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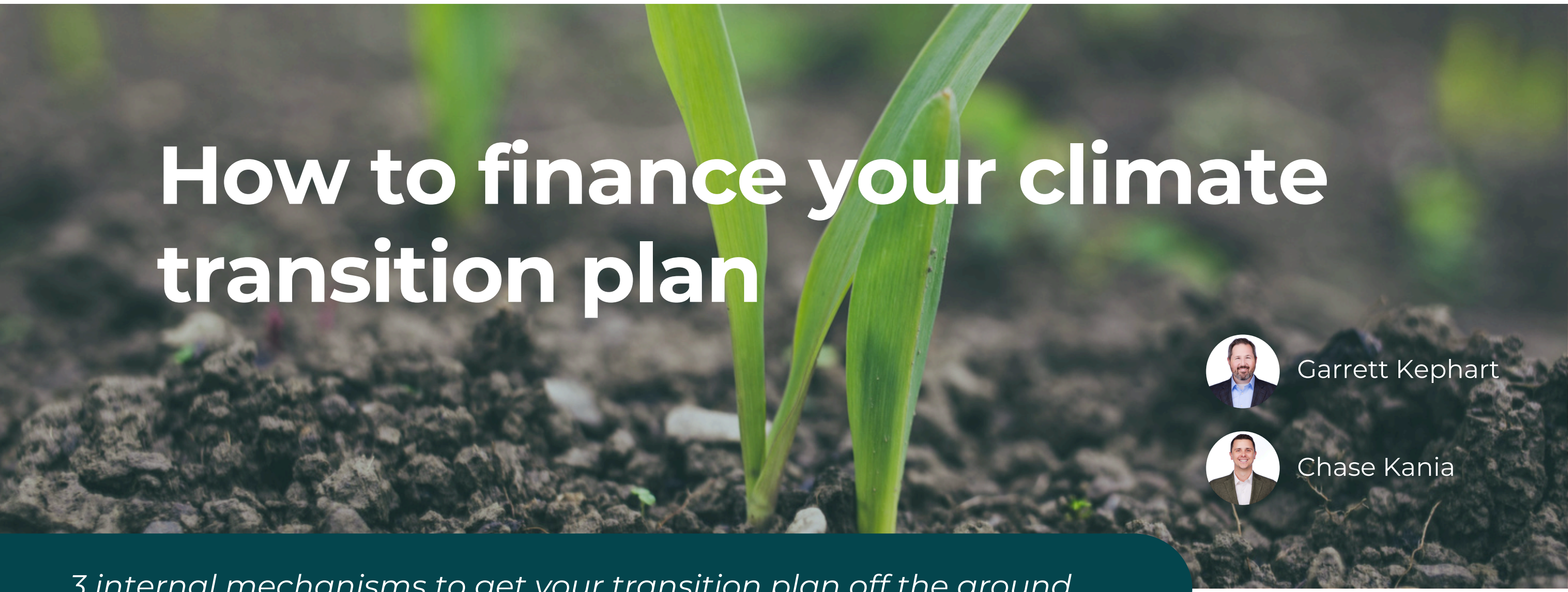
MAY 2024



How to finance your climate transition plan

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3 internal mechanisms to get your transition plan off the ground

We are in the critical decade for climate action. Emissions need to halve by 2030 to limit planetary warming to 1.5°C, and businesses have made ambitious commitments to meet this challenge. As of November 2023, **half** of the world's largest 2,000 companies had set net zero targets. However, many are struggling to drive meaningful progress – businesses are shooting for a median greenhouse gas (GHG) reduction of **just 30%** by 2030, well below what's needed.

This isn't for lack of trying. Companies often understand what's required to reach their GHG reduction goals, but figuring out how to pay for it is an entirely different animal.

High-impact initiatives addressing topics like clean energy deployment, refrigerants, clean fleets, regenerative agriculture, and water stewardship aren't cheap. They often require significant upfront capital investment.

So, how do you pay for this work? Read on to learn about 3 internal financing mechanisms to get your climate transition plan off the ground and how to start using them.

3 ways to finance your climate transition plan

Shadow pricing

Shadow prices put a dollar value on the negative environmental or social impacts associated with your business activities, such as water use, community health, biodiversity loss, and GHG emissions. For instance, what's the true cost of using water? How might you quantify the impacts of air pollution on community health?

Why shadow prices work

Business decisions are largely influenced by cost and ROI. Shadow prices work because they help you understand the true cost of doing business and price hidden externalities in your decision-making. They're a way to communicate your sustainability impact in financial terms without changing your budget or financial obligations.

For instance, if you're identifying potential sites for a new textile facility, putting a price on water provides a more robust understanding of the risks and financial implications associated with each – local consumption needs, potential for wastewater contamination, resilience in a changing climate, and more.

50% of companies reporting impacts through CDP disclosed using a shadow price in 2020.

When should you use them?

Because shadow prices link environmental, social, and financial risk in a way that stakeholders understand (money), this mechanism is most helpful in developing the business case for your climate or sustainability strategy, getting cross-departmental stakeholders bought in, and making informed decisions.

This is especially true for extremely underpriced yet essential commodities like water – shadow prices can help you surface risks and build the backbone for your future corporate water strategy.

It's important to note that shadow prices don't impose any fee on your business; they're just a way to put a price on externalities. To drive internal behavior change and free up capital to finance your climate initiatives, tie your shadow price to an internal fee.

Internal carbon price

A carbon price takes shadow pricing a step further by formalizing a fee on the amount of carbon you emit. But as mentioned above, it doesn't just have to be carbon. You could put a fee on any social or environmental impact. The idea is that the fee applied to various business units in your organization creates a pool of money you can use to fund climate initiatives.

Why carbon prices work

By linking carbon emissions to financial performance, internal carbon fees incentivize your departments and teams to take meaningful steps to reduce their footprint. And of course, they allow you to fund projects that further accelerate your decarbonization goals, creating a positive feedback loop that rewards innovative, sustainable thinking.

Microsoft was one of the early pioneers of this concept. In 2012, they began charging business units on Scope 1-2 and, more recently, Scope 3 emissions. The proceeds are used to invest in renewable energy projects and other sustainability initiatives. Since then, carbon fees have been adopted by companies like Salesforce, Stanley Black & Decker, Autodesk, Mitsubishi Corporation, and more.

Nearly half of the world's largest 500 companies currently use an internal carbon price or plan to over the next 2 years.

When should you use them?

Carbon fees are being applied across industries but are especially useful for retailers with complex, global value chains – if your commodity buyers knew they had to maximize warehouse sales and minimize carbon in what they buy, you could change behavior in a significant way.

Keep in mind

Sometimes there's tension about how to use these funds. For instance, using your carbon price to seed a climate innovation fund is a forward-thinking idea, but you may encounter pushback. A common reaction we see from business units is resistance to being "taxed" and having capital taken away from them to do something with little perceived benefit. Why should your facilities team care about a climate innovation fund or electric vehicle (EV) charging infrastructure when they could be using those funds to automate maintenance tasks or invest in software to streamline work orders?

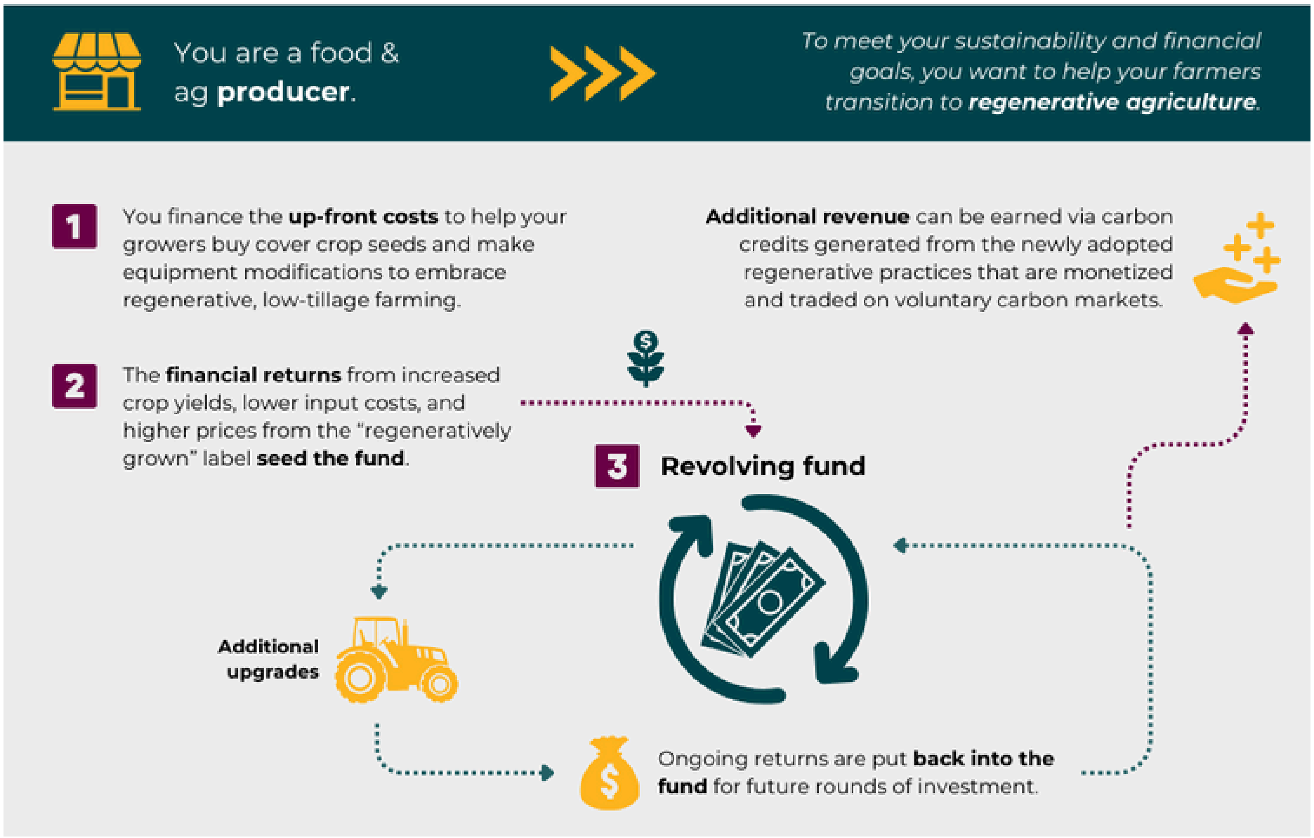
To overcome this reaction, clearly demonstrate the benefits departments might see in ROI, profitability, and efficiency alongside GHG reduction potential. Remember, this kind of work requires thoughtful change management. It'll take time to build up the support and systems you need to integrate behavior-changing mechanisms like internal carbon fees.

Green revolving funds

Green revolving funds use new revenue, efficiencies, or cost savings from climate and sustainability projects to replenish and grow the pool for future investment. This creates a revolving cycle of funding that continues to support climate action initiatives over time while generating positive returns.

How do you get the fund started?

Revolving funds typically start with an initial investment, philanthropic donation, or endowment to get the cycle going. You could even seed your revolving fund through tax credit transfers (in the United States), an internal carbon price, or the proceeds of an innovative investment model with a retail partner. Here's a hypothetical example to illustrate the concept from start to finish:



When should you use them?

Green revolving funds can provide working capital for a wide range of climate transition projects, such as energy efficiency upgrades, renewable energy installations, waste reduction initiatives, sustainable transportation programs, and direct investments in your value chain.

> The key benefit of revolving funds is that they enable you to invest in initiatives that may have a high upfront cost but drive significant long-term revenue generation, cost savings, and other environmental and social benefits.

The trick is focusing on projects that generate sizeable, short-term returns and lower your operating expenses. Energy and resource productivity initiatives are a great place to start because the cost savings can quickly replenish the fund for future investment.

How to Get Started

Ready to use some of these financing mechanisms in your organization? Here are 6 steps to help you get started:

1) Establish a baseline. Calculate a baseline for carbon emissions, water use, and all other externalities you're addressing through a shadow price, carbon fee, or green revolving fund. This provides a benchmark for assessing the effectiveness of your programs over time.

2) Set clear objectives. Clearly define the goals of your shadow prices, internal carbon fee, or green revolving fund. Whether it's reducing overall carbon emissions, promoting energy efficiency, or increasing watershed resilience, having specific and measurable objectives will help guide implementation.

Be sure to involve key stakeholders, including employees, in the goal-setting process to build support for the program and encourage active participation.

3) Adopt a consistent methodology. Be transparent and consistent in how you calculate your carbon fee or shadow price, and ensure the methodology is well-communicated to all stakeholders. For green revolving funds, make sure all parties understand the terms associated with project seeding and revenue sharing.

4) Launch a pilot. Before implementing the fee or fund organization-wide, start with a pilot program. This allows you to identify and address any challenges, gather feedback, and make adjustments before scaling up.

5) Determine how to allocate capital. Decide how you'll utilize the capital generated from your financing mechanisms. Consider reinvesting the funds in sustainability initiatives, renewable energy projects, or other programs aimed at further reducing emissions.

6) Measure and monitor progress. Implement a robust monitoring and reporting system to track GHG emissions, fee collection, and progress toward sustainability goals. Regularly share this information with stakeholders to maintain transparency and accountability.

Keep in mind that your carbon fee program or green revolving fund may need adjustments over time. Stay flexible and adaptive based on changes in your organization's structure, industry standards, and technological advancements.

Thinking Forward

If you're struggling to find ways to pay for your climate transition or sustainability initiatives, you're not alone. But operationally feasible, creative financing solutions do exist, and they don't have to break the bank!

The key is to quantify environmental and social impacts in financial terms and create programs that spur innovation and incentivize sustainable behaviors.

Need help getting your climate transition plan off the ground? Earth Finance helps companies of all sizes close the gap between climate ambition and climate finance.

Get in touch