

Public Sector Support for Early-Stage Renewable Energy Project Development in sub-Saharan Africa

Roundtable Report

On 16 February 2016 a range of clean energy experts - from both the development and finance perspectives - gathered in the Royal Library in Brussels for a round table discussion. They shared experiences and views on how and where public support might be effective in the early stages of developing clean energy projects in sub-Saharan Africa. Such public support would help decrease specific risks, thus expanding the pipeline of bankable clean energy projects in Africa.

During the event the term *early-stage* was used to define the necessary stages before *active* project development, i.e. the period before a business model has been proven feasible and an investment decision has been made which moves the project towards commercial deployment. Discussions focussed on medium-sized on-grid systems (independent power producers and captive power) and off-grid systems (mini-grids and standalone systems) as possible market segments to receive public support.

This summary report of the round-table captures the rich and varied discussions held in plenary presentations and during breakout sessions. The event took place under the Chatham House Rule.

There was consensus amongst participants that **public sector/development aid financing can play an important role** in boosting clean energy projects in sub-Saharan Africa by the private sector. The efficiency of current support mechanisms could, however, be further enhanced and a number of **recommendations** were made throughout the course of the event:

1. Reduce Complexity in applying for Funding – using the same, simple Language

Participants called for **reduced complexity in the application procedures** for financial support from public institutions. It was felt that project developers often spend an unnecessarily long time deciphering application requirements and the overly-complex politically correct language used in funding calls – time which is lost for project development work. “[An] entrepreneur’s language is simple and difficult markets need simple solutions” as one participant put it.

Despite an appreciation of the need for public entities to have extensive - often relatively static - procedures, transparency, and checks and balances, participants noted that these do not often fit well with the **dynamic and fluid nature of entrepreneurial project development**. Information provided by developers in funding calls quickly becomes obsolete, and support may no longer fit with the project’s requirements when it arrives.

Further, public sector funding schemes often bring high administrative costs with them; at times even 25-30%. These are directly correlated to the accountability required for the funds disbursed. Considering this a very inefficient allocation of (public) funds, participants called for a more direct financing approach, with fewer intermediate steps and organisations involved – something more closely aligned to the approach of “angel investors”.

2. Increase the Availability of Risk Capital and ensure “Skin in the Game”

Focusing on the differing roles of development financial institutions (DFIs) and ODA programmes, participants identified a number of hurdles and opportunities for improvement. Overall they noted that for public support to be additional, it should be **oriented towards supporting entrepreneurship** and therefore take on risk.

On DFIs it was noted that they are not prepared for sufficient risk taking. An **early injection of risk capital** is needed to ensure that entrepreneurs are not the only ones with “skin in the game” - but that they are also supported with public funds to **reduce structural risks**. It was proposed that DFIs enlarge their risk capital portfolios using public funds (blending) so that “realisable projects are not stuck in ministries”, awaiting grants from ODA programmes. Strengthening and expanding the number of **dedicated intermediaries** who facilitate project developers in early stage development was another possible solution proposed. A number of good practice examples already exist, and more activity in this area may be needed - especially for smaller- to medium-scale projects.

Blending public funds private venture capital would enable them to be used more as venture funds, helping ensure more bankable projects get off the ground. Though sufficient finance is available, there **not enough funds with the appropriate risk profile** which would enable DFIs to support the early stages of project development. Further, there is often little follow-up or technical support from DFIs during implementation, and little due diligence exercised in determining where funding is allocated. Here **development agencies might play a role**: It was proposed that they seek out projects with scalable potential, providing technical assistance on the ground that can support projects to fruition (project development support). In general all actors were called upon to make greater use of local talent in project development work.

Participants acknowledged a number of **limitations** to the role DFIs can play in early stage development, foremost amongst them that DFIs are primarily banks, and as such are commercial entities which must provide shareholders with a return commensurate to risk. Further, the inherent trade-off between commercial and sustainable development interests prevents development agencies working directly with the private sector.

3. Address contextual Obstacles

Participants also noted the very varied situation across different markets in sub-Saharan Africa, which call for a differentiated perspective on the situation. A number of countries (e.g. Ghana, Kenya, Nigeria and South Africa) have an abundance of project developers, whilst large parts of sub-Saharan Africa still lack developers and capital, as well as capacity and competency in governing agencies to adequately attract investment.

Further, private sector participants also highlighted constraints to conducting business on an ethical basis, given wide-spread corruption in many contexts. Ensuring that public funds are not diverted or channelled into private pockets remains very important.

During the afternoon of the round-table event, participants engaged in discussions on different models by which to provide public support to project development:

- a) Technical Assistance;
- b) Financing;
- c) Development Support.

The three breakout sessions explored the opportunities presented by each model, before reviewing the lessons learned from earlier experience and highlighting points of attention for designing future interventions. An outline of the main elements of the discussions is given below.

a) Technical Assistance Model

This includes the provision of expertise paid for by public funds to assist developers in preparing documentation; carrying out studies; assisting in structuring; providing coaching with the objective of realising a clean energy project.

- **Key success factors** in applying technical assistance (TA) to early stage project development include:
 - i. strong commitment from / aligned incentives with consultants;
 - ii. defining deliverables in a holistic way (relying on more than output reports; aiming to contribute to a project cycle looking at connectivity and assessing projects on the ground);
 - iii. providing a type of risk-sharing in the assignment;
 - iv. incorporating a success fee / approval from invoices by project developers. Including a success fee and risk sharing are especially difficult to implement in publicly funded and tendered consultancy contracts. One solution would be to have the developer pay the success fee rather than the public entity. Clarity about the contractual relationships between finance providers, consultants and the project developer are key.
- From a public funding perspective, it is difficult to identify **transparent criteria** to determine beforehand when to start providing TA, especially in the early stages of development. Despite this limitation, it is often highly beneficial to provide expert advice at a very early stage - sometimes already at the ideas phase, thus calling on a more 'ad-hoc' modality to provide TA to early stage projects. This would help avoid the use of public funds for projects which may look good on paper but would be disqualified at an early stage upon expert review.
- The **geographical proximity** of experts and consultants to projects is essential for effective and efficient TA, enabling as it does the provision of advice in-situ. This also enables consultants to have a high level of local market intelligence.
- There are many TA instruments which help prepare projects for financing. At the same time, there is a widespread **fragmentation** of (development) finance for (early stage) clean energy projects. There are pros and cons to having TA attached to investment / debt funding sources, and these should be considered on a case-by-case basis.

b) Financing Model

This includes the provision of public funds to developers to carry out studies and prepare documentation which represent milestones towards the realisation of a clean energy project.

- Proponents of a project need resources to a) survive and b) to finance the cost of developing a project. To avoid moral hazard and the financing of unnecessary activities, project developers should be provided with **two-tier support**: A basic living wage to provide basic security, while enabling them to apply for additional resources through a competitive process for carrying out other necessary activities. This may only be effective in an environment where very little additional support for clean energy projects is available.
- There may be an opportunity for donor funds and DFIs to **team up with venture capitalists** to jointly select promising projects or developers. This would not necessarily be by public procurement, but rather through business sense and based on personality aspects of the promoters. This proposal would require further legal evaluation to rule out market distortion effects.
- **Projects require different financing approaches to companies** in the early stages of development. A grant for a company that is in its pre-commercial stages makes sense if the resulting structure is scalable; for project development, a grant has to be looked at differently as it is only providing a one-off benefit to society and a (potentially) large benefit to the proponent.
- Accountability requirements for public funding lead to results-based approaches which, whilst seeking to not distort the market, can lead to **Darwinist approaches**; already successful players win a 'beauty contest' based on meeting transparent criteria. Greater attention should be given to ensuring more results are achieved, and that funding is allocated to where it has the largest added value. Public funding should be allocated to involve local experts, increase competencies and technical capacity, and build local partnerships, rather than drawing on external expertise.
- **Profit participation rights** could help facilitate project or company proponents in the start-up phase to develop their idea or project at their own cost, rather than handing over projects to an established entity and reaping only limited benefits. This would be in addition to other instruments of direct investment flows into a project.
- Taking a **step-by-step approach to project support** could address various current shortcomings. Offering tailored coaching and financial support to a pre-selection of promising projects, based on their actual needs rather than on the pre-allocation of a grant, would enable a more adaptive approach, in-line with changing needs and iterative processes. Co-benefits include increased local capacity and sustainable modalities of development.

During the session, a number of ideas for the various forms of financing were also discussed:

- 1) **Grants** can be effective in creating demand in the market and piggy-backing with VC should be explored. They should be restricted to operations that directly benefit social services and to R&D and be used sparingly for operations which include private gains.
- 2) (Unsecured) **loans** are not considered appropriate for early stage development; they may have a role to play for companies in relatively advanced stages of development.
- 3) The provision of **equity** leads to an alignment with the proponents of the project, but might decrease the stake of existing shareholders.
- 4) **Partial risk guarantees** may be considered for some costs incurred by developers if it serves to increase risk-taking under difficult market conditions.

c) Development Model:

This involves the use of public funds for an organisation that is carrying out studies and preparing documentation that represent key steps towards the realisation of a clean energy project which could later be 'sold' to a commercial developer.

- It is unclear how ODA can be used to set up a **legal entity** (either for-profit or not-for profit) with the aim to develop projects; problems are posed by aligning such an organisation with legal requirements on accountability and acting as an active developer pursuing entrepreneurial goals. Further problems arise around the channelling of ODA funds when it comes to such an entity investing in projects and then “selling” its investment later.
- The development of projects by local proponents is often delayed because of a lack of: a) skills and education, b) experience, c) access to finance. **Skills transfer** should be the priority of ODA interventions in the energy sector. Strategic partnerships, secondments or direct training of local staff all play a role here.
- Publicly funded project developers, working in collaboration with governments and (development) financing institutions, should work towards the **standardisation** of project preparation (e.g. financial modelling, contracts, participation agreements, power purchasing agreements etc.), enabling other (local) developers to benefit.

During the plenary wrap-up session of the event, participants expressed following final thoughts:

- Energy finance could learn from approaches in other sectors and regions;
- Support for the direct development costs (personnel costs) of developers is needed;
- Awareness should be raised of already proven mechanisms e.g. EEP/SEED facility;
- Local development teams should be formed and require more than just financial support;
- Investment of public funds in an early stage equity fund should be considered, while mindful of potential moral hazard risks;
- Technical assistance is needed for framework conditions and for appropriate structuring;
- Public sector interventions should be coordinated;
- More efforts should seek to identify the real needs of developers. How to support these needs will then follow from such analysis;
- Support should be diversified by market segment, i.e. IPP, captive power, mini-grids; stand-alone PAYG solar homes systems etc., as they have different business models;
- One or two market segments could be selected for early stage support and an appropriate mechanism designed for them. Segmentation needs to be at least along the lines of project vs. corporate, and small (<5MW) vs. large (>5MW).
- The energy sector has to keep the end users in mind; TA should be targeted to the end user;
- Structured early stage support should have early scalability in mind;
- Working with creative incentives should be encouraged; convertible investments and profit participation as a means to do this.