

State Fragility initiative



CASE STUDY

Harnessing capacity building to improve leverage: AECF and REACT SSA Somaliland

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What works in using blended finance to de-risk investments in distributed renewable energy in fragile and conflictaffected situations? This case study explores the experience of the Africa Enterprise Challenge Fund (AECF) and their pioneering programme, REACT Somalia and Somaliland, which has supported mini-grid development in Somalia and Somaliland.

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ABBREVIATIONS

AECF	Africa Enterprise Challenge Fund		
DFIs	Development finance institutions		
ESG	Environmental, social, and governance		
ESRES	Energy Security and Resource Efficiency in Somaliland		
FCS	Fragile and conflict-affected situations		
FGS	Federal Government of Somalia		
GNI	Gross National Income		
IFC	International Finance Corporation		
IPP	Independent power producer		
kWh	Kilowatt hour		
PV	Photovoltaic		
R&D	Research and development		
REACT SSA	Renewable Energy and Climate Technologies for sub-Saharan Africa		
SGBs	Small and growing businesses		
USD	United States dollar		

Introduction

A key barrier to progressing distributed renewable energy (DRE) in fragile and conflict-affected situations (FCS) is a lack of financing, which primarily stems from the higher risks and uncertainty of FCS, including macroeconomic instability, security concerns, and transfer and convertibility risk, among other factors. To facilitate investment into impactful DRE projects and expansion of clean energy access in fragile settings, **innovative financing mechanisms** and **de-risking tools and approaches** need to be deployed to improve the bankability and sustainability of projects.

This case study will focus on **blended finance**, which uses grants and/ or concessional funding (from, for example, bilateral donors and development finance institutions (DFIs)) to de-risk investments that have potential developmental or social impact, thereby improving the risk-return proposition for private investors and potentially crowdingin additional private finance. It brings public and private financing together to work in a joint manner, thereby harnessing private finance as an agent for the global public good in instances where private solutions alone would not suffice.¹ Blended finance has three key characteristics:

- **Leverage** the use of humanitarian or development finance and philanthropic funds to attract commercial finance into projects.
- **Impact** investments are intended to drive development, social, environmental, or humanitarian progress.
- **Returns** financial returns for private investors are in line with market expectations, based on real and perceived risks.²

Blended finance holds significant potential to crowd-in private finance to DRE projects in FCS. However, rhetoric around leveraging a relatively small amount of concessional funding to successfully mobilise a relatively large amount of private funding is not yet reflective of reality in FCS. Although progress on using blended finance to mobilise private finance in FCS has been relatively limited to date, there is an emergence of initiatives using existing and emerging financing sources and derisking tools and approaches and we anticipate gains to be made in coming years.

Learning from prior experiences on what works (and what does not work) in using blended finance to de-risk investments in DRE in FCS is essential. It is in this context that we explore the experience of the **Africa Enterprise Challenge Fund (AECF)** and their pioneering programme, **REACT Somalia and Somaliland**, which has supported minigrid development in Somalia and Somaliland.

¹ Lankes, 2021.

² NRC, 2022.

1. AECF overview

The Africa Enterprise Challenge Fund (AECF) is a development institution and the world's largest challenge fund. It is focused on **creating impact** through the provision of **patient capital to small and growing businesses (SGBs) in sub-Saharan Africa** that are not covered by traditional lenders. AECF was set up to unlock the potential of difficult settings across sub-Saharan Africa. This includes FCS where conflict, crisis, and trauma have been experienced by local communities, as well as difficulties arising from complex operational environments or transitioning economies where hyperinflation, capital controls, and lack of infrastructure constrains development progress.

AECF's approach has been to **build deep contextual understanding** of both challenges and opportunities at the local level. They see solutions for FCS requiring interventions anchored to tangible action, which necessitates understanding the trauma experienced in the unique operational context before they can devise appropriate solutions to help stimulate market development. Fragility in settings like Somaliland and Somalia brings complexities and barriers to investment that makes it more difficult for market systems to work well. AECF believe that the private sector is a key actor in unlocking opportunities and creating value in such settings, especially for vulnerable communities, allowing them to benefit from activities of SGBs and access to affordable and clean energy.

AECF's provision of finance is **bespoke** and designed to help businesses **grow through patient capital and support services**, including advisory, knowledge insights, and evidence generation. AECF's priority sectors are **renewable energy** and **agriculture**, which they see as the sectors with the greatest potential for transforming lives across Africa. Since launching in 2008, AECF has raised USD 392 million of catalytic funding, which has served 375 enterprises across 26 countries in sub-Saharan Africa, impacting over 30 million lives, and creating 27,000 direct jobs in settings most traditional financing institutions do not go.

AECF works with businesses classed as high-risk due to their locality in frontier markets, including fragile contexts and high-risk economies, where there is limited availability of mainstream financing institutions and access to commercial funding. They use a challenge fund, which is a competitive financing facility used to disburse donor funding for impactful ventures. This incorporates many blended finance principles and a number of the projects that AECF supports have successfully raised additional finance, including USD 771 million in matching funds, to date. **Table 1** outlines the three main financial instruments that AECF uses to provide catalytic funding to commercialise private sector solutions for SGBs and address different market failures.

Table 1: Main financial instruments used by AECF

Financial instrument	AECF's approach	Fragility relevance
Grants	For early-stage projects that are relatively riskier and need seed funding to test the concept, AECF funds R&D activities, pilot tests, or feasibility assessments.	This helps to de-risk the business model, adjust risk- return propositions, and improve investor confidence in the likelihood of success.
Zero-interest loans	Grants are sometimes accompanied by zero-interest loans in settings where loaning and loan recovery are permitted.	This helps drive long-term growth, build credible track records, and position for investment readiness in settings where affordable loans are difficult to come by.
Working capital facilities and guarantees	For entities that have a proven growth track record and require additional working capital.	This is important for accessing short-term capital to finance daily operations and guarantees for additional finance required for growth.

This case study will focus on **AECF's Renewable Energy and Climate Technologies Sub-Saharan Africa (REACT SSA) programme in Somalia and Somaliland (REACT SSA Somalia and Somaliland)**, drawing primarily on the example of **SolarLand Africa**, which offers practical lessons for the use of blended finance in mini-grids.³

1.1 REACT SSA Somalia and Somaliland

REACT SSA is majority funded by the Swedish International Development Agency (SIDA) and is a USD 61 million fund formed in 2021 to reduce poverty through increased access to and use of renewable energy and climate change technologies. The project operates in eight countries in sub-Saharan Africa (see **Table 2**) with four key targets:

- 1. Support 640,446 households (approx. 3,202,232 people) in rural and periurban areas to access low-cost, clean energy products and services.
- **2.** Enable an aggregate installation of 5.9 MW capacity of off-grid clean energy.
- 3. Create 996 new direct jobs.
- 4. Leverage USD 14 million in additional funding.

Table 2: REACT SSA programme summary

REACT SSA Country	Funding size (USD million)	Number of investees
Burkina Faso	6.5	12
Ethiopia	6.7	10
Kenya	6.5	19
Liberia	6.5	9
Mali	6.5	10
Mozambique	6.5	5
Somalia and Somaliland	8.5	7
Zimbabwe	6.5	8

³ SolarLand Africa, n.d.

REACT SSA Somalia and Somaliland is a key component of the REACT SSA programme and seeks to **reduce poverty through an increase in off-grid energy for households** in the Federal Government of Somalia (FGS) and Somaliland. The programme has a dual approach of promoting private sector investment as well as innovation in low-cost energy solutions with high scalability potential. There are three targets of REACT SSA Somalia and Somaliland:

- 1. Support 20,065 households (approx. 100,325 people) in rural and peri-urban areas to access low-cost, clean energy products and services.
- **2.** Enable an aggregate installation of 1.531 MW capacity of off-grid clean energy.
- 3. Create 267 new direct jobs.

AECF's awarding process consists of a publicly accessible competition with six phases:

- Applications and concept note submission,
- · Concept note shortlisting,
- Business plan and due diligence,
- Business plan shortlisting,
- Investment award, and
- Contracting and implementation.

Additional layers of consideration based on the fragility of the setting are also applied using a robust due diligence process (see **Box 1**).

Box 1: AECF's approach to due diligence in a fragile setting: Government involvement

A fundamental component of any investment is **due diligence**. In fragile settings, due dilligence follows the same principles but requires extra information to understand how potential investees navigate the complex landscapes in these contexts. AECF approaches this through their six-phased application process, however, how they run this process varies in fragile versus less fragile contexts. Notably, they have learnt that in fragile settings, such as Somaliland, the influence of government is relatively higher than in other non-fragile settings they operate in.

In settings like Kenya, AECF simply needs to obtain the relevant licences, before advertising and running a grant competition following their six-phased assessment. However, in settings like Somaliland, they need to take account of more dynamic government factors. For example, when implementing the programme in Somaliland, they engaged with the government directly from the very start to make them aware of the objectives and expected impacts of the programme. Coordination with government has been ongoing through significant stages of the programme design and implementation, including pre-notice of grant windows opening and approval of the type of companies to work with and the types of technology being financed.

In addition, the government has to be updated and briefed regularly, including at the shortlisting and due diligence stages. In these instances, AECF briefs government on progress made, such as the number of companies that have applied, technology types, and reasons behind why a company has or has not been selected. Government then has an opportunity to provide input and validation. Without these regular updates to government, the project is at risk of closure.

Initially, this can make it complex for the funder to navigate and strike a balance, however, AECF has been able to use government input and validation to help build their own capability around how best to operate in Somaliland. For example, in the first grant window round, AECF had to redo a grant window based on feedback from the government which raised the need to have a stronger regional spread of organisations in order to more fairly share the benefits of the programme. Government advice included the need for wider advertising across regions and undertaking workshops and other efforts to help sensitise a wider range of organisations across regions about the grant window. This was a contextual learning for AECF and demonstrated the value of government input in helping navigate the local context.

AECF and the government have regular conversations around how much government involvement in the programme is healthy as AECF seeks to avoid bias and ensure quality due dilligence without too much government validation. AECF has clear boundaries against allowing any compromise in quality or impact metrics and where there is disagreement around an AECF decision, AECF has an open discussion with government to explain what improvements and conditions are needed at a project level to raise the prospects of project success. AECF makes a deliberate effort to have strong relationships across all levels of government and involved partners, including Ministers, technocrats, and donors, which allows them to report any situation of over-validation or pressure that may take place.

Additionally, the government sees the direct relationship with AECF as a useful mechanism to inform their own learnings of how to shape the enabling environment and encourage other funders to enter the energy sector in Somaliland.

AECF had to consider the unique relationship between Somalia and Somaliland to be able to offer a productive programme for both settings that takes account of their political dynamics. Specifically, Somaliland is not recognised as a sovereign state and is still considered by the international community to be part of Somalia. Understanding this geopolitical situation has been fundamental for AECF to successfully enable REACT SSA Somalia and Somaliland to operate effectively and create impact in the region.

Building strong in-country relationships in both Somaliland and Somalia was key to this – this enabled AECF to keep abreast with the dynamic political situations in both regions and to keep conversations ongoing around the ambitions and impact of REACT SSA and how the enabling environment could be improved at a policy level. In practice, AECF essentially had to operate REACT SSA as two separate programmes to take account of local politics and allow each government to have a direct relationship with AECF based on their associated programme. This case study focuses primarily on **Somaliland** but considers and reflects on elements of the Somalia programme too.

The REACT SSA Somalia and Somaliland programme has successfully closed two calls for applications, where qualifying companies received

between USD 100,000 and USD 1.5 million in grants, which were awarded upon the achievement of mutually agreed milestones. To date, ACEF has awarded a total of USD 2.5 million across seven successful companies in Somalia and Somaliland.

2. Energy access in Somaliland

Energy access rates in Somaliland are low, estimated at 15%.⁴ There is significant variation across urban and rural areas, with urban energy access estimated at 33% and rural access at only 4% in 2018.⁵ This equates to approximately 1.7 million unelectrified households nationwide, with an average household size of 5.9 people.

Imported diesel fuel is the primary resource used to generate electricity in Somaliland. It is estimated that companies collectively burn 90,000-100,000 litres of diesel fuel every day, which has improved slightly through hybridisation with solar in recent years with the support of collaborative programmes such as the Energy Security and Resource Efficiency in Somaliland (ESRES) programme (see **Box 2**).⁶

Box 2: ESRES programme: How hybridisation helped improve the energy mix in Somaliland

The ESRES programme is funded by the United Kingdom's FCDO and was designed and implemented to support Somaliland in diversifying its energy mix, enhancing resiliance, and facilitating development of an enabling institutional and regulatory environment for increased access to more affordable and reliable renewable energy services.

The primary source of electricity generation in Somaliland comes from imported diesel, which results in high costs and inefficiencies, leaving many households who have a mini-grid powerline near them still without electricity access. Solar energy offers an alternative solution. Solar is abundant in Somaliland and is becoming increasingly recognised as an option for rural communities, individual businesses, and service provision facilities. Horizontal solar energy is at least 200 W/m² over most of the Somali region, equalling roughly 200 kW/km², getting on average 2,900 to 3,100 hours of sunlight per year. It has one of the highest daily averages of total solar irradiation in the world, with a yearly average for Hargeisa at 6.4 kWh/m²/day and an average yearly temperature in the country of 27°C, which is a favourable temperature to permit operation of solar PV systems.

⁴ Government of Somaliland, 2018.

⁵ Ibid.

⁶ Mott Macdonald, n.d.

The ESRES programme aimed to capture this potential and support a transition from diesel-based generation to solar. This was done through two phases:

- **Phase 1** focused on creating hybrid diesel and solar PV mini-grids. It also launched the Somaliland Renewable Energy Fund, which aims to reduce private operators' financial risk during the construction and start-up phases of renewable power projects. This was done through conditional grants distributed among six private operators, who in turn had to commit to lowering their retail price to customers. An important component of the delivery of Phase 1 was the creation of a local-global partnership (i.e., linking local operators with international engineers, etc), which helped the operators to move swiftly through project delivery to operations and earning revenue.
- **Phase 2** built on the success and learnings of Phase 1 and expanded the programme to support three larger operators to achieve the same objectives, which provided higher levels of renewable energy at a lower price per kWh.

The ESRES programme made a significant contribution to advancing energy access and improving the energy mix in Somaliland. As a result, renewables as a share in Somaliland's energy mix increased from 1% to 15%, saving approximately 9000t CO_2 annually due to reduced usage of diesel generators. The programme also brought electricity to remote communities, improving access, reliability, and affordability, and connecting 85,000 households and small businesses and reducing the cost by more than one-third to \$0.65/kWh.

The electricity in Somaliland is generated largely by independent power producers (IPPs) operating through diesel-based mini-grids with an average of 500 kVa to 5,000 kVa installed capacity per mini-grid. Private sector players supply more than 90% of power in urban and peri-urban areas. Although these arrangements require limited infrastructure investment, they tend to struggle with high running costs as operations and maintenance are costly for diesel generators. Additionally, many families in Somaliland earn less than USD 2 a day⁷, resulting in affordability barriers to energy access, especially considering that Somaliland's electricity tariffs are among the highest globally at approximately USD 1.00 to USD 1.40 per kWh.⁸ Somaliland is ranked in the upper 5% globally for power costs and in the upper 15% globally for power expenditure as a share of GNI per household, resulting in low levels of access despite many households living near mini-grid power lines.⁹ High electricity costs also restrict business and development progress more widely.

There are over 20 major IPPs operating in Somaliland, which are well established as the primary source of electricity provision in their given communities.¹⁰ They have been responsible for the generation and distribution of electricity and for developing the electricity infrastructure in their communities since Somaliland's declaration of independence in 1991. They have fully vertically integrated systems and build and

9 RISE, n.d.

⁷ Central Department of Statistics, 2019.

⁸ Somaliland Energy Regulatory Commission, n.d.

¹⁰ Embassy of Republic of Somaliland, n.d.

maintain the infrastructure to generate, transmit, and distribute electricity in the areas in which they operate. It is also important to note that these IPPs consist of both dedicated IPPs selling electricity as the core part of their business model, as well as others that require electricity generation for their own business activities and sell excess electricity to nearby customers to supplement their own income and recoup costs. In recent years, IPPs have begun merging to form larger companies to avoid duplication and inefficiencies and to position themselves for better access to finance opportunities (see **Box 3**).

Box 3: How mergers can lead to better access to finance in Somaliland

The trend in IPPs merging in Somaliland, especially in Somaliland's capital Hargeisa, has been fundamental from the IPP's perspective to avoid duplication and inefficiencies. However, there is another key reason this trend of mergers is taking place: larger players have utilised this opportunity to pursue funding outside of Somaliland, which is an endeavour considerably more difficult for smaller players.

IPP mergers provide confidence to external funders based on three key signals:

- competitive advantage,
- operational capacity to deliver and serve the wider geography, and
- increased know-how to improve productivity.

Although this approach may not be standard across other settings, the lack of access to finance in Somaliland has meant merging IPPs to put forward a more compelling pitch to funders in order to access resources is very pragmatic, particularly where individual IPPs would not be able to surmount access to finance barriers themselves.

The main authority for energy access and coordination is the Ministry of Energy and Minerals, which is responsible for developing and implementing policies related to both renewables and non-renewables, as well as extractives, including minerals and hydrocarbons. This is guided by the Somaliland Power Master Plan, which is funded through the World Bank and focuses on the introduction and establishment of modern, cost-effective, reliable electricity supply systems over a 20-year planning period.¹¹ The Ministry of Energy and Minerals works in close coordination with the Ministry of National Planning and the Ministry of Finance. At the regulatory level, the Somaliland Energy Regulatory Commission is the body responsible for regulating and managing the development and utilisation of energy resources in Somaliland, as well as providing the legal and regulatory framework for all providers of energy in the country. This includes granting licenses for the generation, distribution, transmission, and sales of electricity.

¹¹ Ministry of Energy and Minerals, n.d.

The Somaliland government relies extensively on consultants, which undermines capacity development and longer-term institutional and sectoral knowledge and expertise. As a result, data and information collection is intermittent, making the relationship with AECF very important for government to build up the stock of knowledge on Somaliland's energy situation to inform government decision-making. By working with energy developers in communities that are being reached for the first time, AECF is able to generate new data and information about previously unconnected areas, which they share with government in the form of inception reports or feasibility studies, giving government a good source of data and credible insights into the energy situation at local levels.

The high turnover of political appointees in the Somaliland government has been a major risk for AECF. Since the start of the REACT SSA Somaliland programme, AECF has had three different Director Generals and two different Ministers as their key government counterparts. Therefore, they have to ensure that the relationships AECF holds with government are at an **institutional level** and not based only on individual decision-makers, or there is a risk they would have to restart dialogue with government repeatedly. As a result, AECF signs a Memorandum of Understanding and a Non-Disclosure Agreement with relevant line ministries clearly defining the scope of their working relationship on items such as data sharing, sector inputs, conflicts of interest, and issues around confidentiality.

3. SolarLand Africa: AECF grant as leverage

Off-grid solar remains the primary driver of impact within the REACT SSA Somalia and Somaliland programme, accounting for 62% of households reached. In Somaliland, off-grid solar home systems and mini-grid systems are now the least-cost option for rapidly deploying affordable 'first' electricity access to underserved off-grid customers. One of the first investee companies that AECF invested in through REACT SSA Somalia and Somaliland programme is **SolarLand Africa Innovative Energy Solutions**, who are spearheading solutions to progress reliable and affordable renewables in Somaliland.¹² SolarLand Africa is a 100% women-owned company, and it provides engineering, procurement, and construction of solar hybrid solutions and electricity sales.

In 2021, SolarLand Africa won the AECF challenge fund and was awarded a USD 728,000 grant. The funding was used to expand their micro-grid solution in Hargeisa to generate and distribute affordable and reliable power across seven villages with a cumulative capacity installed of 303.6 kWp. The expected outcomes of the project were to provide 709 households with access to new renewable energy, create 42 direct

¹² SolarLand Africa, n.d.

jobs (50% of which were allocated to women), enable a net benefit per household of USD 173, and avoid 1,085t CO_2 per year.

SolarLand Africa had already led several successful mini-grid projects in Somaliland and Somalia since 2013, making clean energy available to homeowners, businesses, farmers, and industries at affordable prices. They approached the AECF challenge fund with a credible team that understood the local context and had the necessary technical knowhow about what would be required for the project to be successful. In addition, they were able to successfully model the project and associated risks and define clear scope for the grant funding to be productive in advancing the project in terms of commercial derisking. This allowed the team to approach other financiers to leverage additional finance for the project. Impact was also modelled and quantified into the project, allowing the different stakeholders involved to get a measurable benchmark, and milestones were agreed to measure the project's impact achievements across (i) energy access, (ii) job creation, (iii) electricity affordability, and (iv) CO₂ emissions avoided.

In many developing countries, including fragile settings like Somaliland, the trends show that mini-grids struggle to be commercially viable and require subsidies to provide electricity to rural and poor population groups (SolarLand Africa has a target price point of USD 0.5 per kWh). This is especially the case in Somaliland, where income levels are notably low, yet it suffers from some of the most expensive electricity tariff rates globally. Without subsidies, it is difficult to serve these target populations and, typically, companies will instead focus on less risky consumers to raise their chances of becoming profitable, with the result that the most vulnerable often remain without energy access.

SolarLand Africa has an ambition to serve vulnerable and hard-to-reach communities, and this led them to see the AECF grant as catalytic to enable the project to be kickstarted and to achieve financial returns. Specifically, the **AECF grant allowed the tariff to be lowered** and enabled the project to be modelled in a way that both generates returns and provides confidence to other providers of capital.

Using the grant to de-risk the project positioned SolarLand Africa to leverage additional finance. The AECF grant was vital to kickstart the project – without it, SolarLand Africa would have needed to find other forms of concessional capital to subsidise the electricity provision and improve affordability for the intended consumers. The AECF grant included a matching condition, however: SolarLand Africa had to contribute a 40% equivalent as a condition to receive the grant, which meant they needed to create leverage immediately in order to fulfill the matching condition of the grant. The match funds could come from shareholders' equity or another form of finance such as loans or assets. SolarLand Africa did this through a combination of shareholder equity and bank loans, which allowed them to fulfill the matching condition and fully fund the project. This arrangement also achieved additional risk-sharing between AECF and SolarLand Africa. This is a great example of blended finance working in practice and the project clearly meets the characteristics of blended finance, namely:

- **Impact** the project had notable development impact potential that could be measured and quantified.
- **Returns** the grant allowed for de-risking, which improved the commercial feasibility of the project.
- **Leverage** the grant provided SolarLand Africa with a mechanism to leverage private finance through the form of bank loans. More on leverage is outlined in **Box 4**.

Box 4: SolarLand Africa investment readiness and leverage through project phases

The SolarLand Africa project funded with AECF is part of a bigger project that had already completed an initial pilot. The pilot electrified one village (Phase 1), the AECF funding supported the electrification of seven villages (Phase 2), and the fully-scaled project aims to cover 20 to 30 villages in Somaliland (Phase 3).

There was a dual purpose to the leverage component of the AECF grant:

- To mobilise additional funding to fully finance Phase 2 through grants, loans and equity.
- To successfully position SolarLand Africa to improve their likelihood of raising further funding for Phase 3 of the project (beyond the AECF grant).

The AECF grant enabled SolarLand Africa to further prove their concept and build data and knowledge to raise the financing potential and feasibility of Phase 3 effectively. This type of leverage links directly with technical assistance and investment readiness.

It also allowed AECF to better understand the scale and types of finance that may be needed for Phase 3 and how they can provide support for SolarLand Africa through introductions within their network. It became clear, for example, that the funding for Phase 3 would need to have a pure debt component, be patient capital, and be tailored to the design of the project (which has a high initial capital expenditure with revenue payments coming further down the line from connections over approximately 15-20 years).

AECF's investment facilitation department played an important role in building the investment readiness of SolarLand Africa, ensuring they had the correct documents ready (e.g., pitch deck, financial model, policy development proposals, etc), and providing technical assistance to prepare them to withstand the level of scrutiny required to access the next phase of financing, including ESG and technical advisory support.

The leverage indicator is therefore measured both in terms of the grant enabling the project to secure further financing for Phase 2 and also through SolarLand Africa's increased capability to pass the due diligence requirements of investors and obtain the financing needed for scaling the project (Phase 3), with this second type of leverage potentially being even greater in scale.

4. Environmental, social, and corporate governance considerations

AECF has aligned themselves to globally accepted environmental, social, and governance (ESG) standards, anchored primarily by the World Bank and IFC's Environmental, Health, and Safety standards.¹³ National-level ESG laws and regulations usually develop in alignment with these international standards. In the non-fragile settings that AECF operates in, such as Kenya, systems are in place to enforce ESG standards and AECF can work directly within these existing structures and relatively minimal capacity building on projects is needed. However, this is not the situation in more fragile contexts.

ESG standards in Somaliland are still at early stages of development. This is common in FCS where national-level regulatory, compliance, and accountability systems are often absent or very undeveloped and compliance with international standards is rare. Where energy access is as low as it is in Somaliland, expanding connection often takes precedence over adhering to ESG standards, with both government and energy developers giving relatively little attention to ESG standards.

AECF considers adherence to ESG standards as being at the centre of risk management, despite its complexities in fragile settings. They emphasise the importance of complying with international ESG standards when speaking to new entrants, existing developers, and government. They address ESG from a **behavioural change and capacity building perspective**, recognising that adopting new approaches takes time in fragile settings and that people and institutions may resist change. They see their role as a funder to **set the example** and, through their own work, ensure that the ESG standards they set for the developers they fund are met. Through a bottom-up approach, they hope to support national policy development efforts over time.

Throughout the application stage and onboarding of a project, AECF considers ESG standards and utilises several tools to understand the ESG-related risks of a project and they work with grantees to ensure mitigation measures are developed and put in place. The concept note (for initial screening) includes a self-assessment evaluation that grant applicants need to complete. Grant applicants must check that the project does not fall into any categories on the AECF 'exclusion list', which outlines projects that AECF cannot support due to their potential to violate ESG standards, including projects that support terrorist organisations, have humanitarian consequences, or significantly interfere with the quality of the natural environment.

A project-specific assessment is then done to gauge the project against applicable ESG standards (beyond the grant applicant's self-reported evaluation). AECF makes it a deliberate practice to conduct this projectlevel assessment *with* the grant applicant to ensure ownership and buy-

¹³ World Bank, 2017; IFC, 2007.

in over findings and solutions. The level of involvement that this projectspecific assessment necessitates varies depending on the project and level of sensitisation needed for behaviour change.

The project-specific assessment covers the AECF's ten ESG standards (see **Box 5**) and ensures that the grant applicant understands what they are and what they require. It then explores the specific ESG risks that the developer has identified and the mitigation measures or interventions the developer has proposed. AECF's approach is to educate applicants that the identification of many risks does not necessarily mean a project is a 'bad project' (which is often assumed). Rather, emphasis is placed on **developing robust mitigation measures** for the risks identified to enable better implementation of ESG standards. AECF has found that when project developers can see the benefit of adhering to ESG standards (compliance with which can sometimes take a while to be realised), it supports long-lasting behavioural change and can create wider influence across the sector to other developers.

Box 5: AECF's ten ESG standards

- **1.** Assessment and management of environmental and social risks and impacts.
- 2. Labour and working conditions.
- 3. Resource efficiency and pollution prevention.
- 4. Community health, safety and security.
- 5. Land acquisition and involuntary resettlement.
- **6.** Biodiversity conservation and sustainable management of living natural resources.
- 7. Indigenous peoples.
- 8. Cultural heritage.
- 9. Gender equality and women's economic empowerment.
- **10.** Access and equity and protection of human rights.

Once this project level risk assessment is done, the developer (with the support of AECF) puts together an environmental and social management plan, which is a risk management plan that has a mitigation strategy for each of the risks identified. This is the central action plan that is used to monitor and mitigate the risks along all ESG standards and is implemented directly by the grantee as part of their grant conditions (i.e., it is a contractual requirement). Regular reporting on ESG risks is required and disbursements of funding are tied to compliance with agreed ESG standards. Additionally, the developer is also encouraged to appoint an ESG Champion to act as its main ESG focal point. Compliance with ESG standards that AECF applies to their portfolio in Somaliland is an important form of capacity building for grantees. It helps them to understand the importance of complying with ESG standards and how compliance can be measured and accounted for in practice. It also creates a capacity building opportunity for government officials that visit project sites and who are, ultimately, responsible for the development of an enabling environment that upholds ESG standards.

Conclusion

AECF and their development of blended finance models to fund solar mini-grids in fragile settings have important lessons for other initiatives active in (or considering becoming active in) these environments. These lessons include:

- 1. Approach compliance with ESG standards as behavioural change. Developers must be sensitised to the importance and benefits of complying with ESG standards and the value of continual, long-term identification of ESG risks and development of effective mitigation measures. Joint assessment by funders and developers of projectspecific risks and proposed mitigation measures is an effective way to facilitate developers' buy in to ESG compliance, which will translate into superior outcomes over the long-term. Peer-to-peer learning on ESG may also be valuable for energy developers.
- 2. Support bottom-up development of an enabling environment that upholds ESG standards. Learnings from projects funded by AECF and other funders who require adherence to ESG standards can create, over time, bottom-up strengthening of ESG standards in the local policy environment. In fragile settings where enforcement is scarce, funders with clear ESG requirements help significantly with monitoring and enforcement. Through this, they could influence governments' policymaking in this space. Additionally, developers and funders that share data, insights and learnings with government can contribute to government having a better understanding of the situation and dynamics in different local communities, which may be difficult for government to do themselves in fragile contexts.
- 3. Utilise capacity building to improve leverage. AECF measures leverage in two ways: first, based on how much additional finance is mobilised for a particular project as a result of the grant (or concessional financing) provided by the funders, sometimes captured as a matching condition (as in AECF's grants). Second, they also see leverage as including making investees more investment ready and to position them to secure financing for later phases of a project (beyond the phase where the initial funder is involved). The latter of these involves important capacity building and is an integral part of grant programmes to enable grantees to be better equipped to leverage additional finance.

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