Private Sector & Development

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What indicators for finance devoted to climate change adaptation?

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Adaptation is by definition the response to a shock – in this case a climate shock. But if this issue is not identified and taken into account in the business practices and procedures of private players, it is unlikely that an indicator devoted to climate adaptation will come about by chance. Yet this tool is becoming essential. It is increasingly used by private finance to measure climate adaptation, in particular at the request of donors.

If a client requests support from a donor for a project that has already been developed but ignores climate shocks, it will find it difficult to change it sufficiently to make it eligible for the “adaptation finance” category. It is therefore especially important to create and implement indicators for project initiators seeking private financing, in order to take into account the necessary adaptation to climate change. The definition of these “adaptation indicators” also poses several recurrent problems which need to be taken into account.

These indicators are firstly specific to a given climate and social context. Consequently, an indicator that is relevant for one project is not necessarily so for another which seems identical, but is implemented in a different climate context. Reducing water consumption in a country where there is no scarcity is not an adaptation project: the investment does not correspond to any climate risk. The measurement of water savings can therefore be a relevant result indicator for climate adaptation – or not so… This variability makes it difficult to use it consistently in a portfolio.

This is also the case for cross-sectoral aggregation, which is complicated to apply in a portfolio: cubic meters of water saved in Namibia cannot be directly compared with hectares planted with climate-resilient crops. So, a "derived aggregatable indicator" may have to be used to carry out a comprehensive analysis of a portfolio. For example, this derived indicator may be a category of individuals or entities (beneficiaries of more resilient services), or a financial or economic monetization. Cubic meters of water can thereby be converted into a value via a shadow price, which allows the use of a cross-sectoral aggregation.

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In absolute terms, it is not difficult to find relevant adaptation indicators. Indeed, they fit in very well with the standard "logical framework" approaches. However, the outcomes or impacts related to these indicators are not always verifiable due to the unpredictable nature of the climate stresses concerned: the project's performance cannot be confirmed until there is a drought. The indicators therefore remain a hybrid solution, halfway between the output and the outcome.

Remove the barriers to private finance

It is easier for the public sector to support adaptation. However, it is a question of tempering a recurring idea that it is not suited to the private sector. While it is true that development banks find it hard to generate "adaptation finance" via the private sector, in particular due to the specific nature of its accounting indicators, other factors account for this situation. The specific temporality of business cycles between funders on one side and private clients on the other is one of the barriers to its development. Project initiators and their backers often submit applications to banks that are already quite detailed. If the "climate risks and opportunities" are not included in them, banks do not always have the possibility of proposing changes that are "acceptable for the client" for projects that are already very developed. Consequently, "adaptation opportunities" cannot be seized, whereas the quality of the project could have benefited from them. The issue must therefore be addressed with the client at the earliest possible stage.

Clearly, the sticking point here is not the private nature of the players involved, but rather the lack of understanding of the "climate risks and opportunities" and the financing related to them. For example, if a client has only complied with the Eurocode (European code for designing and sizing of construction works) to scale its infrastructure, it means it has not taken into account the effects of climate change expected over the next 20 years, but just the average climate over the last 30 years. If it does not apply internal procedures that are more demanding than the existing standard, the project seeking financing may have no climate resilience dimension or it may be ill-suited. Furthermore, most development actors only consider adaptation in terms of a response to climate risks. Yet the IPCC definition does not limit adaptation to "problem management", it also encourages "opportunities related to climate change to be seized".

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Consequently, while looking for climate risks in private sector projects is obviously a relevant approach, it must be complemented by a logic of seizing opportunities: How can the responses to

reduce the climate vulnerability of third parties also fit in with a business logic?