ADVANCING GREEN ECONOMY THROUGH MICROFINANCE IN EUROPE

PART THREE: ACTIONS TO STEP UP GREEN MICROFINANCE

Kinga Dabrowska, Piotr Korynski, Katarzyna Pawlak, Justyna Pytkowska

MICROFINANCE CENTRE

December 2021

CHALLENGES TO EXPANDING GREEN MICROFINANCE

The interviews with a select number of MFIs in Europe point to various challenges to introducing green microfinance, which at this time outweigh the potential opportunities that green microfinance may bring to clients, MFIs, and local communities.

The challenges to introducing green finance faced by MFIs relate to low demand for green products by clients, ability to promote and sell green loans, but also to overcoming staff resistance and building internal capacity to provide green financial services.

WEAK DEMAND FOR GREEN LOAN PRODUCTS

The relatively low awareness of climate change and sustainability issues coupled with the unknown nature of the green economy products leads to a relatively low demand for financing. In addition, the loan process is too cumbersome for many clients who need to do many additional calculations and provide many documents that are not typically required for a regular microfinance loan.

DIFFICULTY IN SELLING GREEN LOANS

MFIs face a challenge how best to deliver green finance to their clients: through existing products or through specialized and narrowly defined green loans. Developing new loan products is labor intensive and requires time and effort for their promotion. However, the special products are preferred by investors, who often impose the introduction of green products on MFIs.

LOW GREEN MICROFINANCE PROFITABILITY

So far none of the MFIs interviewed reported that green finance is a profitable activity. Lack of profitability is a major challenge that casts doubt over the future of green finance activities which so far require subsidies in addition to the subsidies offered to clients. The financial shortfall is covered in most cases by the donors and investors although in some cases MFIs use their own funds to subsidize their green finance loans.

STAFF RESISTANCE AND LOW ENGAGEMENT

Education of customers is needed, but also staff are uneducated and unwilling to offer green loans. Staff want to disburse loans quickly, but in the case of green loans they must collect more information which takes additional time with clients and in the office. The extended time needed for loan preparation affects staff incentives which requires MFIs to introduce special bonuses for selling green loans.

INCONSISTENT SUPPLY OF GREEN TECHNOLOGY PRODUCTS

While there are green products in most countries, there are also major differences in supply and availability between countries and regions. Some technologies are available on a consistent and predictable basis, others may not be in permanent supply, or may not be of the type or quality that would qualify under the narrow and restrictive guidelines set by most microfinance investors funding the green finance products. In addition, the sustainable products and services are evolving fast with new technological solutions arriving on the market with increased frequency, which complicates the ability of MFIs to follow trends and keep abreast of the supply.

LACK OF COLLABORATION WITH SUPPLIERS AND VENDORS

The easiest way to promote green products and services is to create partnerships with producers and vendors, however creating such arrangements is difficult for MFIs which are seen by the vendors and producers as less viable than banks because they offer smaller amounts of money to a limited number of clients.

RIGID APPROACH OF INVESTORS

Microfinance investors and lenders are the main providers of funds for green loans to finance sustainable activities. However, the funds are made available with conditions which are perceived by the clients and MFIs as too onerous and too complex. While there may be good justification for the conditions, especially when they include subsidies and technical support for clients (e.g., controlling the use of funds, demonstrating positive outcomes, applying the most efficient solutions, etc.), these conditions reduce the interest and uptake of green microfinance loans.

WEAK PUBLIC SUPPORT

So far MFIs have not benefited from government programs for sustainable economy and mitigation of climate change even if such programs are increasingly available in most EU countries. MFIs are not seen as viable partners for such programs, and they cannot leverage the potential opportunities for subsidies offered, for example, by local governments and other promoter organizations.

OPPORTUNITIES FOR GREEN MICROFINANCE IN EUROPE

Green microfinance may unlock new opportunities but at this point they appear to be largely potential and conditional on many external factors that are not easily met by clients and MFIs.

CLIENTS

Clients can take advantage of several opportunities in green microfinance.

Loans are generally offered at a lower interest rate, even if not by much, and some loans have an additional grant component which decreases the overall cost. In addition to the subsidized loans, clients can get training and technical assistance that will help them make use of green technologies.

New green technologies and lower operational costs can lower the cost of doing business and can be used to create an eco-friendly image of the business or brand that may be appealing to new market segments of buyers.

Finally, green microfinance loans can open access to new technologies that use less energy and offer long-term savings, in addition to saving the planet and mitigating climate change.

MFIs

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, and can also call 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 helping families to accumulate and diversify assets, as well as providing 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.

INVESTORS

Investors could expand their lending to MFIs if they find ways to simplify the reporting and monitoring requirements. Also, making the eligibility for green microfinance funds more open and flexible, for example by allowing a broader range of products from more vendors. Green economy and sustainable products are an emerging market for most consumers and small businesses, which require additional incentives in the form of lower interest rates on green microfinance loans and cheaper funds from investors.

ACTIONS TO ADVANCE GREEN MICROFINANCE IN EUROPE

Green microfinance is an emerging segment of microfinance that until recently was not considered to have a role and be a part of the microfinance operations. However, as climate mitigation efforts become mainstream and more and more activities trickle down to micro- and small businesses and the institutions that support them, green microfinance is on its way to become one of the products of the microfinance sector. For it to play a major role however, various actions are needed on the part of MFIs, microfinance investors, governments, and policy makers as well as industry associations and support organizations.

MFIs

The possible actions by MFIs include the following:

- **Lead by example as a sustainable organization.**

  MFIs could themselves become examples of eco-friendly low carbon organizations and showcase these efforts to clients. MFIs could use tools like the Green Index or the relevant ISO standards (like 14001) to upgrade their internal operations and processes to be in line with energy efficiency, resource conservation and sustainability in general.

  MFIs can turn their branch offices into showrooms of sustainability and circular economy. Providing an example to clients is important as an educational tool and an encouragement for clients. MFIs could use various promotional slogans such as “We save water? Do you?” or “We conserve energy? Do you?” throughout the branch office. They can display educational materials about energy efficiency and green methods in production and consumption for the clients to read while on the premises.

- **Segment consumers according to their green needs and preferences.**

  So far, green microfinance and sustainable products are offered to an “average everyone” without much success. Clients’ needs and preferences vary. It is important to understand consumer needs and their buying behavior, both on the household and business level, to be able to develop financial products and marketing messages that appeal to different segments.

  One approach that MFIs can take is to identify various client personas built around their needs and use of green products which can be used as the basis for developing products and marketing efforts. In addition, MFIs need to monitor the changing preferences of clients through surveys and focus groups.

- **Develop user cases to attract followers.**

People are more likely to engage in sustainable practices when they see others obtaining tangible benefits. In addition to being a living example of sustainable practices, MFIs may develop and showcase prototypes of green products, organize (or participate in) showrooms and "green" fairs and other ways to promote the use and benefits of green products. Instead of advertising loan products, MFIs may advertise green products.

MFIs may also develop and disseminate promotional and educational messaging that incorporates testimonials of real users and clients. Such messaging can be displayed in the branch offices as well as through online communications channels and social media.

- **Offer tangible benefit for clients.**

Eco-friendly economy and environmental sustainability are noble but distant goals for most households and firms, therefore green products need to be promoted through benefits and savings that accrue to clients as opposed to pitching saving the planet and mitigating climate change.

MFIs can provide tools for clients to calculate the potential monetary savings from using green products (accounting for the cost of the loan) and can present other tangible benefits beyond the economic calculus which may be as important for clients to make their choices. An eco-friendly washing machine may not only save money in the long run, but often is also more efficient, creates less noise during the wash and spin cycles, and offers gentler washing. Providing such information about tangible benefits may entice clients to purchase and finance it through a loan.

- **Secure the buy-in from staff.**

The success of any loan program depends on the ability and willingness of loan officers to sell it to clients. In addition to training and technical education on issues related to green economy and sustainability, MFIs (and green investors) may consider providing green products (like energy efficiency appliances) to staff first to have them experience the benefits of the solutions and become green product ambassadors. It will be easier for them to promote the products and present their benefits.

With first-hand experience, staff will be more likely to learn about green technologies which may help overcome the resistance to acquire new technical knowledge that is not typically expected from loan officers.

- **Reconsider the remuneration system.**

The variable portion of loan officers' pay must be revised to correctly account for the increased time and effort required to make green microfinance loans.

Green loans, especially those that need to demonstrate environmental impacts and monetary gains, are more time consuming than traditional microcredit. MFIs may choose to have dedicated staff to handle such loans with a different remuneration system or adjust the pay system appropriately if all loan officers are expected to handle such loans.

- **Seek opportunities with local and national government programs.**

MFIs could benefit from grant programs offered to individuals and businesses which they could leverage with green finance loans to top up the grant funding and allow the clients to acquire better quality green products.

MFIs may also serve as a source of information about potential grant funding opportunities and help clients with grant applications.

- **Create stronger links with vendors.**

Developing a funding agreement with suppliers and vendors of green products may be a viable option for MFIs to stimulate demand for sustainable solutions, especially for high-priced items.

If an individual MFI is too small to be a good partner for the vendors, MFIs in a country may consider joining forces and approaching the vendors as a consortium with a larger potential demand and purchasing power.

In addition, vendors could be allowed to promote their products and services through MFIs' channels to educate clients about the opportunities to acquire green products.

- **Promote 'living green' strategies among clients and local communities.**

MFIs should be visible and present at various 'green' events and initiatives such as green fairs and promotional initiatives. This will strengthen the image of the MFI as an organization engaged in green sustainable development.

INVESTORS

Investors can increase their role and impact by considering some of the following actions:

- **Simplify lending procedures.**

One of the reasons why green loans are not taken up is the complexity of the requirements that the borrowers must meet. Borrowers would be more interested in green loans if the procedures were simpler and shorter. Similarly, MFIs would be more open to disbursing loans that are less cumbersome and time consuming.

- **Relax eligibility for loan recipients.**

Investors in green economy limit the range of products that the borrowers may acquire and the vendors from which they purchase the items. The terms and conditions for green microfinance products need to be more flexible and need to consider local market conditions where items of the preferred technical specifications may not be available or may be priced above the borrowers' willingness to pay.

- **Offer technical assistance**.

MFIs still do not have technical and selling skills related to green technologies. Technical assistance provided by the investors will help overcome the capacity challenge faced by MFIs in implementing green microfinance programs.

- **Align expectations with the cost of funding for MFIs**.

Green technology is still more expensive than traditional products. Borrowers expect to be able to borrow funds at lower rates that would compensate for the higher retail price of green products. It is unrealistic for investors to expect a high volume of loans if the investment funds are expensive and do not allow the cost of green loans to be reduced. If the funds are relatively expensive, investors should not impose too stringent conditions on MFIs because the cost of funds make loans expensive and therefore dampen the demand for green finance. The expectations need to be aligned with the type and cost of funding offered to MFIs for green microfinance.

GOVERNMENTS

Local and national governments have an important role to play in including the microfinance sector, and through it micro- and small businesses, in climate mitigation activities:

- **Recognize MFIs as a viable partner.**

MFIs as a sector and individual small-scale financial institutions do not appear on the list of potential partners of local and national governments. Collectively MFIs represent a sizable pool of potential users of green technologies, and they could be connected with various local and national green economy programs.

- **Educate the public on green technologies and sustainability.**

Greater awareness of green technologies will increase the demand for green products and indirectly, the demand for financing from MFIs. In general, people are not well educated about the benefits of green technologies, not to mention the sizable portion of the population who are climate skeptics and do not believe in taking any additional measures to save the planet. Therefore, governments need to intensify their efforts in educating the public about climate risks and the need for sustainable products. With government support, MFIs can offer 'green education' and promote green products among their clients.

- **Promote the production of green technologies.**

A wider offer of low-carbon technologies on local markets, through support for green entrepreneurship and preferences for sustainable production, will increase the willingness of individuals and businesses to acquire eco-friendly products, leading to higher demand for green microfinance loans. The supply of green technologies is uneven, and many products are not available in local markets. MFIs can serve as a conduit for green entrepreneurship with appropriate government support in terms of grants, low-cost loans, and technical assistance to the new green entrepreneurs.

POLICY MAKERS AND REGULATORS

Policy makers and regulators can help MFIs develop green microfinance activities by offering:

- **A regulatory capital relief for MFIs for green loans as an emerging business activity.**

  Lower capital requirements will lower the cost of doing business for MFIs and will help them build scale and establish a business case for green microfinance. This could be a tangible incentive for MFIs to engage in green finance which still accounts for a very small portion of the loan portfolios, and therefore does not pose a systemic risk.

- **Apply differential risk norms to green microfinance.**

  Green microfinance loans as a new product may require different risk measures than regular business and consumer loans. MFIs could be allowed to experiment with green loans for a period of 2-3 years and not count such loans in the overall PAR calculation, which would create incentives for MFIs to introduce new products and allow institutional learning. Regulators could work with the MFIs and industry support organizations to design the appropriate risk measures and risk assessment protocols for green microfinance.

INDUSTRY SUPPORT ORGANIZATIONS

Industry associations and support organizations can influence the development of green microfinance on the level of MFIs, microfinance clients and on the level of the enabling environment for sustainable finance.

- **Promote green microfinance.**

  Present and broadly promote the role and contribution of the microfinance and non-bank sectors to the low carbon and green economy among MFIs, governments, and investors. As a new line of business for most MFIs in Europe, green finance requires active promotion. Industry support organization should engage MFIs in the green finance dialogue, connect them with good practices, showcase successful applications, and highlight the benefits of green finance for clients and MFIs.

- **Translate the tenets of the EU's Green Deal to meet the needs of the microfinance sector.**

  The EU's Green Deal is a higher-level policy agenda that must be operationalized for the use by the microfinance sector. First, similarly to the overall European financial system, microfinance needs to become more sustainable and oriented towards green economy. Second, microfinance needs to be included in green finance polices that will allow the sector to contribute to sustainable and inclusive economic recovery from the COVID-19 pandemic and the long-term sustainable economic development of Europe. Industry associations should play a vital role in making the EU Green Deal accessible and applicable to the microfinance sector. For example, the microfinance support organizations can prepare guidelines for MFIs to adjust their internal policies and operational practices to the expectations of the EU Green Deal, develop standards to orient MFIs towards Green Deal targets, and support the sector in implementing Green Deal activities.

- **Apply the EU Taxonomy Climate Delegated Act to Microfinance**

The EU Commission's EU Taxonomy Climate Delegated Act, a science-based transparency tool for companies and investors, introduces clear performance criteria for determining which economic activities make a substantial contribution to the Green Deal objectives. The microfinance sector should follow the EU Taxonomy as guidance in making decisions regarding carbon mitigation and sustainability lending to be in line with the overall EU policies and recommendations. These criteria also create a common language allowing MFIs to communicate about green activities with increased credibility and transparency in a uniform and codified way. Microfinance support organizations should ensure that the Taxonomy is applied by MFIs, and they should review and adjust the Taxonomy to the specificity of microfinance, educate the sector about the Taxonomy, and create a uniform reporting system for all MFIs in Europe.

- **Develop risk assessment and management methodologies for green finance lending.**

Green microfinance products pose new risks that need to be better understood and quantified so that MFIs can make profitable loans for the green economy. Microfinance support organizations can lead research and development efforts to create appropriate risk assessment tools that can be applied by MFIs in a consistent way in line with the EU Taxonomy. Such efforts can be conducted jointly with MFIs with the participation of regulators and experts from the green technology sectors to capture the multitude of risks involved in green finance.

- **Launch the EU Green Microfinance Week to promote green finance among MFIs.**

This would allow MFIs to promote green microfinance and create broader awareness among clients, producer, vendors, and other stakeholders. For example, various promotional activities can be organized in conjunction with the Earth Day that would engage MFIs in the global movement for climate change. Industry support organizations can champion these activities and provide support for local associations and MFIs.

- **Advocate with microfinance investors to develop appropriate forms of green finance for microfinance including adjusting thresholds, eligibility, simplifying reporting, etc.**

The source and type of funding to a large degree determines the ability of MFIs to implement green finance. Investors wishing to go beyond token green programs need to reconsider the terms and conditions on which funding is made available for sustainable green lending. Investors should recognize the infant industry stage of green microfinance and adjust their funding policies accordingly.

- **Build up MFIs' capacity in green microfinance.**

  Create learning and professional development opportunities for MFIs and their staff to acquire skills to promote, sell and administer green microfinance loan products. Industry support association could develop training programs for MFIs, in collaboration with universities and environmental organizations, launch certificate programs and create a knowledge platform for MFIs. In addition, it is necessary to promote peer learning and sharing of experience to encourage the adoption of green microfinance by MFIs in Europe. There is some experience, good and bad, that can be shared among the MFIs to calibrate the emerging good practices and turn them into sharable knowledge.

- **Promote green business development services.**

  Clients need to be educated about green technologies and sustainable solutions. There is a need for developing a series of green training and mentoring programs that will educate potential clients about the benefits of low-carbon sustainable products and the assistance of MFIs to acquire them.

These and other actions will help to further develop green microfinance and eventually establish it in the mainstream as one of the core financial offering of MFIs in Europe.

ACKNOWLEDGEMENTS

The MFC team would like to extend its gratitude to the following people who shared their insights:

Ksenia Brockmann, Jolanta Gabriel, Anna Chmielewska	EBRD
Senad Sinanovic, Edisa Sijercic	Partner
Manuchar Chitaishvili	Crystal
Liisa Andersson, Carlos Marín De La Fuente, Mejra Juzbašić Bajgorić	GGF
Ana Kentera	Alter Modus
Florian Babameto	BESA
Alban Gerguri	KRK
Erind Shehi	FED Invest
Serghei Cunetchi	MicroInvest
Khurshed Tadzhibaev, Aziza Ganieva	IMON
Cyril Gouiffes	EIF
Sofia Tulupova	Symbiotics
Izabela Norek	Helenos
Firdavs Mayunusov, Alisher Nuraliev	HUMO
Prashant Murthy	FMO
Silke Mueffelmann, Marjan Stojiljkovic	Frankfurt School of Finance and Management
Karina Navarro	Inpulse
Adrien Gizon	Adie

This initiative has received financial support from the European Union Programme for Employment and Social Innovation "EaSI" (2014-2020). For further information please consult: http://ec.europa.eu/social/easi

CONTACT US TO LEARN MORE:

Microfinance Centre (MFC)
Noakowskiego 10/38
00-666 Warsaw, Poland
tel: + 48 22 622 34 65
microfinance@mfc.org.pl
www.mfc.org.pl

MICROFINANCE CENTRE

ABOUT MFC

The Microfinance Centre is a social finance network that promotes fairness, inclusion, equality and responsible service. We unite over 100 organisations 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.