Financing is not flowing fast, nor far enough to achieve the climate goals of the Paris Agreement. Globally, over $100-150T is needed over the next three decades to decarbonize industries, build renewable energy and green infrastructure, and support adaptation and resilience projects around the world. We have seen tremendous progress, however for every one dollar that was deployed towards climate finance in 2020, we needed four more.

There are reasons to be optimistic: buoyed by landmark policies such as the US Inflation Reduction Act and the EU Green Deal, among others, the financial sector is responding, in some cases very rapidly, to unprecedented new opportunities. Heading into 2024, we are seeing continued interest in areas such as renewable power and transportation, but new momentum in areas such as nature-based solutions, as well as adaptation and resilience. New models for financing nature-based solutions and first-of-a-kind climate technologies offer promise. As countries and companies alike contend with the mounting physical impacts of climate change, there is now a burgeoning financing market for adaptation and resilience solutions.

However, further changes to market systems need to be implemented to ensure investments are focused where they have the greatest impact. Catalytic capital is needed to enable more investment to flow towards emerging markets. High quality, comparable private sector climate data is needed to enable the financial market to assess and manage risks.

If you read one report: Sustainability in Private Equity, 2023 (Oct 2023)

Finance has the potential to be the most effective lever for delivering net zero. With a multitrillion climate finance gap, we need to rethink and implement a new financial architecture to achieve our climate goals. And we need to act quicker, and work together, more than ever before.

- Veronica Chau, Partner & Director, Sustainable Investing & Social Impact, Toronto

BCG'S TOP TAKEAWAYS:

1. We need to deploy transition finance to increase investment in early-stage climate technologies and critically drive change in hard-to-abate sectors.

2. We need to work together to solve deployment challenges: Most investors believe that policies like the IRA are creating major incentives, but execution challenges are constraining deal flow.

3. Blended finance and catalytic finance will be vital tools in creating a new financial architecture and delivering funds for net zero agreements.

4. We must not forget the need for adaptation and resilience financing: It’s critical we change the current perception that this area is not financeable.

5. Over $40 trillion in economic value annually is directly dependent on nature and its services. A nature strategy enables to achieve net-zero targets, mitigate portfolio risks, and unleash new value-creation opportunities.

6. By leading on nature, financial institutions can also facilitate a just transition that addresses environmental challenges in ways that support human rights, social inclusion, and the eradication of poverty.
Recommendations for governments

1. Close the cost gap - while the energy transition will cost consumers in the short to medium term, it will pay off in the long term.
2. Get granular - clear, year-by-year deployment targets are crucial.
3. Redesign energy markets - the whole system needs unprecedented levels of low-carbon investment.
4. Cut planning and permitting times - streamline processes to power rapid progress.
5. Ensure a just energy transition - share the costs and benefits of energy transition equitably.

Recommendations for the private sector and investors

1. Engage with regulators and governments - with a focus on unlocking unprecedented levels of investment.
2. Do not lose sight of infrastructure investments - the success of the energy transition will depend on new networks.
3. Consistently integrate carbon into decision making and asset valuations - encompass carbon costs, alongside value created.
4. Apply a programmatically focused approach in financing - move beyond financing individual projects.

We need to rapidly deploy transition finance to drive action

1. Financing to achieve real economy decarbonization remains a small fraction of what is needed. To attain net zero, public and private sector entities across the globe will need approximately $3.8 trillion in annual investment flows through 2050.
2. Analysis from BCG and The Rockefeller Foundation suggests that the capital currently deployed provides only about 16% of the total climate finance required to mitigate negative climate effects and adapt processes and infrastructure worldwide. When we looked through a wider lens that includes transition finance and financing deployed to intermediaries that target climate impact, we found that financing need outweighed flows by 46%.
3. Private-market investments present near-term opportunities for climate-focused investors to drive change and gain insight into this large and long transition. They already play an important role in leading asset owners’ allocations to climate solutions: fundraising for climate transition funds reached $75 billion in 2022, a 29% increase from 2021. Is this research linked? Please include.

Nature-focused financing is key priority and required a full ecosystem approach

- Financial institutions understand the need to accelerate progress toward net zero—and many are actively advancing efforts to do so. But climate is just one part of a larger nature-based ecosystem on which people, industries, and entire economies depend. Today, many elements that make up that ecosystem—from water and critical minerals to farmland and pollinators—are under threat. Some are being depleted, others contaminated, and still others destabilized by habitat decline.
- In their role as capital providers and advisors to entities and individuals around the world, financial institutions are at the epicenter of many of these changes, and their portfolios fundamentally depend on and impact nature. This two-way relationship gives institutions a unique vantage point to identify key risks, fund smart interventions and open new avenues of growth. By leading on nature, financial institutions can also facilitate a just transition that addresses environmental challenges in ways that support human rights, social inclusion, and the eradication of poverty.
- Financial institutions cannot deliver the change needed alone. Nature is an ecosystem challenge that requires an ecosystem solution. Coordinated action and collaboration by governments, nongovernmental organizations (NGOs), and the private sector are essential to delivering real-world impact.

Increased investment is required to finance development and upscaling of climate technologies

The transition requires massive new investment of some $7 trillion in energy and industrial infrastructure by 2030. Even if all $19 trillion in planned energy-sector investment is realized, an $18 trillion gap remains, $9.8 trillion of which involves end use, according to BCG analysis. Financing the energy transition will require collective action, including through ecosystems of public and private players.

There is an urgent need to change the narrative around adaptation and resilience financing

In 2020, financing flows for climate adaptation and resilience in 2020 amounted to only 10% of what is needed. There is a need to change the perception of adaptation and resilience projects as not financeable, to ensure they receive the necessary capital.

The need for greater financial market alignment

The financial market faces significant challenges that can be addressed through a willingness to reprioritize objectives, reallocate resources, adjust incentives, promote cross-sector collaboration, and encourage international cooperation on a more ambitious agenda.

Financing a just transition

Investors can embed just transition principles into investment criteria and lead the way to scale up climate financing, while national and international DFIs—including multilateral development banks—can help address inequities in global climate finance.

- Leverage metrics. Investors should focus on building tools that assess companies through a just transition lens—and incorporate findings into investing and capital allocation decisions.
- Scale up global financing and address funding gaps in developing economies. Investors can also support efforts to integrate climate-related factors into risk models, quantify the cost of inaction, and collaborate with companies, policymakers, and NGOs to overcome barriers to deploying private capital.

Nature-focused financing is key priority and required a full ecosystem approach

- Global leaders expect blended finance to play a central role in meeting many of the world’s biggest climate challenges, especially those in emerging markets and developing economies. For blended finance investments to have a risk-return profile suitable for private-market investors, public and philanthropic organizations must assume an additional share of the risks.
- Blended finance is not yet happening at the necessary scale. However, several major projects (many pursuing the development of low-carbon hydrogen) were announced in 2022, and global leaders are working with development finance institutions to do more to increase blended finance.

ADDITIONAL PROOF POINTS

- Investors can embed just transition principles into investment criteria and lead the way to scale up climate financing, while national and international DFIs—including multilateral development banks—can help address inequities in global climate finance.
- Scale up global financing and address funding gaps in developing economies. Investors can also support efforts to integrate climate-related factors into risk models, quantify the cost of inaction, and collaborate with companies, policymakers, and NGOs to overcome barriers to deploying private capital.
- Global leaders expect blended finance to play a central role in meeting many of the world’s biggest climate challenges, especially those in emerging markets and developing economies. For blended finance investments to have a risk-return profile suitable for private-market investors, public and philanthropic organizations must assume an additional share of the risks.
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