Financing Local Green Enterprises

Thematic Session Note

6 February 2020

Context

India has accepted its role as a frontrunner in achieving the 2030 Agenda for Sustainable Development. One set of institutions that can help achieve this transformation are green Micro and Small Enterprises (MSEs). In India, as per the Federation of Indian Chamber of Commerce and Industry (FICCI), there are around 63 million MSMEs that employ around 111 million people and contribute to 28.77% to the GDP. (MoMSME[1], 2017) These are expected to grow at 10% per annum, significantly contributing to employment generation while delivering multiplier effects on economic resilience and social well-being.

India, over the last decade, has witnessed the development of inclusive and green business models that which have not only successfully reinforced the triple bottom line, but also demonstrated their business potential. **However, these businesses, especially green MSEs, are inhibited in their set up and scale up owing to the lack of readily available finance.**

Framing Local Green Enterprises

Environmentally conscious MSEs, or what we call 'Local Green Enterprises' (LGEs), are those that build their business models on the principles of resource conservation, resource efficiency and waste management from the environmental end; while also creating decent jobs, enabling availability of products and services, and thus boosting the local economy. These LGEs are critical enablers of green and inclusive economy at the grassroots.

Green is not a very well defined attribute in the country. For the purpose of discussion, some of the examples from LGEs are, but not restricted to, the following:

- In the agricultural sector: farmer based collectives and producer group companies, which are building their agri-based business models on the principles of environmental sustainability
- In the construction sector: local enterprises focused on alternatives to highly resource and carbon intensive materials (like red bricks) – such as fly ash, pond ash, plastics and other available alternative materials
- In the tourism sector: enterprise models that focus on enhancing local jobs, like home stays, and promoting local handicrafts and culture, within the environmental limits of the region as against the mainstream tourism sector
- In the energy sector: enterprises that are serving energy demands of the last mile through solutions of decentralised clean renewable energy.

Financial institutions and banks are unable to secure financial sustainability owing to uncertainty related to policy changes, systemic barriers, perceived risks, externalities, asymmetric and limited information, and limited regulatory guidance. Increasing dialogue with stakeholders and literature continues to indicate that MSEs remain underserviced. According to the International Finance Corporation (2017), only 12-16% of enterprises have access to formal finance, including non-banking and government institutes, small banks, public sector banks, private sector, and foreign banks.

A majority (67%) of finance supply for small businesses in India comes from informal sources such as money lenders, friends and family, according to the data compiled by the consulting company Dun & Bradstreet (D&B).

[1]Ministry of Micro, Small and Medium Enterprises, Government of India

Another 21% comes through equity finance. (Financial Express, 2019) Of the 12-16% financing that happens through the formal sector, about 80% still comes from commercial banks. However, one can clearly see the trend where others like Non-Banking Financial Companies (NBFCs), fintech are picking up. (Economic Times, 2019)

Another report by GIZ (2013) highlights that almost 94% of enterprises fall under the missing middle segment where credit requirement varies from INR 50,000 to 10,00,000. While Micro Finance Institutions (MFIs) support loans up to INR 50,000, banks are hesitant to support enterprises below the threshold of INR 10,00,000.

Key Challenges

While there are initiatives by banks for large businesses and blended financing models that have been successful in few pockets in the recent past, no major breakthroughs for mainstreaming green finance for MSEs have been achieved in the country. Some of the major challenges that have been identified by studies and the experience of agencies working in the area are:

- **Information Barriers:** LGEs are unaware of the range of sustainability related investments as tools to foster competitiveness. LGEs are also often intrinsically less able to access sustainable finance because of capacity barriers, including financial literacy around the range of products provided by promotional institutions, as well as challenges in accessing capital market products.

- **Higher Perceived Risks:** Unproven business models and a corresponding lack of credibility with bankers, limited purchasing power of the Bottom of the Pyramid (BOP), and low levels of financial inclusion among the BOP.

- **Lack of Capacities in Financiers:** Banks and financial institutions lack robust data on green and sustainable financing needs of LGEs. If needs and potential opportunities are not clearly understood, financial institutions may face difficulties in advancing the business case for scaling up green and sustainable finance.

- **Limited Products and Instruments:** There is a lack of green and sustainable financing products and instruments specifically for LGEs, especially across the enterprise life cycle (e.g. seed funding). There is limited diversity in financial institutions that offer long term and sustainable financing for LGEs.

- **Metrics for Evaluation:** Environmental and social performance is not considered in the assessment of LGEs funding decisions. A lack of familiarity, common approaches or standards for evaluating the credit quality of LGEs engaged in new clean technologies, green products or sustainability services may affect risk pricing, ultimately impacting the cost of capital.

Focus of the Round Table

The session aims to consolidate policy asks for ease of financing LGEs. The round table participants will delve deeper into identified challenges, and explore the potential of new financing models, instruments, regulations and fiscal measures to support LGEs financing. The summary and key recommendations of the session will be shared with the Ministry of MSMEs and UN-PAGE India team to be incorporated in the national policy frameworks and the action plan of PAGE India, which has a special focus on scaling up MSMEs.

The two specific discussion points include:

- New and/or innovative financing instruments to reduce costs and (perceived) risks of servicing green enterprises, focusing on enterprises with a range of investment requirements from INR 5,00,000 to 15,00,00,000 (approx USD 10 K to USD 200 K)

- Enabling a policy ecosystem for banks to undertake financing of green micro enterprises as per the demand of green businesses and needs of bank, focusing on information and capacity gaps.