are great, but the opportunities are greater[5]."

"The time to choose our future is now. It is a matter of both environmental urgency and economic common sense.These challenges are great, but the opportunities are greater."

5.Secretary of Climate Change for the Republic of Argentina, Cecilia Nicolini speaking at the GCF Private Investment for Climate Conference in Songdo, Korea. September 2022.

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About *GCF insight*

This survey and report is an initiative of E Co., emerging from work we are doing to develop low-carbon, climate resilient projects. E Co.'s team of consultants designed and administered the survey and prepared this report. E Co. has conducted this research independently and is not affiliated with the GCF, the GCF Secretariat or donors. The views expressed in this report are those of the authors and do not represent those of the GCF. Nothing in the interviews or any information or material relating thereto shall be construed as implying any official endorsement of or responsibility on the part of the Green Climate Fund.

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About E Co.

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Climate finance expertise

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