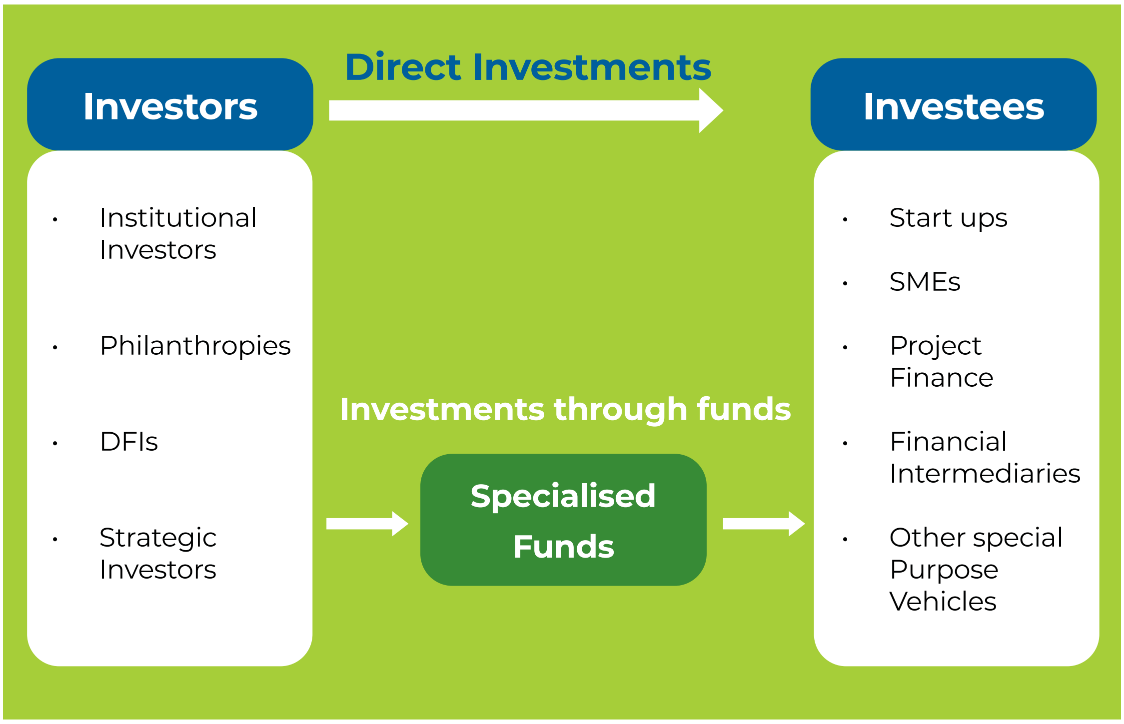
The challenges associated with investments in renewable projects include currency risks, high up-front costs, and under-developed markets in developing countries. The rationale for concessional equity investments is to fill the gap in underserved markets in developing countries. But due to the new and risky nature of such investments, the returns may be lower. On the other hand, equity investments can also allow the bank to earn high rates of interest through investments in proven technologies and established markets. Thus, a balanced approach to equity investments can help fulfil the mandate of maximising developmental impact while earning a commercial rate of return. Equity investments also have a higher demonstration effect as it encourages further investments by other players.

The Solar Finance Corporation that is being proposed in this report will have to develop a balanced portfolio with some speculative projects with steep returns that will offset more traditional projects with well-defined returns. The International Finance Corporation's (IFC) proven returns shows that it is possible to achieve both these objectives: the IFC has obtained 15 percent returns over the last 20 years in markets where it was a first-time investor.[9] The positive returns can then be used to provide concessional loan products to LDCs and developing countries.

Equity investments can be made directly or indirectly through specialised funds (See Figure 4). Direct equity investments can help the SFC to establish its local presence and exert more direct governance over the workings of the company. At the same time, investing in first-time funds can be useful in developing the expertise of fund managers in new markets. This is one area where existing DFIs have a lower emphasis and something that the proposed Solar Finance Corporation can seek to develop.

Figure 4. Equity Finance (Direct and Indirect)



Source: Authors' own, using data from various sources

Investing in established funds can also be useful to enter a market where the SFC has little experience or presence and it can then use this experience to invest more directly in the future. A study highlights that when investing in established funds, it is important to understand the investing strategy being followed by these funds.[10] This is especially important when the objective is to support new and risky technologies. Thus, the SFC's investment approach should consider these historical biases or directions when selecting financial instruments.