# ADVANCING GREEN ECONOMY THROUGH MICROFINANCE IN EUROPE

## PART ONE: GREEN FINANCE ECOSYSTEM AND MICROFINANCE

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# EU FRAMEWORK FOR FINANCING SUSTAINABLE GROWTH

The purpose of green financing is to increase the level of financial flows (from banking, micro-credit, insurance, and investment) from the public, private and not-for-profit sectors to sustainable development priorities. A key part of this is to better manage environmental and social risks and seize opportunities that generate a return and an environmental benefit while delivering greater accountability and transparency for the outcomes.

The EC Action Plan on Financing Sustainable Growth (European Commission, 2018), published in March 2018, includes ten initiatives, and has three stated objectives:

- Reorient capital flows towards sustainable investment, to achieve sustainable and inclusive growth.
- Manage financial risks stemming from climate change, environmental degradation, and social issues.
- Foster transparency and long-termism in financial and economic activity.

The EU Taxonomy[1] aims at defining which economic activities can be considered as sustainable as per European legislation. The definition of sustainability includes social elements on top of environmental objectives. The six environmental objectives identified for the purposes of the taxonomy are:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems.

However, making a substantial contribution to climate change mitigation is not enough. The sustainable economic activities must avoid causing significant harm to other environmental objectives, and must be assessed on general principles, metrics, and thresholds.

These principles in addition to the European Green Deal[2] set the stage and the high-level framework within which green microfinance should operate in Europe.

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[1] https://www.oecd-ilibrary.org/sites/134a2dbe-en/1/3/1/2/index.html?itemId=/content/publication/134a2dbe-en&_csp_=062998fb6eb20cf4e25d9a4ba3ba529e&itemIGO=oecd&itemContentType=book

[2] The European Green Deal is a set of policy initiatives by the European Commission with the overarching aim of making Europe climate neutral in 2050. https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

# GREEN MICROFINANCE ECOSYSTEM

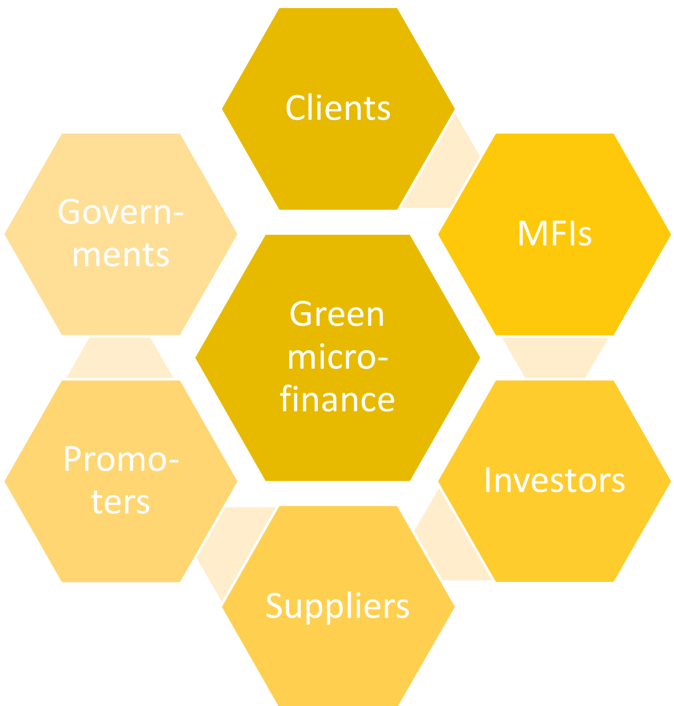
Green microfinance operates within a network of stakeholders and broader ecosystem policies, regulations, and market conditions. Green microfinance captures a wide variety of products and services whose application may reduce carbon emissions, lower energy use, or otherwise contribute to conserving the natural environment and mitigating the negative consequences of climate change.

## GREEN MICROFINANCE STAKEHOLDERS

Green microfinance operates within a complex system of stakeholders each having their own interests and strategies that need to be aligned to advance the sustainable economy through microfinance.

In addition to clients and MFIs, the ecosystem involves investors and lenders providing finance to MFIs, suppliers of green economy products and services (producers and vendors), governments (local, national) which set policies and provide support for the sustainable economy, and various organizations and initiatives that set rules and targets for climate protection and promote green economy ('promoters').

**Figure 1. Green Microfinance Stakeholders**



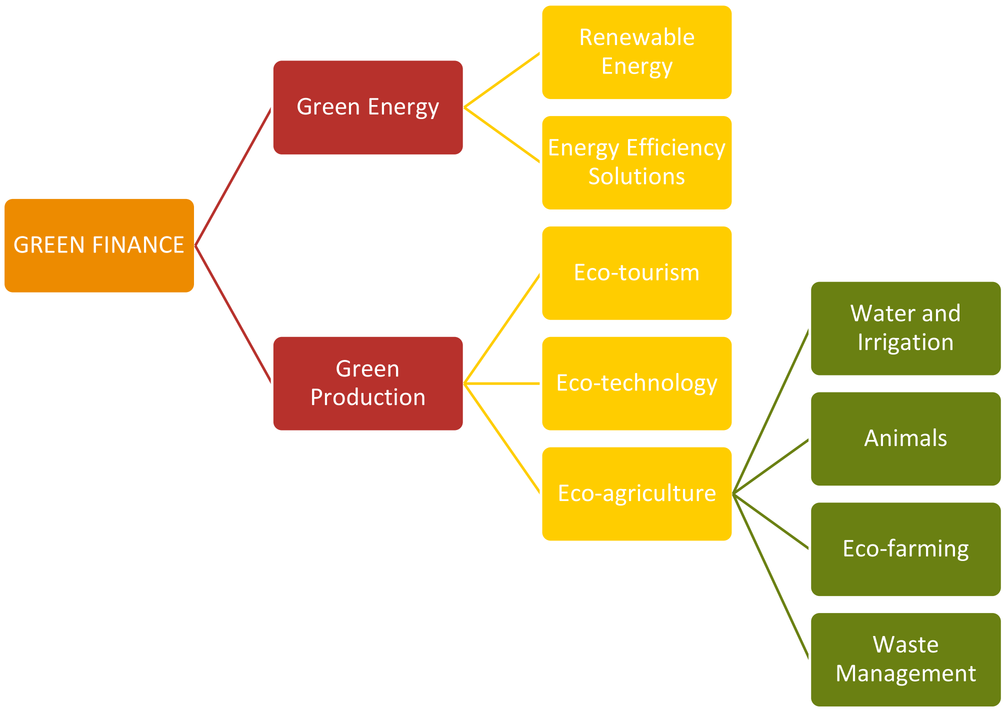
# GREEN MICROFINANCE ACTIVITIES

Green finance activities encompass two main lines of 'green' activities: green energy and green production.

Green energy and energy efficiency is by far the most popular sustainable product. This includes using, or transitioning to, renewable sources of energy such as solar panels or wind power, and a variety of methods to increase energy efficiency, for example the use of energy efficient lighting or appliances such as refrigerators, heat pumps or smart thermostats.

Within the green production segment there are three main components: eco-tourism, sustainable production methods and sustainable eco-friendly agriculture, with each having various sub-sectors and sub-divisions.

**Figure 2. High-level Segmentation of Green Finance Activities**



# GREEN MICROFINANCE MARKETS

In terms of microfinance markets, two types of market can be identified:

The **current** markets where MFIs already have experience in green financing. They are mainly in the rural sector and involve granting loans of medium duration to small and medium entrepreneurs (usually peasant families). The activities that are financed are mainly the acquisition of solar panels for family and productive use, and to a lesser extent, financing of other types of green projects like drip irrigation, water reservoirs, genetic improvement of livestock, eco-vans, crop diversification, home gardens, beekeeping and pisciculture.

The **potential** market, focusing mainly but not exclusively on rural sectors, financing agricultural production. Green finance investments such as working capital loans and micro-leasing can be applied to the acquisition of environmentally friendly technologies allowing the MFIs to finance activities such as seed bank development, agro-silvo-pastoral systems, hydroponic crops, organic agriculture, planting or preservation of forests, carbon sinks, certified ecotourism, produce certifications, milk cooling systems and by-products.

# GREEN FINANCE AND MICROFINANCE

The role of climate change and ecological sustainability in microfinance has been recognized for some time but microfinance is slow to embrace green finance activities and to champion the green economy.

The purpose of green financing is to increase the level of financial flows (banking, microfinance, insurance, and investment) from the public, private and not-for-profit sectors to sustainable development priorities. A key part of this is to better manage environmental and social risks and seize opportunities that generate both a financial return and environmental benefits while delivering greater accountability and transparency for the outcomes.

Despite its proclaimed social mission, microfinance is a newcomer to green finance and ecological sustainability. In recent years microfinance institutions (MFIs) have started to include environmental and social impacts in their measures of success, following the triple bottom line approach of “profits, people, and planet”, largely due to pressure from ecologically-minded social investors. In reality, MFIs are at the early stages of green finance although there is notable progress and the sector is slowly veering in the right direction.

The scale of green microfinance activities remains low, although in some isolated cases green economy loans make up 20% of the total portfolio. The scope of sustainable products funded by green microfinance in Europe is also narrow, predominantly limited to alternative energy and energy efficiency solutions.

MFIs themselves are rarely an example of an ecologically-sustainable institution and do not serve as an example for clients to follow. There are also no demonstration sites that could help clients see and test green economy products in action.

The ability of microfinance institutions to engage in green finance depends to a large degree on the interest and willingness on the part of their clients to engage in green technologies. In general, microfinance institutions report low awareness of sustainable technologies among clients and their low interest in green economy projects. These two factors lead to low demand and limited borrowing for green technologies despite often favorable pricing of such products. However, lower propensity to borrow may not always reflect lower interest in low carbon and sustainability issues.

MFIs get involved in green finance for various reasons, some of which are not related to the pressure exerted by the investors. For some MFIs, the motivation to start green financing was the social responsibility of their organization related to their social mission and purpose. By entering the green finance activities, they were also able to better signal their difference from the money lenders and fintechs. In other cases, the green finance activities were started in response to the increasing pollution, especially in the urban areas. MFIs felt that they have a role to play and decided to get involved in the sustainable activities. Still in other cases, regulators question the proclaimed social missions of MFIs and urge them to engage in activities that will prove their active involvement in social and environmental issues. Finally, there are cases where MFIs responded to the clients' needs and demands and started to request funding for sustainable products and services.

There are many factors that make green microfinance a challenge: clients of MFIs are still reluctant to embrace new technologies which are often riskier and more expensive, despite monetary incentives. MFIs are not yet green-finance-ready in terms of staff skills, remuneration systems and internal processes to disburse green loans. Loans funded by microfinance lenders and investors still bear onerous eligibility and monitoring conditions which make them less attractive than regular loans. And no less important is the fact that MFIs are not seen as a viable partner by local and national governments in climate mitigation actions.

There are also opportunities for MFIs to become agents of green finance and promote sustainable products through their lending activities. Even though climate mitigation instruments perform better at the national and international levels, MFIs can promote low-scale clean energy financing [e.g., biofuels, solar energy, etc.] and engage in the carbon credit market to finance site-specific mitigation projects, also by calling on specialized agencies for project preparation through strategic partnerships.

MFIs also have a stake in fostering adaptation strategies to clients. These actions combine both financial and non-financial services aimed at aiding families to accumulate and diversify assets, as well as coping mechanisms over time (e.g., savings and microinsurance policies], whilst sharing knowledge and information to influence customer's behaviors towards more sustainable practices. MFIs can also help governments to leverage their scarce grant resources and create more cost-effective programs that combine subsidies with microloans.

Green microfinance is emerging as a sub-sector within microfinance with some promising activities proving that it has a potential for growth in the future. However, for this to happen, all stakeholders need to align their strategies and actions to make the green microfinance loans more attractive for clients and appealing to various consumer segments. The funding processes for MFIs must be simpler to allow them to reach scale and profitability on this segment which so far is not the case. In addition, there is an important role for industry associations to play both on the policy and advocacy front as well as on the operational levels of MFIs.

Green microfinance is taking shape within a changing broader social and political context defined by heightened focus on sustainability and climate change on the highest levels of government and society. Far-reaching conceptual policy frameworks such as EU New Green Deal, Bauhaus and Build Back Better provide inspiration and guidance for green economy and frame the application of finance to climate change and sustainability. The microfinance sector needs to take cues from these frameworks and develop a strategy on how it can become a part of the global movement in green finance and ecological sustainability.

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## ABOUT MFC

The Microfinance Centre is a social finance network that promotes fairness, inclusion, equality and responsible service. We unite 113 organisations (including 77 MFIs) across 36 countries of Europe, Central Asia and beyond, who together deliver responsible microfinance services to over 1,000,000 low-income clients.

## OUR MISSION

Our mission is to empower individuals and sustain communities through innovative social finance and microfinance

## OUR VISION

Our vision is a financial system that works for all people and all communities in a responsible and fair way.

**Our members and partners** are guided by the principles of fairness, inclusion, equality and ethical service delivery. They acknowledge and contribute to the MFC's values of empowerment, forward-thinking and mindfulness.