Accelerating finance mobilisation for just and climate-aligned growth in developing markets

camco

A BRIGHTER FUTURE, TODAY

Abstract

The financing gaps for climate action and economic development are both significant. It is important to ensure that efforts to fund one does not come at the expense of the other, given clean economic development and improving the climate resilience of populations are both essential for achieving climate and human development goals.

Given the limited reach of international support, it will be necessary to access additional finance through private or public development lending to help bridge these financing gaps.[1] This puts the responsibility on policymakers and financiers to ensure public finance is used effectively to leverage private capital for investing in emerging and nascent markets. For a long-term investment shift to occur and financing gaps to be addressed, private financiers will need to achieve returns on investments in these challenging contexts in line with the associated level of risk; and over time a track record of success will contribute towards the lowering of the cost of capital as risk perceptions adjust. This will enable wider-reaching impact on both climate and development, even in the poorest contexts.

This paper taps into Camco's nearly decade-long experience in delivering clean energy in less developed economies and successfully mobilising private finance to achieve this. To achieve global climate and development goals, we need more actors doing this and faster. The paper also draws on Camco's active role in global policy dialogues, including recent contributions to the discourse and policy processes in the UK. This includes joining the advisory panel for the All-Party Parliamentary Group for Africa's inquiry into UK-African partnerships for just energy transitions in Africa, as well as written submissions such as to the government's call for evidence on 'International development in a contested world: ending extreme poverty and tackling climate change'.

This paper is the first of two papers that bring together our work and expertise in unlocking private capital for development and climate goals in lower income countries. The papers underscore the significance of achieving just, green growth. This paper provides evidence on why private finance is crucial for just, climate-aligned development. The subsequent paper will explore how to mobilise commercial investment to low-income countries, given the challenges of gaining returns in these contexts. We will share specific suggestions for the effective design and implementation of climate- and impact-focussed funds, specifically targeting the markets with the greatest development needs and addressing the challenges to working in these environments.

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Authors: Ieva Indriunaite and Grace Jackson

Contributor: Nisha Makan

1 IMF. Emerging Economies Need Much More Private Financing for Climate Transition, 2023

Introduction

Source: ARC Power

The financing needs for both climate action and socio-economic development are far beyond what can be met with the global public purse alone. Developing countries face an average funding gap of USD 2.5 trillion in Sustainable Development Goal (SDG) -related sectors based on current levels of public and private investment combined.[2]

The Green Climate Fund (GCF) estimates that developing countries will require between USD 2 and 4 trillion annually to avoid the need for mass migration, loss of livelihoods and health risks associated with climate change. These countries contribute the least towards emissions yet suffer the most from climate change impacts. Between 2010 and 2020, highly vulnerable regions, such as Least Developed Countries (LDCs) and Small Island Developing States (SIDS), experienced human mortality rates from floods, droughts and storms 15 times higher than regions with low vulnerability.[3]

At the same time, developing countries are rightly focused on their economic growth, where a significant increase in capital flows is also critical. It is estimated that donors and multilateral development banks (MDBs) need to leverage an additional USD 500 billion of private capital annually to bridge the SDG funding shortfall.[4] With global policymakers' attention increasingly shifting towards addressing the climate crisis, it is important that this does not come at the expense of socio-economic development in the Global South. Given the shortage of public finance,[5] it is critical to use the limited resources that are available to mobilise private investment and ensure climate-focused funds have just and green growth at the core of their design, tapping into cross-sectoral synergies and co-benefits.

The pursuit of equitable and climate-aligned growth in developing markets requires immediate attention. Accelerated action to adapt to climate change within this decade is crucial in closing the gap between existing adaptation and what is needed, while limiting warming to 1.5°C requires a deep, rapid and sustained reduction in greenhouse gas emissions across all sectors.[6] Policymakers and donors must find the right strategies to ensure the prompt and judicious deployment of funding into the most fitting and impactful solutions for mitigating climate change and adaptation.

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[2] UNSDG data. Unlocking SDG Financing: Findings from Early Adopters, 2018.
[3] UN data. Goal 13: Take urgent action to combat climate change and its impacts.
[4] International Banker data. Bridging the $2.5 trillion SDG-financing gap, 2019.
[5] LSE. A climate finance framework: decisive action to deliver on the Paris Agreement – summary, 2023.
[6] IPCC data. Urgent climate action can secure a liveable future for all, 2023.

Optimising development impact

How to achieve more with limited resources

Source: Nuru

Official development assistance (ODA) accounts for over two thirds of external finance for LDCs,[7] acting as an urgently needed and valuable resource for progressing climate adaptation and sustainable development in those countries. However, the COVID-19 pandemic has seen ODA budgets around the world squeezed, which has been made worse by ongoing global wars and conflicts and increasing prioritisation of global defence spending.

Promoting just and fair growth involves maximising the social and economic benefits of climate action for local communities and businesses by catalysing locally led economic development. This can be achieved by sourcing bankable, high-quality projects and ensuring that spending achieves more climate and development impact per unit of financial contribution and effort. For example, financing interventions that expand or improve access to reliable and affordable clean energy is vital for reducing emissions, but they can also have a transformative impact on socio-economic development, education and food resilience. This can be done through myriad ways, including powering schools, boosting agricultural productivity, progressing technological advancement and supporting business growth through reliable and more affordable electricity access, to name just a few.

Source: ARC Power

This impact can be further strengthened through targeted additional support, for example, by supporting the uptake of productive uses of electricity (such as solar-powered irrigation) in the newly electrified communities. These will improve farming or business opportunities whilst increasing yields and incomes. This can be achieved by providing financing and capacity building to local businesses, as well as strengthening access to markets to which they can sell their produce.

The key to optimising development impact lies in understanding the synergies between climate and sustainable development and ensuring a thoughtful approach in prioritising and designing impactful interventions at both the programme/fund and project/investment levels, not simply a box-ticking exercise.

[7] OECD data. Foreign aid surges due to spending on refugees and aid for Ukraine, 2023.

Targeting impact: Where is concessional finance needed most?

Source: Rift Valley Energy

On a project level, achieving both development and climate goals involves the careful selection of initiatives with substantial impact potential. For instance, the Renewable Energy Performance Platform (REPP),[8] managed by Camco and funded by the UK government through the Foreign, Commonwealth & Development Office (FCDO), has financed several high-impact projects in Sub-Saharan Africa, such as the Mwenga wind farm in Tanzania. This initiative supports anchor clients, including two tea factories, and provides clean energy to numerous microbusinesses and workshops utilising over 400 productive use of energy appliances. It also offers reduced-rate energy to local residents, providing 3,000 households with clean and affordable electricity. Moreover, the wind farm provides an additional diversified energy supply to the main grid, enhancing its resilience.

Financing smaller-scale projects like Mwenga may seem counterintuitive in an investment landscape that often prioritises large-scale interventions. Investors typically gravitate towards "vanilla" investments – the straightforward forms of assets or financial instruments – rather than identifying earlier-stage, higher-risk opportunities that demand a more long-term, hands-on and bespoke approach, but will support the poorest communities. However, it is precisely in these high-impact, underserved sectors that limited public financing should be strategically deployed to achieve truly catalytic effects. These communities are generating returns for investors, too.

Source: Rift Valley Energy

Supporting local, small-scale projects is crucial for achieving rapid and cost-effective progress, especially in emerging markets, since they allow for the swift and cost-effective deployment of innovative technologies and solutions, fostering quicker advancements.[9] In the energy sector, small-scale renewable energy initiatives offer a fast and practical way to bring electricity to remote and hard-to-reach areas where establishing a centralised grid would be both time-consuming and expensive. This approach not only addresses the immediate need for energy, but also unlocks the doors to economic and human development, enabling the powering of essential facilities like schools, clinics, agricultural equipment and local businesses. Furthermore, these projects can adapt more readily to local conditions, making them more robust in the face of the worsening impacts of climate change while improving the resilience of local communities through diversified economic income opportunities.

[8] Find out more at repp.energy.
[9] The Conversation. Climate change is best tackled through lots of small-scale solutions, 2020.

Scaling finance for adaptation and mitigation: De-risking strategies to scale up private investments

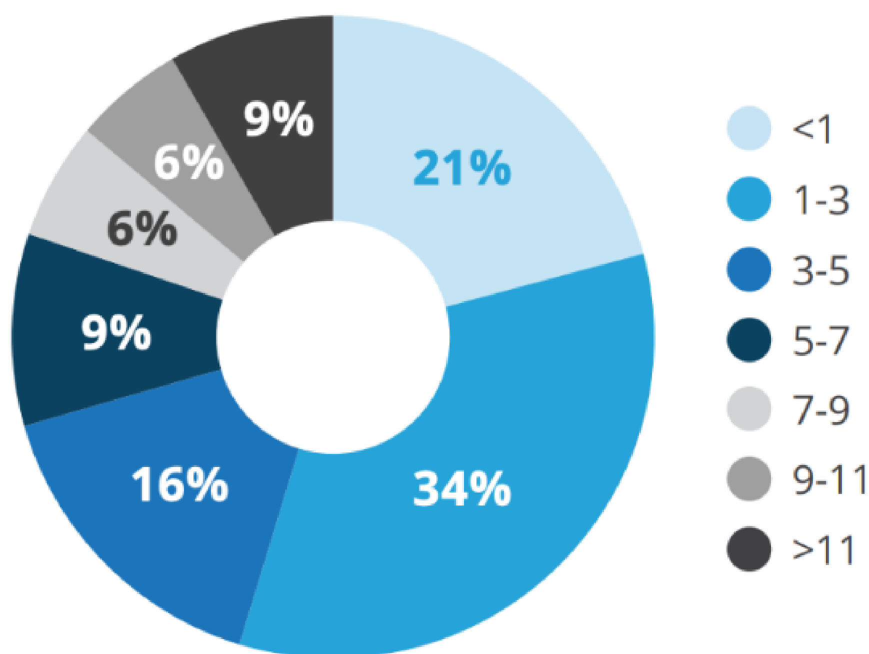
Blended finance is critical for mobilising private investors

Despite the clear impact case, the influx of capital remains constrained by elevated risk perceptions. These perceptions are often exacerbated by the early stage of market development (including weak institutions and policy and regulatory frameworks) or the presence of innovative yet untested business models, or sometimes, a combination of both. Blended finance uses public financing to mitigate these risks, functioning as a form of first loss capital. In essence, public finance assumes a higher risk position with generally modest returns. This approach introduces an additional layer of security, cultivating an environment conducive to increased involvement from commercial and private financiers.

Consequently, investors contributing substantial funding tranches find themselves better protected and more inclined to embrace the associated risks. As a result, public funds amplify their impact by leveraging significantly more private finance than they could attract independently. The application of this strategy is versatile, extending to both funds and projects.

Blended finance offers a way to optimise additionality (encompassing both mobilised finance and development impacts) while minimising concessionality. A recent study by Convergence found that blended finance funds on average leverage four dollars of commercial capital for every dollar of concessional capital.[10] Under Camco's management, REPP has committed GBP 47.5 million to projects, with a further GBP 21 million in approved investments, and has mobilised GBP 362 million (realised and committed), GBP 176 million of which is from private sources.

Using a blended finance approach broadens the potential pool of investors willing to invest in progressing just and climate-aligned growth in emerging markets. Furthermore, by using public money to make investments rather than grants, that capital can be recycled, multiplying its impact over time, and laying the groundwork for self-sustaining financing facilities and private investment.



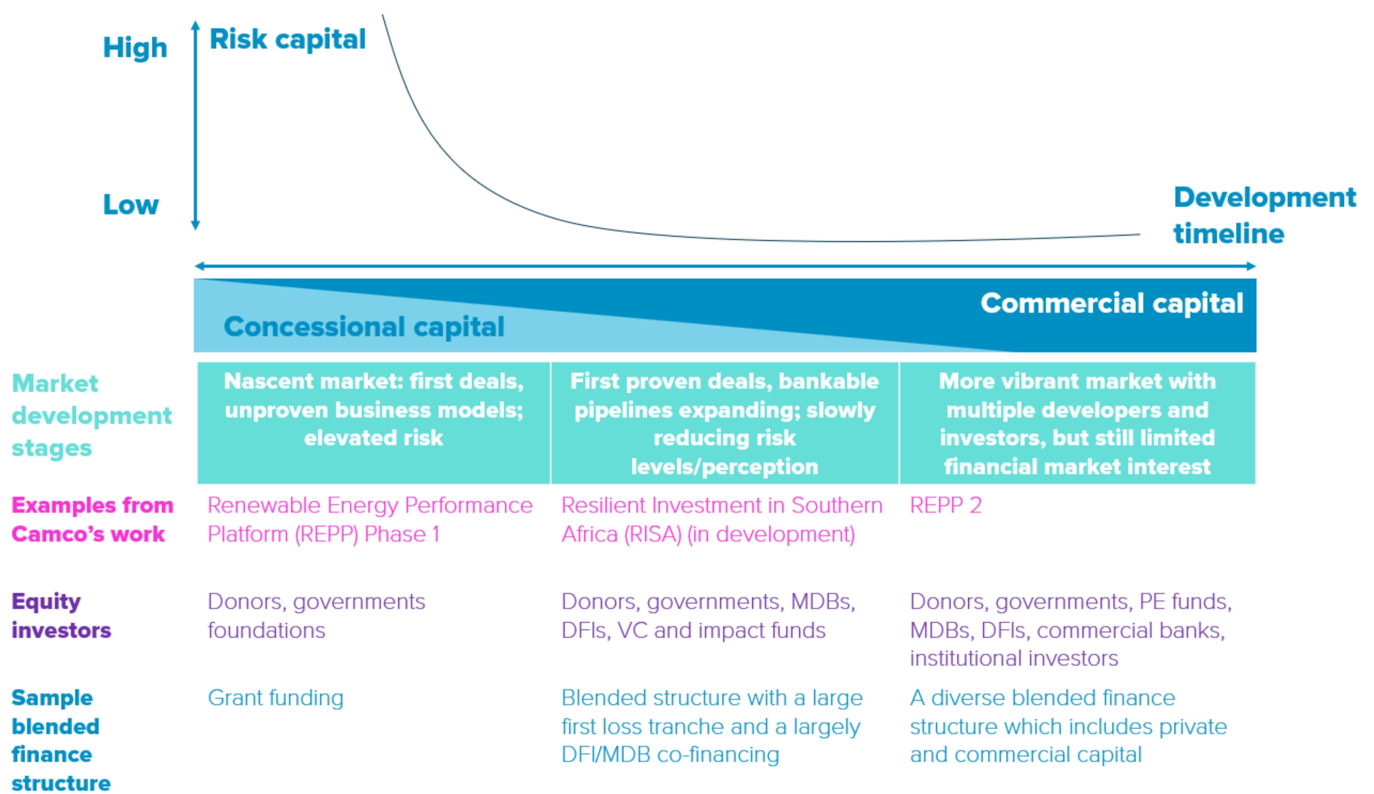
Analysis of 340 blended finance transactions has demonstrated that 79% of them have successfully mobilised private capital (Convergence). The colour key reflects commercial capital leveraged for every dollar of commercial capital of transactions analysed.

[10] Convergence data. Leverage of concessional capital, 2018.

Examples of using concessional funding for market development

Small-scale localised renewable energy solutions are often perceived as only being feasible through grant funding. Against this prevailing belief, Camco and other impact fund managers have demonstrated that employing concessional capital (in the form of loans or equity) can effectively de-risk investments in these solutions. However, gaining the trust and support of governments, communities and small and medium sized enterprises (SMEs) for such initiatives is a substantial undertaking that necessitates a proactive and hands-on management approach.

Our experience indicates that as a market matures, the reliance on concessional financing diminishes, with the private sector stepping in with increased confidence and experience. This can be compared across different funds and financing vehicles currently active and in development, where the ability to mobilise commercial capital increases based on the level of development of targeted geographies and market segments.

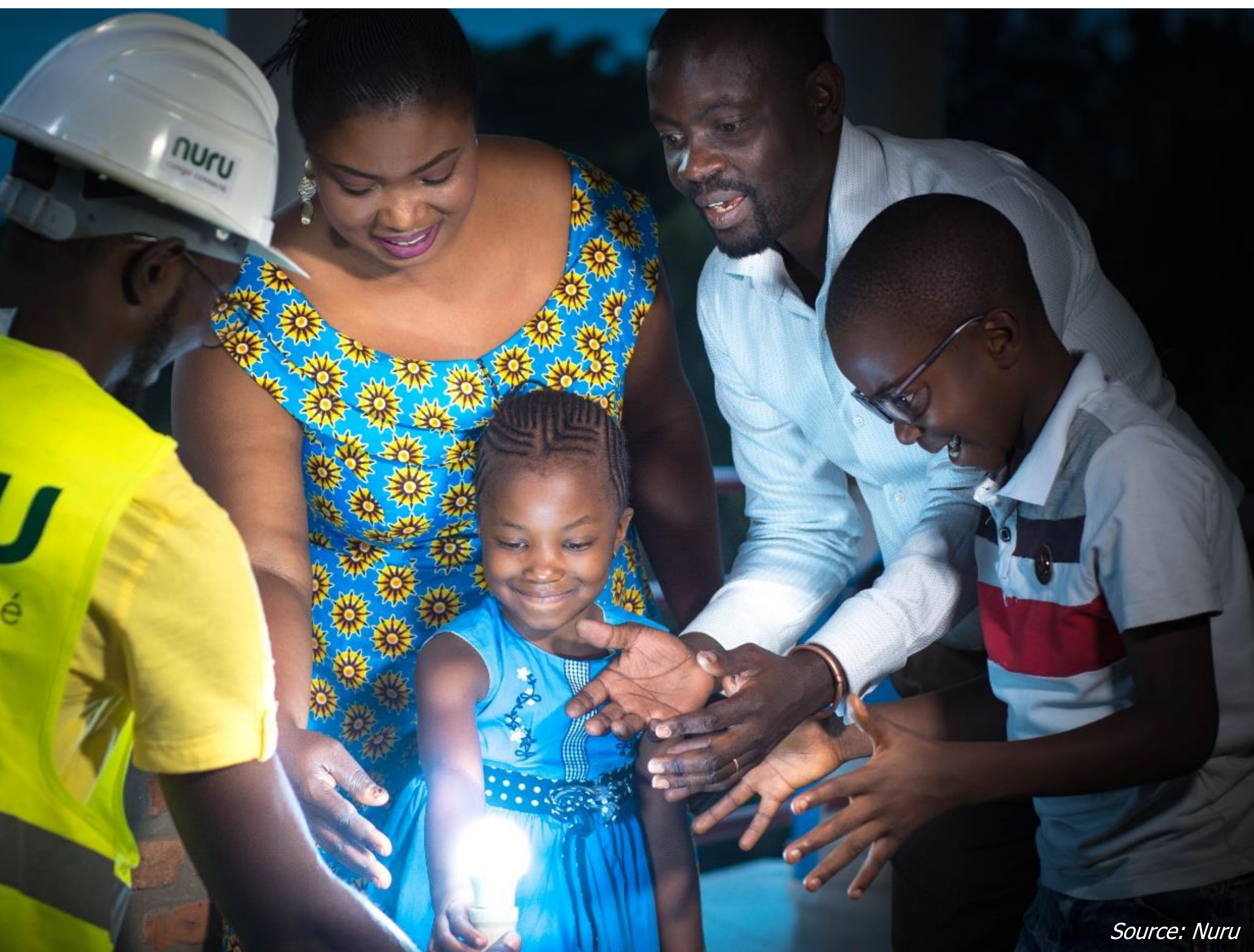


*As markets develop, less concessional capital is required to attract a broader, more commercial investor base at fund level (**Source: Camco, based on OECD DAC blended finance principle 4 guidance, 2020).***

With demonstrated success in project delivery and returns for initial funders (as has been achieved by fund managers in the space), we also anticipate a reduction in risk perceptions associated with investing in low-income countries for climate action and development. This in turn will further facilitate capital flow, contingent upon the presence of robust project pipelines adhering to budget constraints and profitability goals.

To be truly catalytic, the use of concessional funding in blended finance structures should:

- Be directed precisely at the appropriate level to prevent market distortion, which requires a nuanced consideration of the project's maturity and market dynamics.
- Focus on providing truly catalytic and higher risk types of funding for the blended structures (e.g., equity, local currency financing).
- Prioritise early-stage project or company development to stimulate market growth and attract the necessary commercial capital.
- Target high-impact sectors that have often been underserved, thereby contributing to broader societal and environmental goals. Examples of this approach include focusing on energy access projects. supporting productive use of energy and financing smaller-scale renewable energy projects. This will help support local developers who may lack the experience for utility-scale projects, ensuring localised impacts and fostering sustainable development.



Source: Nuru

Allocating development funding

Channelling all development funding through MDBs and development finance institutions (DFIs) might allow donors to deploy large ticket sizes quickly, but the speed of translating this funding into impactful investments can often be lacking. This approach also may not necessarily translate into the desired localised socio-economic impact compared to utilising the range of existing businesses and fund managers, which often have highly localised and specialist teams with years of experience delivering commercial returns in these high-risk contexts. The MDB approach could also potentially prove to favour Western businesses over local developers and job opportunities due to MDBs and DFIs generally requiring larger ticket sizes, and therefore often being risk-averse on selecting partners. This can crowd out smaller, less experienced developers, limiting their market access and ability to scale.

The strategic combination of using MDBs and DFIs as direct delivery partners for scale and also leveraging the specialised expertise of fund managers, exploiting each party's core strengths, can serve to bridge the climate financing gap effectively, ensuring private finance mobilisation and the efficient use of public funds for underserved groups. The emphasis here is on avoiding the altering of MDB mandates so that they design duplicating funds. Such actions might be inefficient since they could inadvertently compete with finance for SMEs and fund managers who have been successfully leveraging private finance for years, whilst still being commercially viable (as compared to MDBs who are publicly funded).

The more essential role that MDBs and DFIs can play is to have a greater risk-appetite through access to concessional finance designed specifically to deliver impact outcomes. For example, in new funds and investment facilities, MDBs and DFIs should prioritise the first loss or junior positions that private capital will not reach. Instead of deploying significant capital into lower-risk, more established projects or addressing investment areas which are already covered by commercial funders, they can deploy it with greater impact by focusing on leveraging finance for local projects that support businesses and communities which are most underserved by more traditional financial institutions, working with experts who have been able to generate returns in this context for many years.

This paper has looked at how to deploy existing concessional capital from development partners smartly. However, approaches which look at mobilising other innovative financing streams for climate action are equally important. These include debt relief and increasing special drawing rights of countries in the Global South and innovative taxation – both domestically and on global industries (such as shipping or aviation). Countries in the Global North also have an important role to play in supporting less developed countries in advocating at the global policy level for their enhanced and faster direct access to global climate funding, such as the GCF.

Source: Voltalia

Conclusion

We need a smart, long-term strategy for private finance mobilisation, but faster deployment if we are to meet the challenges of both climate change and global poverty.

Urgent action is crucial for addressing the existing funding gaps for climate action and sustainable development. To achieve just and green growth, policymakers and financiers must rethink how to deploy catalytic capital. A strategic long-term approach, involving collaboration between governments in the Global South and their partners, supports private sector finance mobilisation for effective climate action. Emphasising a cross-sectoral approach aligns with climate goals and fosters just economic development, addressing broader societal and environmental goals.

Blended finance is pivotal in this strategy, using concessional funding as first loss capital to mitigate risks, attract commercial funders and broaden the investor pool. This innovative approach efficiently utilises public funds and catalyses private investment for climate and development goals. Accelerating the deployment of catalytic capital, along with the strategic use of blended finance, provides a tangible opportunity to scale up funding for a greener and more resilient future.

Pathways to a greener future

Accelerating finance mobilisation for just and climate-aligned growth in developing markets

Policy recommendations for policymakers and investors:

- Climate action cannot come at the expense of socio-economic development. Invest strategically, deploying capital in a manner that ensures catalytic impact, addressing the climate crisis while also supporting socio-economic development.
- Consider and recognise synergies between climate impact, economic growth and poverty reduction when designing funds and selecting projects. Where able, invest in smaller-scale, locally tailored projects that offer more granular and innovative solutions.
- Public finance should be used for catalysing investments in riskier projects rather than crowding out the private finance that already flows into lower-risk projects. The same approach should be used at the fund level. Direct concessional funding to high-impact, higher-risk sectors, prioritising early-stage project or company development to ensure maximum impact, foster green and just growth and support further private finance mobilisation at the deal level.
- Donors should avoid the exclusive channelling of all development funding through MDBs and DFIs, instead advocating for a balanced approach that combines the scale of these players with the expertise of specialist fund managers to ensure effective bridge financing.
- Use blended finance structures to leverage concessional funding as first loss capital to reduce risk and crowd in commercial capital in these riskier projects, thereby broadening the pool of investors and encouraging a self-sustaining cycle of financing.
- Adapt concessional funding strategies to the evolving risk profiles of projects throughout their cycle, understanding that the reliance on concessional funding decreases as a market matures.

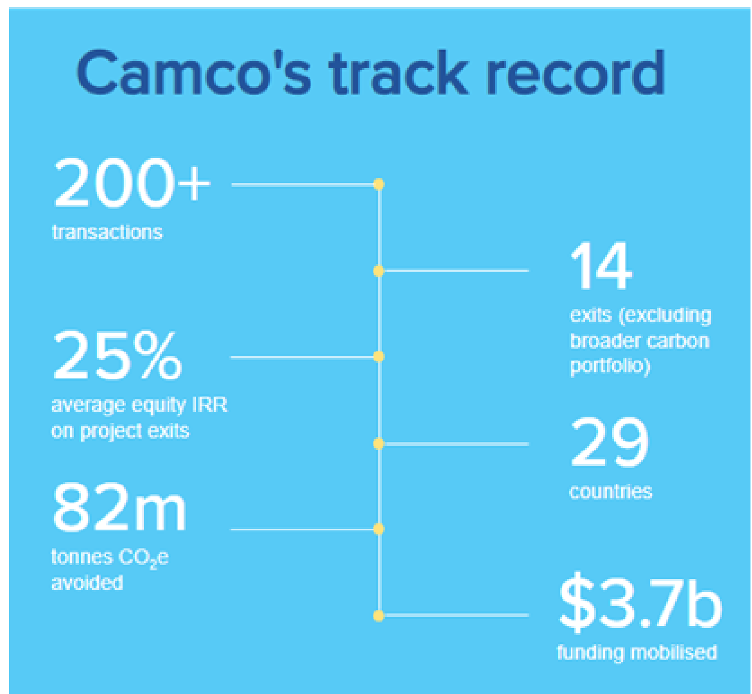
Source: Ha Makebe

Camco is a climate and impact fund manager, leading the transition in emerging markets.

The Camco team has focused on the climate and impact space for over 30 years[11] and has been an active impact investor over the last eight years. Over this time, we have adapted to suit market needs while building long-standing, broad experience across the sector and developing fund management capabilities.

As an impacts-focused fund manager, as well as through earlier activities,[12] Camco has achieved a 25% equity IRR on project exits. Activities which pre-date the establishment of Camco as an impact-focused fund manager include management of a carbon portfolio and RE project development.

Camco is a regulated Alternative Investments Fund Manager in the UK and is a GCF Accredited Entity. We have local offices in Kenya, Ghana, South Africa. Our head office is in the United Kingdom, with other offices in New Zealand and Finland. Our on-the-ground presence allows us to better originate with "fresher" deal flows and access to local innovative developers, build a geographically diversified portfolio and better understand (and thereby manage) risk and cultural nuance in complex environments.

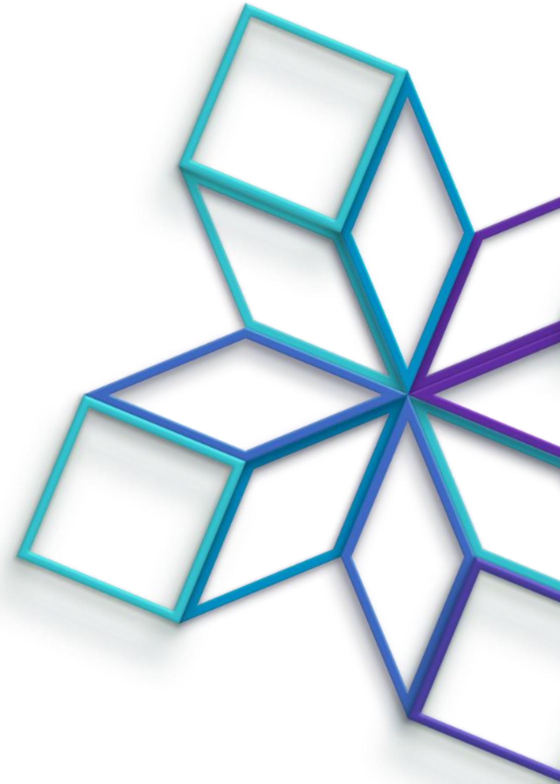


Our sectoral experience covers a whole range of disciplines including policy, regulation market development, technical assistance, project finance, equity, debit, asset management and exits, impact and ESG management and monitoring.

Camco manages multiple investment platforms aimed at financing innovative solutions to address climate change and deliver positive impact in emerging markets and has been recognised as a leading climate and impact fund manager in emerging markets for two consecutive years by ImpactAssets for consistently demonstrating a commitment to delivering E&S impact.

11 Camco and companies which pre-date its incorporation as a funds management business.

12 Activities which pre-date the establishment of Camco as an impact-focused fund manager include management of a carbon portfolio and renewable energy project development.



+44 20 8142 9187 info@camco.fm

Camco Management Limited. Company number 09902551
Registered address 28 St John’s Square, London EC1M 4DN, United Kingdom.
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