

Financing adaptation: the private sector's role

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The climate crisis has become increasingly evident in the last five years. Its alarming effects are also becoming more apparent. Thus, it has become clear that the actions taken to adapt to global climate change have not been sufficient. With the world's populations facing climate-related hazards, much more has to be done to address the issue and accelerate action. Yet, mobilizing the actors and finance will necessitate investment.

Despite the various bold statements made by heads of state and delegations at the COP26 climate summit in Glasgow, the world still has a long way to go to keep global warming below 1.5 degrees Celsius. Moreover, a study by McKinsey highlights that even if the global temperature warms by 1.5 degrees Celsius by 2030, [almost half of the world's population](#) will be exposed to climate hazards, such as heat stress, drought and floods.

Before investing in climate change adaptation, businesses need to have a strong business case, which can be developed by analyzing the risks, costs, and expected returns and the contribution of business to provide solutions towards climate stressors. Key factors that need to be considered include the availability of resources, security of operations, and market opportunities.

With limits to mitigation, the need for adaptation is towering

The Adaptation Gap Report released by the United Nations Environment Programme² estimates that the cost of adapting to the effects of climate change will increase from around US\$170 billion to US\$320 billion by 2030. By 2050, the figure will reach around US\$500 billion. The National Oceanic and Atmospheric Administration (NOAA) estimated the cost of natural disasters in the US in 2021 to be over \$145 billion, 50% higher than the previous year. Further, a report by Swiss Re Institute notes that by 2025, climate-related disasters could cost the country's economy around 10% of its gross domestic product.

According to the State and Trends in Adaptation Africa Report of the Global Center on Adaptation (GCA), around 50 natural disasters were reported across Africa every year from 1991 to 2020. Although floods cause the most financial damage, droughts are more common on the continent, with over five times as many people affected. According to this report, funding for climate adaptation is being cut, while climate impacts are growing. To respond to escalating risks, a five- to ten-fold increase in funding will be needed for adaptation globally, up to \$300 billion annually.

In 2019, developed countries agreed to provide financial support to developing countries to help them address the effects of climate change. However, in 2020, they failed to meet their financial commitments. According to estimates released by the Organization for Economic Cooperation and Development (OECD), the total amount of climate finance reached almost \$80 billion in 2019.

Only 7% of total climate finance

Adaptation finance gained momentum in 2019/2020, **increasing 53% to an annual average of USD 46 billion**, up from USD 30 billion in 2017/2018. However, adaptation still accounts for just 7% of total climate finance, based on available data.

Source: Global Landscape of Climate Finance 2021 - Climate Policy Initiative.

Adaptation remains minor and struggles to grow within climate finance

Adaptation is the uncomfortable guest at all climate finance forums. The latest global landscape of climate finance, published by the Climate Policy Initiative in 2021, shows that the global climate finance flows - including public and private flows of both domestic and international origin - were tracked at US\$ 632 billion per year for 2019-2020.

The majority (US\$ 571 billion or 90%) of tracked finance flowed to mitigation, with US\$ 46 billion for adaptation and US\$ 15 billion for cross-cutting themes that include mitigation and adaptation. Private climate investments increased by 13% from 2017/2018 to USD 310 billion in 2019/2020. However, only 1 billion dollars were invested in adaptation.

What motivates actors to adapt?

The goal of adaptation is to enable actors to cope with the increasing number of weather and climatic conditions expected to occur due to climate change. This can be done by developing technology or establishing a more robust risk-management framework.

Tech-intensive and expensive innovations drive adaptation in the developed countries, given their competitive advantages in R&D. Developed countries have available and reliable climate data that allows them to manage risk and develop technology to cope with climate risks. However, in developing countries, adaptation is driven by daily survival.

Every day, businesses around the world invest in climate change adaptation. From small farmers to large corporations, all contribute significantly to the fight against climate change. Although they may not consider climate change a threat, many businesses still invest in their operations' resilience. They are adapting to the effects of climate change by planning for the future, managing their resources, and responding to droughts and floods. However, investing in adapting to climate change can be daunting for small businesses in developing countries. Due to the lack of resources, they often prioritize their immediate needs over their long-term goals.

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Investments in adaptation can lead to a [return on investment of 2:1 to 10:1](#). For example, every dollar invested in resilient infrastructure in Africa yields four dollars, and investing a dollar in climate-smart crops in most African countries [can generate between 2 and 14 dollars in benefits](#).

Despite the positive benefits and returns of investments, it is not always easy to convince investors that investing in adaptation is a good business practice. Many factors can affect returns, such as the cost of doing business, the availability of resources, and a lack of clear indicators of success. In addition, climate data is not always available, particularly in developing countries. Nevertheless, connecting climate science with financial techniques will translate a climate vulnerability into a business opportunity.

To mobilize the actors and finance needed for adaptation, investment is necessary. It will enable understanding the rationale for the investment and deployment of an array of financial instruments and mechanisms. These must attract finance from entities with a range of risk appetites and be able to raise capital and deploy it flexibly. In addition, the level of "concessionality" required for specific instruments will vary by market or policy environment.

Not all instruments work in all contexts. The enabling environment in a country will determine the viability of specific financial instruments. In some cases, a lack of financial sector development or commitment to a sector (i.e., water, agriculture) will make specific financial instruments challenging to implement. In these instances, there may be a more substantial role for concessional capital from development finance institutions (e.g., project preparation grants, first-loss debt tranches, and premium support) to facilitate deploying the instrument effectively. For example, local capital markets are a significant source of water infrastructure finance in developed markets and often employ special purpose vehicles (SPVs) to mobilize finance alongside commercial bank lending. However, in developing countries, water infrastructure is sourced from public finance.

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What role is the private sector playing in climate adaptation?

Getting the finance for adaptation is not an easy task, especially in developing countries. Several factors prevent investors from making informed decisions when it comes to investing in climate change. These include a lack of data at the local level, the lack of a bankable pipeline, and high transaction costs.

As governments start to formulate their National Adaptation Plans, the private sector must play a leading role in its efforts to implement these plans.

To ensure that the private sector is well-informed about the various activities involved in climate change adaptation, governments must establish a clear business case and an enabling environment for their investments. Doing so will help them attract more private sector support and encourage more investment.

'Adaptation' and 'resilience' definitions

The Intergovernmental Panel on Climate Change (IPCC) [defines adaptation and resilience](#) as:

- **Adaptation:** The process of adjustment to actual or expected climate and its effects. In human systems, adaptation seeks to moderate or avoid harm or to exploit beneficial opportunities. In some natural systems, human intervention may facilitate adjustment to the expected climate and its effects.
- **Resilience:** The capacity of social, economic, and environmental systems to cope with a hazardous event, trend or disturbance, responding or reorganizing in ways that maintain their essential functions, identities, and structures, while also maintaining their capacity for adaptation, learning, and transformation.

In summary, we can define adaptation as the process of adjustment to actual or expected climate shocks and their effects (risks as well opportunities). We define resilience, as the result of such adjustment enabling a system and its parts to anticipate, absorb, accommodate, or recover from, the effects of a hazardous event in a timely and efficient manner.

Usually adaptation action has two layers, as per also recalled in the EU taxonomy on climate finance:

- A micro layer: Adaptation OF the I.e. how the project can deliver its benefits even under current and future climate. This is often designated as “climate proofing”.
- A systemic layer: Adaptation BY the project. I.e. how the project provide resilience to the environment in which it operates. It is obvious that such systemic contribution needs first climate proofing check (a water network does not provide systemic adaptation benefit if you don't have enough water in the pipes.