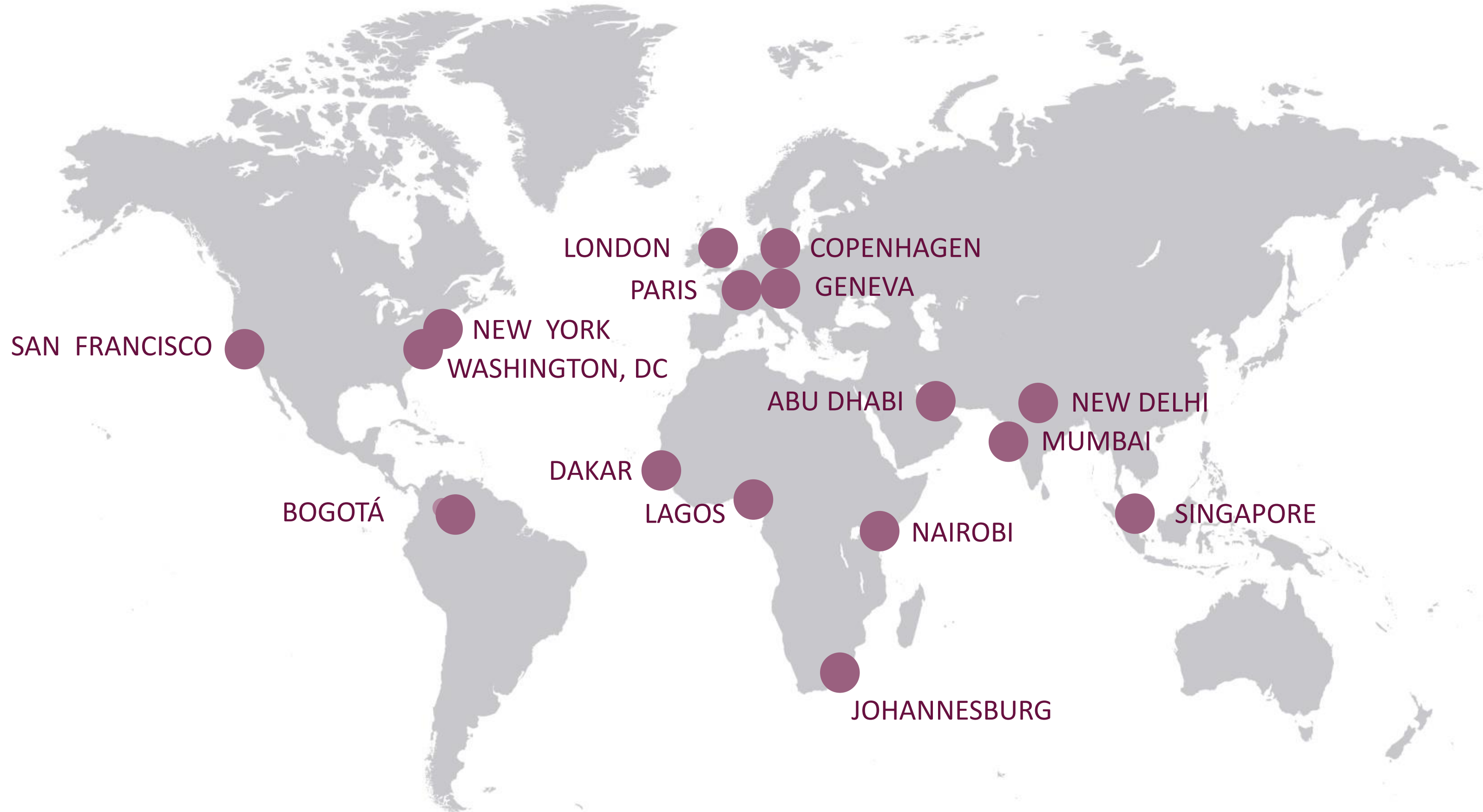
Increasing MSME Access to Climate Finance

February 2016, Vienna

Dalberg



Key facts:

- Founded in 2001.
- 300 consultants in 16 offices.
- Mission: To mobilize effective responses to the world's most pressing issues.
- Practices covering the key sectors of economic development.
- Three main client categories: Development agencies, foundations and private sector companies.

Agenda

Importance of MSMEs in climate strategies

Barriers to climate finance access by MSMEs

Existing solutions

Implication for climate programs

Greening MSMEs must be an essential component of climate strategies in developing countries

Quick refresher of the standard definition:

MSME meet two of three criteria:

Category	Employee	Assets	Annual Sales
Medium	50 - 300	$3M – $15M	$3M – $15M
Small	10 < 50	$100K < $3M	$100K < $3M
Micro	< 10	< $100K	< $100K

In developing countries, MSMEs contribute:

90%
of companies

80%
of employment

60%
of GDP

Sources: Two trillion and counting: Assessing the credit gap for micro, small, and medium-size enterprises in the developing world, Edinburgh Group; The SME Banking Knowledge Guide, IFC

The involvement of MSMEs in climate programs can be considered under three angles

Customers of product/services for mitigation and adaptation	**Providers** of tech. / services for mitigation and adaptation	**Voices** embedding awareness
e.g., Upgrading boilers in small textile firms in Maharashtra	e.g., Low cost efficient irrigation systems	Building broad awareness around tangible examples

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Three dimensions considered when reviewing barriers to climate finance access by MSMEs

Three stakeholder groups

Investors

↕

Local intermediaries

↕

MSMEs

Three types of hurdles

Enabling environment

- *Access to financial products limited by misaligned or poorly enforced policies*

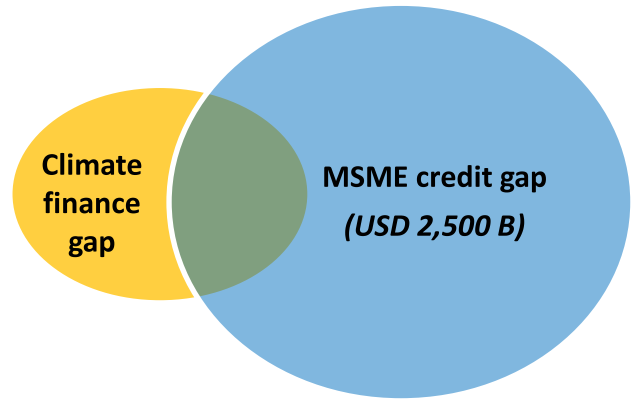
Knowledge and awareness

- Lack of awareness of the options available

Financing Instruments and process

- The amount and type of financial instruments are not aligned with MSME needs

MSME finance vs. climate finance



Barriers can be clustered in 9 groups

	Enabling environment	***Knowledge and awareness***	***Financing Instruments and process***
Investors	• Lack of visibility on climate policies undermine investment attractivity	• Lack of documented track record on the benefits of climate investments	• High risks associated with new and unproven technologies
Local intermediaries	• Financial regulations limit the ability of intermediaries to provide long-term capital needed for green MSME investments	• Limited technical expertise of intermediaries makes it difficult to effectively assess and evaluate MSME green opportunities	• Onerous investor reporting requirements limits the demand for financing from intermediaries
MSMEs	• Existing fossil-fuel subsidies limit the attractiveness of investing in green technologies	• Limited knowledge of the benefits of green investments results in a low demand for investments from MSMEs, and limited technical capacity means it is difficult for MSMEs to apply for, and report on, green investments	• Small size of MSMEs means that energy efficiency savings take a long time to accrue, which restricts MSMEs to taking on long-term financing only which is limited in availability

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Why MSMEs matter to climate strategies

Barriers to MSME access to climate finance

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Enabling environment: selected solutions and current initiatives

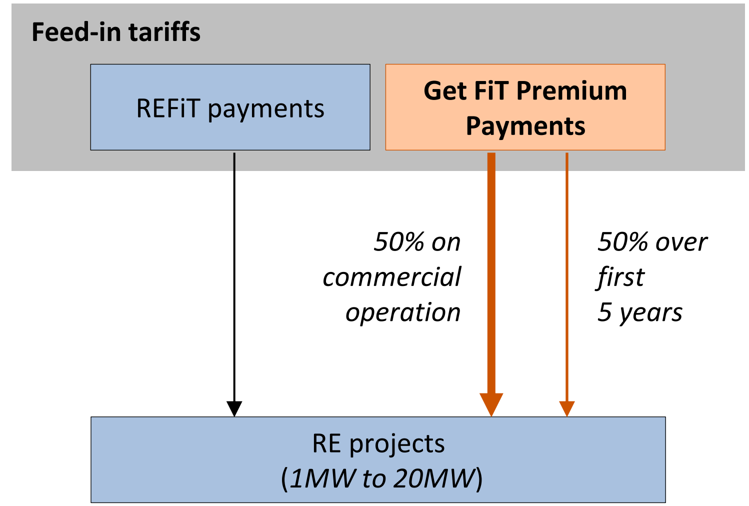
Stakeholder	Barrier	Solution	Examples
Investors	Weak financial infrastructure and political instability	-	-
		-	-
	Weak climate policies and strategies	Develop national climate change policies	*Ethiopia's Climate Resilient-Green Economy*
		Incentivise green investments	*Green Funds Scheme, Netherlands*
Intermediaries	Weak financial infrastructure and legal and regulatory frameworks	Adjust investment regulations	*SME Development Framework, Malaysia*
		Improve insolvency frameworks	*Insolvency reforms, Europe*
		Develop pro-MSME lending policies	*Priority Sector Lending, India*
	Lack of policies that support green investments	Develop pro-green lending policies	*Framework Act on Low Carbon, Green Growth , Republic of Korea*
MSMEs	Limiting international trade laws and weak legal frameworks	Promote free trade in green goods and services	*Asia-Pacific Economic Cooperation policy on green free trade*
		Create national standards for green goods and services	*IFC/World Bank's Lighting Africa initiative*
	Counterproductive subsidies and weak market incentives	End counterproductive subsidies and incentives	*Reform of fuel subsidies, Ghana*
		Create green incentives for MSMEs	*GET FiT, Uganda*

Solutions to increase MSME access to climate finance
GET FiT, Uganda

The objective of GET FiT is to leverage private investment into renewable energy (RE) generation projects in Uganda. It aims to close the gap between the current RE feed in tariffs (REFiT) and the financial incentives needed by investors, through a results-based payment that tops up Uganda's REFiT and is front-loaded to the first 5 years of operation. The GET Fit portfolio has supported 17 projects to date, which produce 128 MW of renewable energy.

Assessment

	Key factors	Description
GCF criteria	**Leverage**	Achieved a 1:5 leverage ratio
	Country-driven approach	Joint development between the Government of Uganda, Uganda's Electricity Regulatory Authority and KfW
	Climate impact	Anticipated emissions reductions of 11 Mt CO_2 over the 20-year lifespan of the program
Other	**Scale**	Operational in Uganda, but plans to expand across East Africa
	Sustainability	Fully funded by a single donor



The GET FIT Premium Payment Mechanism provides additional cash flow to project owners in the early phase of debt repayment

Key successes and challenges

Key successes

- The program has catalysed over USD 400 M of investments

Key challenges

- It has been difficult to integrate small renewables into the existing grid infrastructure , and legal and regulatory barriers (tax reforms and cross-border issues) have prevented projects reaching financial close

Source: GET FiT Uganda Annual Report 2014

Awareness and technical assistance: selected solutions and current initiatives

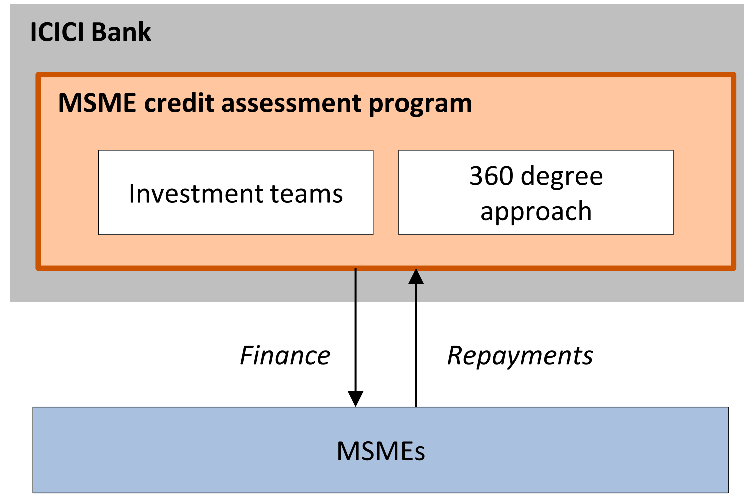
Information flow	Barrier	Solution	Examples
Investors	Lack of effective communication channels	**Match-making platforms** between climate investors and intermediaries, and between intermediaries and MSMEs looking for climate finance	*REEEP Investment Accelerator, REEP*
	Lack of capacity to access and evaluate opportunities		*Switch-Asia Network Facility, Switch-Asia Programme*
Intermediaries			*IFC info DEV Climate Technology Program, Middle East and North Africa*
	Lack of effective communication channels	**Technical assistance** and capacity building for intermediaries and MSMEs	*IDB Ecomicro Program, Latin America*
MSMEs	Lack of capacity to access and evaluate opportunities		*Small Enterprise Assistance Fund Business Assistance Program*

Financing: selected solutions and current initiatives

Interaction	Barrier	Solution		Examples
Investors	Funding is difficult for intermediaries to access	**Earmarked funding for MSME climate investments**		*IFC / GEF Small and Medium Scale Enterprise Program*
		Simplified application criteria		*European DFIs (multiple)*
	High cost and risk of lending to MSMEs	**Risk / cost sharing mechanisms for intermediaries**	Provision of concessional finance / grants	*Pilot Program for Climate Resilience*
			First loss investments	*Regional MSME Investment Fund for Sub-Saharan Africa (RegiMIFA)*
Intermediaries			Guarantees	*European Investment Fund SME Initiative*
		Build MSME networks / aggregation points		*Nexus Carbon Finance, South-East Asia*
	Financing is difficult for MSMEs to access	**Use alternative collateral sources or methods to assess credit worthiness**		*ICICI Bank MSME program, India*
	Sub-optimal product design	**Provide tailored MSME financing products**	Products tailored for different stages of the MSME life cycle	*Shell Foundation / OPEC responsibility Working Capital Energy Fund*
MSMEs			Product or sector specific products	*The Global Innovation Lab for Climate Finance Energy Savings Insurance Program, Mexico (pilot)*

ICICI Bank MSME program, India

The ICICI Bank MSME program provides nontraditional financial services to MSMEs. To evaluate credit risk, the program uses market segmentation and a “360 degree” approach. Credit scorecards (based on industries, linkages or market segments), SME value analyses, relationship manager site visits and personal references are used to evaluate the credit worthiness of each MSME. ICICI has an MSME client base of almost 1 million enterprises.



The ICICI Bank MSME program uses alternative sources to evaluate credit worthiness of MSMEs and provides nontraditional services

Assessment

	Key factors	Description
GCF criteria	**Leverage**	Unavailable
	Country-driven approach	Local approach for local markets, but limited government involvement
	Climate impact	Does not specifically target climate change
Other	**Scale**	National level, and serves 1 million SMEs
	Sustainability	Self-sustaining

Key successes and challenges

Key successes

- The relaunch of the SME strategy in 2003 tripled the banks overall SME loan portfolio and its revenues

Key challenges

- MSMEs borrow at low rates, so a high volume of MSME loans are required to make the strategy profitable

Sources: International Finance Corporation: The SME Banking Knowledge Guide; Central Bank of Egypt: Financing Small and Medium Enterprises – the Indian experience

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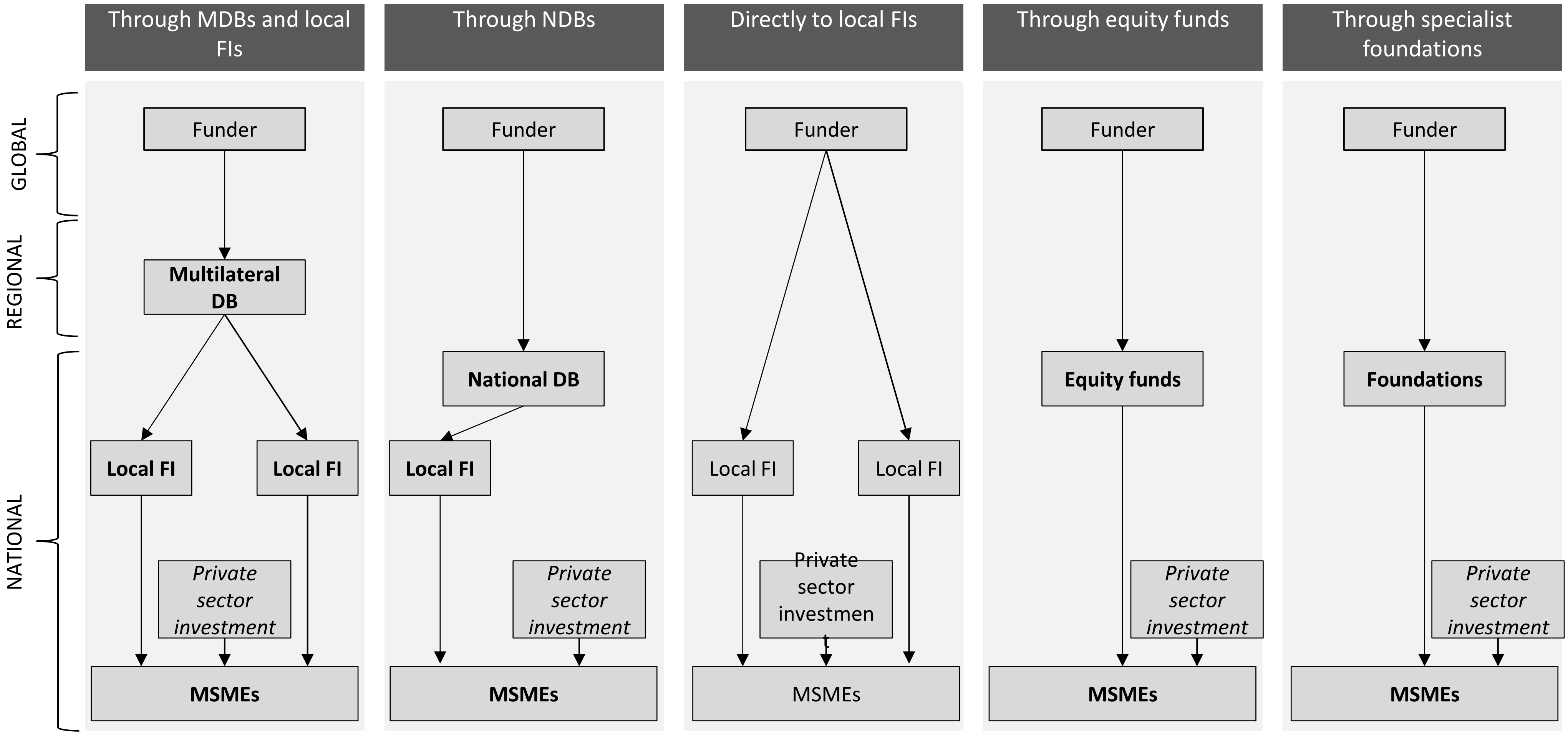
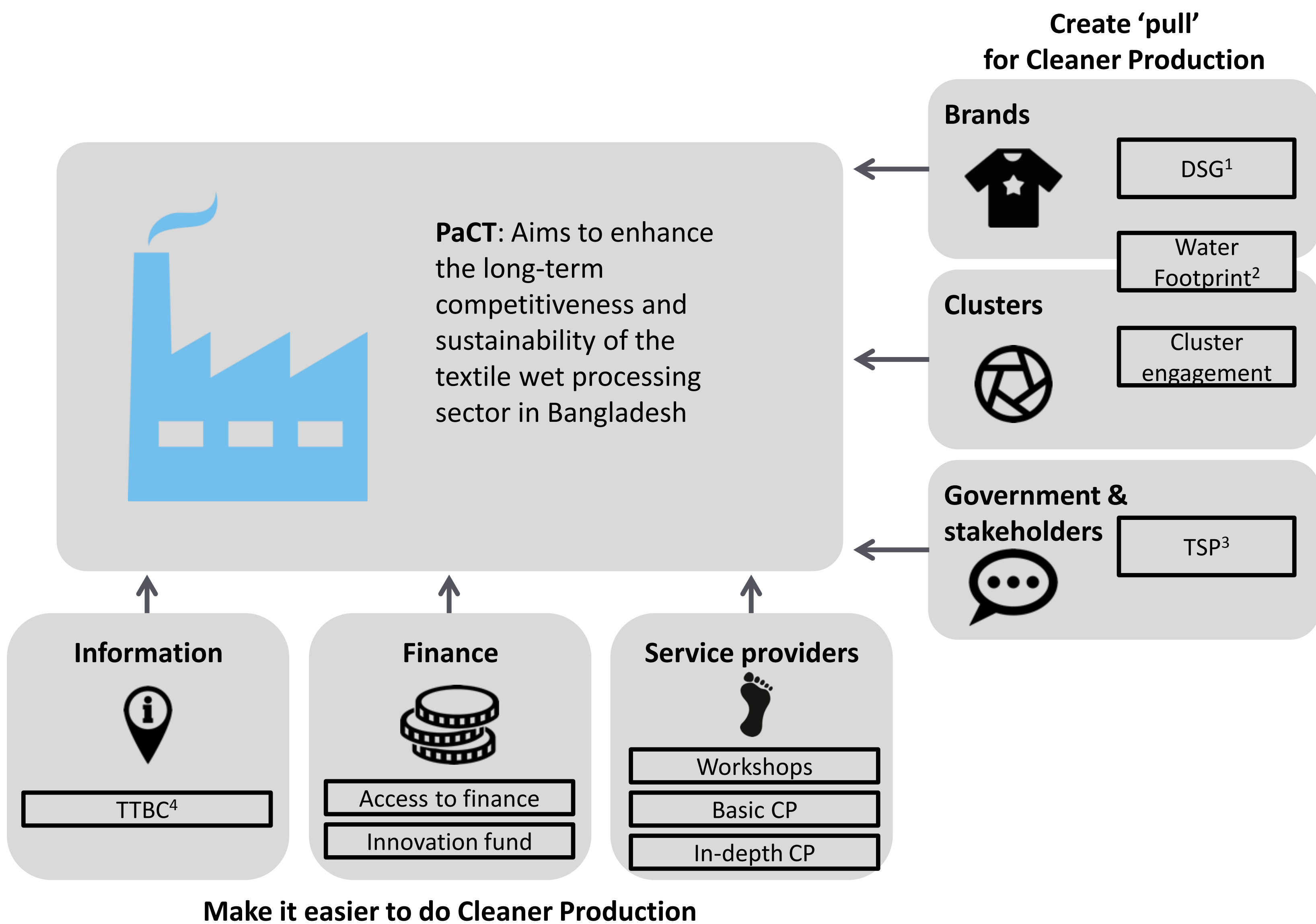
The lead climate funders are adopting a range of approaches to channel funds to MSMEs



Funding typically combined with TA, e.g. EBRD SEFF

Another option: embed MSME efforts in sector transformation programs

Example of PaCT, Bangladesh



Note: (1) Decision Support Guidance; (2) Water footprint accounting for brands, water footprint assessment at cluster level; (3) Textile Sustainability Platform; (4) Textile Technology Business Center. Source: PaCT, Dalberg

In summary

- Micro, small and medium-sized enterprises (MSMEs) have an important role to play in climate action as they account for 80% of the jobs in developing countries.
- The challenges of access to climate finance come on top of an existing access to MSME finance; MSMEs requires an engagement at multiple levels - enabling environment; knowledge and awareness of MSME climate finance opportunities; and tailored financial products.
- Solutions exist for each identified barriers, and the challenge is about how to package them into programs that work
- Funders can consider two modes of engagement: comprehensive financing programs are currently the most common approach; sector transformation programs which could offer interesting opportunities to engage private sector players

Thank you!