Federal Ministry for Economic Cooperation and Development

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Frankfurt School FS-UNEP Collaborating Centre for Climate & Sustainable Energy Finance

UNEP FINANCE INITIATIVE

Demystifying Private Adaptation Finance

Joint Study between UNEP-FI, the German Federal Ministry for Economic Cooperation and Development (BMZ) and the German Development Corporation, (GIZ)

Climate Adaptation Finance for the Private Sector – Towards an Actor Based Perspective

Climate change will increasingly impact economies around the world, forcing them to adapt. In response, governments have begun to expend considerable effort in order to identify and plan measures to cope with these impacts – measures to adapt.

In developing economies small and medium enterprises (SME) make up the majority of businesses whilst generating a considerable portion of economic activity. This study takes the perspective of a commercial actor that is affected by climate change in their daily business and contributes to adaptation through their individual activities. These actors routinely deal with risk and uncertainty in decision-making where climate change is one of many different risk factors to take into account.

As a consequence of climate change, business models may be modified or new business models developed, against the background of these actors' expectations about the future - which is also shaped by climate change. The study looks at how their financing approaches and challenges to different financing instruments are affected by climate change and how governments and public finance institutions could help overcome barriers to mobilize private adaptation finance at scale.

Adaptation Themes

Adaptation related activities are almost as heterogeneous as economic activities. To accommodate this diversity the study uses 'adaptation themes' to cluster adaptation-related activities into groups. This serves as a basis for understanding what type of financing instruments are used to finance the respective activities. These themes consist of:

- A particular climate change impact plus affected private (commercial) actors;
- A typical adaptation measure;
- Private sector actors' typical activities to finance and implement these adaptation measures

More than 25 case studies across 6 themes demonstrating adaptation-related activities or adaptation components within a larger business model are analysed to identify what are the typical instruments (e.g. debt, equity, mezzanine and risk mitigation instruments) and reflect on the major differences between them. These include water saving as a response to water scarcity and droughts; insurance to deal with climate extremes; and urban planning to deal with extreme heat. Consequently they involve the full spectrum of finance instruments used by the diverse set of actors, from SMEs to large infrastructure projects.

Demystifying Barriers to Financing Adaptation

In order to formulate recommendations for policy makers, public finance institutions and adaptation-related funds to support private sector actors in financing adaptation related activities, we analyse the major barriers to private adaptation finance in relation to a given market imperfection. We show how these barriers lead to an "unjustified" reduction of the attractiveness of adaptation investments as well as indicate an impact on the actor's risk return profile. This analysis may be used as a guide to discuss potential options to eliminate (adjust market) or perhaps compensate (e.g. through investment subsidy) the barriers.

Key Questions Addressed

- Is the climate resilient pathway for commercial actors different to business as usual?
- Which private finance instruments are relevant and well suited for financing which types of adaptation activity?
- How can we demystify the barriers to private adaptation finance?
- How can we translate specific barriers into policy options to overcome and/or compensate them?
- What is the role of public funds in private sector adaptation?

Preliminary Findings

- An actor-based perspective in combination with a focus on barriers can provide useful guidance on how government and public finance institutions may act in order to facilitate private adaptation finance:
- Whereas some business activities will be negatively affected by climate change, increasing risk or reducing potential returns, other business models may emerge or profit from climate change.
- Businesses may be affected directly, by changing weather-related climate variables. There are also indirect impact channels such as health or the urban heat island effects and impacts on up or downstream supply lines.
- Business activities – even with a commercial focus – can generate positive adaptation related externalities, such as experience based learning from their activities. These positive externalities may justify public financing support.
- The perspective of individual businesses such as SMEs may be integrated into national adaptation planning. Such a focus might be to enable commercial actors to make their business decision on an informed basis, for example. by making climate data readily available. At the same time, climate related impacts on the traditional investment barriers that SMEs are exposed to may be integrated into general SME support measures that are implemented by most governments anyway.
- Instruments of public-private financial risk sharing related to climate change may be explored. Examples might be government provided insurance schemes or the pooling of climate related risk in commercial financial portfolios.

Research team

This study is being compiled in collaboration with a consortium of experts from Frankfurt School - UNEP Collaborating Centre for Climate & Sustainable Energy Finance, Deutsche Institut für Entwicklungspolitik (DIE) and Acclimatise

For more information please contact:

George Scott - George.Scott@unep.org

Angelika Frei-Oldenburg - Angelika.frei-oldenburg@giz.de