ADVANCING GREEN ECONOMY THROUGH MICROFINANCE IN EUROPE

PART TWO: MARKET CONDITIONS OF GREEN MICROFINANCE

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DEMAND FOR GREEN MICROFINANCE

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 and low interest in green economy projects. These two factors lead to low demand and borrowing for green technologies despite often favorable pricing, although lower propensity to borrow may not always reflect lower interest in low carbon and sustainability issues.

AWARENESS OF GREEN ECONOMY AMONG MFI CLIENTS

Awareness among the microfinance clients about sustainable green technologies and eco solutions is relatively low. While clients may be generally aware of the importance of low carbon and sustainable activities, and even declare positive attitudes towards eco-friendly products and services, few follow through with their wallets. One study showed that 65% claimed they would purchase products that advocate sustainability, but only 26% did so[1], pointing to an important 'intention-action gap' among consumers and business owners.

Not all individuals will respond favorably to opportunities or incentives that have been designed for the 'statistical everyman'. So far, no segmentation efforts have been attempted in relation to the consumer preferences in sustainable products[2] and therefore it is not possible to assess the clients' level of awareness.

In addition, there is less awareness and knowledge about ecological technologies as they apply to business processes than to household use, which makes engaging business owners and entrepreneurs a bigger challenge than consumers.

In general, people are not technologically savvy and may not be able to assess the value of a particular product. However, it is interesting to note clients who have been previously exposed to sustainable practices, for example individuals who returned to Eastern Europe from Germany and Austria use green loans as they better understand climate issues and are willing to engage in low carbon activities.

[1] Katherine White, David J. Hardisty, Rishad Habib, The Elusive Green Consumer, Harvard Business Review, July-August 2019.

[2] For an example of a segmentation, see: Wouter Poortinga, Andrew Darnton Segmenting for sustainability: The development of a sustainability segmentation model from a Welsh sample. Journal of Environmental Psychology 45 (2016), pp. 221-232.

DEMAND FOR GREEN FINA`E PRODUCTS

The interviews with the select MFIs in Europe and Central Asia confirm the 'intention-action gap' among their clients. With some notable exceptions, demand for special green financial products and borrowing for green technologies using general business loans is low. Even products enhanced with education, technical assistance, grants, and other incentives do not lead to a high take-up of loans on the part of business clients. There are various reasons for low demand which are explored in the following sections.

DEMAND FOR GREEN TECHNOLOGIES AND DEMAND FOR GREEN FINANCE

Although it is obvious, it needs to be stated at the outset that not all entrepreneurs and small business owners need to borrow funds, and in particular borrow from a microfinance institution, to acquire low carbon and other sustainable solutions. Some clients can finance such purchases with their own resources, others who need funding may use other sources such as banks (especially as microfinance loans may be too small to finance green technology) or financing offered directly by the suppliers. In short, the low demand for financing cannot be immediately assumed to mean low interest or low uptake of green technologies. However, it may indicate that the availability of funding such as microcredit may not be a necessary or a sufficient condition to make a purchase decision, and that other factors may play a larger role. So far, in general green technology is too costly to replace the old equipment or energy solutions.

TYPES OF LOW CARBON TECHNOLOGIES AND PRODUCTS

Not all types of low carbon solutions enjoy the same interest that translates into demand for funding. Some items such as energy efficiency household appliances are more popular, and the demand is stronger because there is a selection of items to choose from on the market and the price differences between them are not so big. Still the limiting factor is the price of such solutions which is typically higher than the traditional products. Insulation systems are easier to sell, as are solar collectors for heating water, because they are cheaper and clients can see the change in their electricity bills after one month of using these solutions.

Solar panels on the other hand are difficult to sell because the returns on investment are seen only in 7-8 years, which is too long a time horizon for most clients who expect the savings to appear within a shorter period. According to the MFIs, the 1–2-year perspective is optimal for clients to be interested in a particular solution and get a loan for it. Customers need to know how much they will save per month or year.

The demand for alternative solutions has also been affected by the pandemic. For some segments, for example SMEs in the tourism business (such as hostels and bed and breakfast houses, many of them registered on the Airbnb platform), the demand for loans diminished as there were no tourists in recent months and therefore no incentive to make improvements. After the pandemic they may start installing solar panels for the guest houses again and the demand for loans may pick up again.

Finally, not all products are available under the various funding schemes from the MFIs which are determined by the conditions imposed by the investors. For example, refrigerators and air conditioners are not eligible under some types of funding, therefore people cannot borrow money for them; however, there is demand for these products. Clients have problems with producing invoices as businesses which sell the installations and materials are informal and cannot issue invoices.

COSTS AND PRICING

Cost of the sustainable technologies is a major factor for making purchasing decisions. When clients are interested in sustainable technologies, they are likely to choose cheaper products, even secondhand ones if they cost less.

Another cost-related factor is the requirement by funders and consequently MFIs for borrowers to evidence their purchases with invoices (and often from a pre-selected certified sellers). In some cases, certified merchants sell their products at prices 20% lower if no invoice is required. This is an instant benefit unlike the 20% grant from the program which, although monetarily equal, requires the borrower to apply and provide documents, and then wait for the approval and disbursement. Moreover, grants are not automatic; there is no guarantee to qualify for a supplementary grant at the time of making the purchase decision.

Another cost consideration that plays a role, especially for energy efficiency products, is the cost comparison between the savings from the alternative technologies and the cost of energy from the traditional sources. In some countries electricity bills are not very high, therefore the cost differentials may not be high enough to entice people to make the investments in energy efficiency[3].

LOAN CONDITIONS AND FINANCIAL PRODUCT DESIGN

When MFIs offer special green finance products, these loans tend to be more complicated (technical specification, documentation from vendors, etc.) and time consuming for clients. It is not unusual for the application to take 60 days or more, which stands in stark contrast to the regular microfinance loans approved within several days at most. Even though the loan may be subsidized, a client may receive a grant and there may be energy cost saving, clients prefer regular, more expensive loans which are disbursed quickly.

Certain technical requirements tied to the loan products are also difficult for clients to meet. It is not easy to find, for example, insulation materials or windows with the requested parameters on the local market. Substitute products which could ensure the same energy saving are not recognized by some funders even if they are cheaper and readily available.

[3] Reduction of energy expenses may in some cases increase energy consumption which, thanks to the lower costs, appears to be relatively cheaper. This is a not desired outcome for sustainability as the overall objective is to reduce energy consumption.

SMES VERSUS HOUSEHOLDS

Although the overall demand for green products and green loans is low, relatively speaking there is a higher demand from households than from businesses. Serving small businesses is more difficult for several reasons. They are small, so the cost savings are typically small. In addition, businesses often don't own their facilities and only rent premises, therefore they are limited as to what improvements they can make. Businesses that make improvements and invest in new technologies are often those that are located on the ground floor of the owner with a living space above. Finally, economic calculus is a major factor in business decisions; while selling to the hearts may have some appeal to the individuals, it is not very effective when it comes to selling sustainability products to small businesses.

OLD VERSUS NEW CLIENTS

Offering green finance products could be an opportunity to attract new clients, but the experience reported by MFIs shows that it is easier to attract existing clients rather than new ones to these products.

SUPPLY OF GREEN FINANCING BY MICROFINANCE INSTITUTIONS

Some, though not all, interviewed microfinance institutions offer options to finance green technologies and low carbon solutions to their clients, although to a varying degree and in different ways. Although the sample of MFIs included in the project is small, it signals that most MFIs are open and ready if not actively involved in green finance.

MOTIVATION TO GET INVOLVED IN GREEN FINANCE

Microfinance institutions engage in the green finance activities for different reasons and in different ways. The following are the main motivating factors mentioned by the MFIs:

- Social responsibility. 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 green finance activities, they were also able to better signal their difference from the money lenders and fintechs.
- Strategic choice and market positioning. Green finance has become for some MFIs one of the strategic pillars for future development combined with commitment to a sustainable development.
- Response to local climate change and increased pollution. In other cases, the green finance activities were started in response to increasing pollution, especially in the

urban areas. MFIs felt that they have a role to play and decided to get involved in sustainable activities.

- External funding opportunity. For other MFIs, the starting point was opportunities offered by donors and microfinance investors. For example, donor grants to initiate green energy projects and create demonstration effects among clients as a precursor to a larger green finance engagement.
- Regulatory expectations. Some regulators question the proclaimed social missions of MFIs and urge them to engage in activities that will prove their active engagement in social and environmental issues.
- Market response. Finally, there are cases where MFIs responded to the clients' needs and demands for funding for sustainable products and services.

It seems that MFIs that have entered the green microfinance space through internal decision-making processes (for example, CRS, market positioning or branding, etc.) and in response to market demand enjoy more success than institutions that tried to capture the external funding opportunity from donors and investors.

SCALE AND SCOPE OF GREEN MICROFINANCE IN EUROPE

Both the scale and scope of green microfinance remains limited although there is some progress in terms of amounts disbursed and the number of clients served.

SCALE

When speaking of scale, we need to distinguish between the potential amount of funding that an MFI has at its disposal and the actual ability to disburse funding. The potential of providing funding is much greater than the actual level of demand for loans in the green finance space. Some organizations report having millions of Euros unspent in green products while others claim that green finance is an important portion of their products, reaching up to 20% of the total loans and several thousand clients served with 'green' loans. There are more MFIs in the first category than in the second.

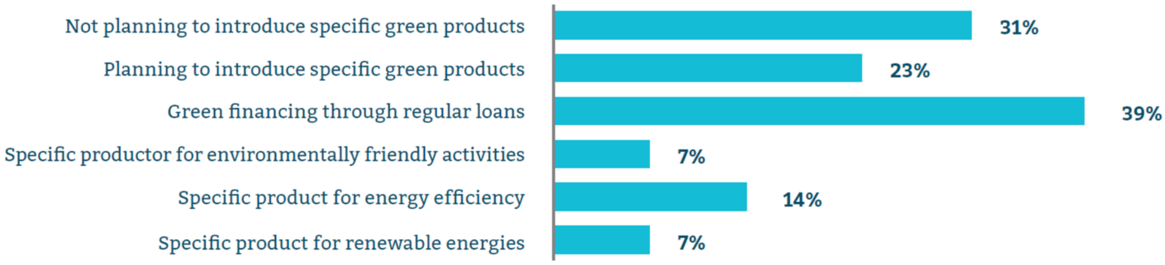
According to the findings of the 2020 Microfinance in Europe Survey Report[4], 55% of MFIs in Europe are involved in green microfinance to some extent. The majority of responding MFIs finance environmentally friendly technologies without a specific loan product (39%). However, 16% of MFIs offer specific green microloan products, most commonly specific energy-efficiency loans. 23% of the responding MFIs plan to introduce a specific green product soon. However, another 31% of MFIs do not plan to have green loans in their offer at all.

Financing green solutions is more prevalent in Western Europe, with 62% of MFIs financing environmentally friendly technologies through general or specific loans. In the East, the share

[4] EMN-MFC Microfinance in Europe: Survey Report 2020 Edition.

is smaller (52% of MFIs). The regions also differ by method: Western MFIs often finance green solutions with regular loans (56% of Western MFIs vs. 31% of Eastern MFIs) while Eastern MFIs more often develop separate green products (21% of MFIs vs. 5% of MFIs in the West. Additionally, Eastern MFIs are more likely to start financing green technologies in the future (32% of MFIs vs. 5% in the West).

Figure 3. Engagement of European Microfinance Institutions in Green Finance in 2020



Source: EMN-MFC Microfinance in Europe: Survey Report 2020 Edition.

SCOPE

There are differences regarding the scope of green finance activities by MFIs. However the most prevalent and popular green finance products relate to energy efficiency. They are the best understood and demanded by clients, and they bring the potential cost savings the fastest. Other sustainable products play a secondary if not marginal role in the menu of green finance offerings.

SOURCES OF FUNDING

The funding for green finance loans comes for the most part from microfinance investors and lenders, and mainly from two investors in Europe (Green for Growth Fund[5] and EBRD's GEFF[6]). Very few MFIs use their own financial resources (i.e., not borrowed from external lenders and investors) for the purpose of funding green finance loans.

[5] https://www.ggf.lu/
[6] https://ebrdgeff.com/

MARKET ENTRY

Entry into the green finance activities is neither easy nor quick. Regardless of their initial motivation to enter, MFIs received some form of initial assistance: a pilot project, subsidized capital for loans, staff training or technical assistance. Some MFIs started with grants and low interest loans before launching regular financial products.

Despite the initial entry support, MFIs report it taking a long time to overcome the internal and external challenges.

Partner, Bosnia and Herzegovina

MFO Partner was one of the first microfinance institution in Bosnia and Herzegovina which engaged in green microfinance as early as 2012. Since then, it has been providing financing for energy-efficient solutions for the improvement of living conditions of Bosnian households.

In the early 2010s, the awareness of environmental issues was much lower than nowadays, and the availability of the technological solutions with reduced energy consumption was almost non-existent in the country.

The MFI had to work on several levels in the value chain: stimulate the production and/or import of the technological solutions, stimulate the awareness and sensitivity to the environmental issues among its clients, and train the MFI staff in product delivery.

While all three levels were challenging, developing staff capacity and engagement turned out to be the most difficult part. Partners had to commit far more resources and time to achieve satisfactory outcomes.

While training the sales staff in product features was straightforward and much alike the training on any other new product, building the capacity for "selling" the benefits in energy efficiency gain was the most time consuming. To well promote the energy efficiency products, the sales staff had to understand and be convinced themselves about the energy-saving technologies.

It took 2 years to develop staff capacity in promoting the green product – ability to explain the concept of energy-efficiency and clearly present the benefits for the client. In parallel, the incentive system was adapted to consider the specificities of the green loan products.

Now, all sales staff is very knowledgeable about energy efficiency, can well explain the benefits, show the energy-saving calculations using eSave developed by GGF (described in the case study of GGF). Energy efficiency loans is becoming more and more important segment of Partner's loan portfolio.

The key internal challenge was staff. Loan officers are not used to selling loans for green sustainable products, they lack knowledge and sales skills in this area, and the incentive and remuneration system is not compatible with the time and effort to make a green loan. One MFI reported that they spent two years and a lot of money on staff training, and as a result staff are knowledgeable about the energy efficiency products. However, they would need to invest more if they were to introduce other types of sustainable products. Another MFI started the green finance project with an awareness campaign for employees followed by modifications to staff incentives.

The external entry challenges include low levels of knowledge and interest on the part of clients and few if any policy-based or economic incentives from the government to transition towards low carbon and green economy solutions.

FINANCIAL PRODUCTS AND SERVICES

MFIs use both specialized green finance products as well as general business or housing loans to finance sustainable products, in addition to grants offered by donors and social investors.

SPECIALIZED GREEN FINANCE PRODUCTS

Only some MFIs offer specialized products, and in most cases these products were developed at the recommendation or request of the investors who believe that specialized products would better stimulate demand and make the overall offer more transparent. Few MFIs introduced specialized green finance products that are self-funded and not dependent on investors' financial resources.

There are some benefits from offering a specialized green finance product: it is easier to monitor the uptake and loan performance, easier to promote the product and report to the investors. Specialized loans also help with marketing green economy and sustainable behaviors. It is also easier to develop green finance packages that may include training and other components such as grants.

Adie, France

Adie is a leading microfinance provider for microentrepreneurs in France.

Adie's approach is to develop customized green finance products for the unique needs of each segment of their clientele.

To support microentrepreneurs who travel a lot throughout the town during the day Adie developed a unique loan product - cargo bikes – a soft mobility solution. With a loan from Adie, the entrepreneurs offering services (e.g., plumbers, small repair handymen, delivery men) around the town can buy a cargo bike with containers to carry tools and other accessories. The benefit is quick transportation avoiding traffic jams.

The loan is coupled with a grant and training about adjusting the bike to the client's needs – how to arrange the containers so that they are sufficient for the carried tools and materials while ensuring maximum safety when riding.

There are also important drawbacks of having separate products for green economy. Clients often need funding for several purposes and not one single green product. Clients must take several separate loans, for example one for an energy-efficient stove, another for sustainable building materials, and another cash loan for working capital needs. This adds workload to loan officers and MFIs and complicates loan repayments for clients, who must manage several loan contracts at the same time.

FUNDING GREEN ECONOMY PROJECT THROUGH EXISTING PRODUCTS

Funding green economy through existing products such as general business loans or housing loans, is the easiest and in most cases the preferred way to provide financing. In this case, MFIs simply extend the eligibility of their existing loan offer to green products and services. Using existing products also gives MFIs and clients more flexibility as loans can be multi-purpose and not restricted to one specific green economy product.

OTHER FUNDING OPTIONS

Grant components are sometimes offered by donors or investors to entice clients to engage in green products and services. Attractive as they may seem at their face value, grants have not proved to be an effective tool to stimulate interest and demand for financing from MFIs. However, for some clients, the availability of grants is a motivating factor.

MARKETING AND PROMOTION OF GREEN MICROFINANCE

Since awareness of sustainability issues and knowledge of available solutions appears to be low, green finance requires intensive promotion and client education to get clients interested in the new alternative solutions. In addition, in the case of some technically complex products clients need assistance with installation and on-going maintenance in addition to product education.

Crystal, Georgia

Crystal, the leading microfinance organization in Georgia offers green microfinance loans for individuals to purchase household appliances (energy efficiency loans), hybrid cars and energy-saving construction materials.

As one of the limitations in the uptake of green microloans is low awareness of the benefits, Crystal decided to use a new tool to present the energy-saving potential of various technologies for housing improvement.

It developed VR video which offers a virtual walk around the town (green street) and an environmentally friendly house with various energy-saving solutions installed. It provides information how much energy can be saved with each of the solutions. When a customer comes into a Crystal branch, he/she can put on VR glasses and walk around the house to check what improvements can be made. With such a tour the client can more easily imagine how their own house can be changed and how much can be saved on energy bills.

Despite their critical importance, climate change and environmental protection messages do not entice clients to get involved in green economy. As such, “green” does not sell; clients need to see results, if not immediately then in the short term, and get tangible benefits that translate into cost savings or better functionality. The promotional campaigns need to focus on issues that are less abstract and better understood by clients. MFIs can have a choice between emotional levers and rational arguments. Either can be effective but the conditions under which they may be effective are not yet well explored and used by MFIs.

Since sustainable products and services are not on everyone’s daily shopping list but rather fall into the ‘specialty’ and ‘unsought’ category of goods, they need to be actively promoted and marketed. Specialty products are recognizable in the buyer’s mind (for example, a stove) but they are durable goods therefore purchased infrequently and typically more expensive. Unsought products are items customers aren’t aware of or don’t often think about. Many sustainability products that have no brand recognition or that have unknown application fall under this classification. Unsought products must be deliberately introduced to the consumer, who might otherwise remain unaware of them.

As already signaled in the earlier sections, the marketing challenge (and a decision point) for microfinance institutions is whether to promote only financing for green products and services, or whether to promote the availability of financing and green products jointly as a package.

Some MFIs have taken a strategic longer-term view and put sustainability at the center. This is reflected in the brand positioning of the organizations as a socially responsible company that makes green financing a priority. For these MFIs marketing and promoting green products and finance is part and parcel of their overall strategy.

MFIs use booklets, brochures for clients, educational videos on energy-efficient stoves, short films with testimonials of clients who installed the solution and talk about their energy savings. One MFI developed a VR (virtual reality) video that allows clients take a virtual walk around the town to visit a ‘green’ street and a ‘green’ house with various energy efficiency solutions installed. They can find information on how much energy each distinct solution saves. It is educational and not commercial.

The eSave app is another useful tool to help clients calculate the potential savings from green products and help them make their purchase decisions leading to borrowing funds from MFIs. Clients can also use the online Technology Selector tool developed by EBRD-GEFF where they can review various options and learn more about sustainable solutions. In addition, GEFF offers connections with sources of financing, and several MFIs are listed on this platform as green retail funders. The tool is universal and available in local languages, but it is not integrated with the loan application process.

TECHNICAL ASSISTANCE TO CLIENTS

Some microfinance institutions offer technical assistance to clients and position themselves as not only a lender but also a capacity builder for clients. However, technical assistance to clients is rather an exception than a norm as MFIs do not have technical knowledge or capacity to provide such specialized services. If technical assistance is provided, it is channeled through partnership arrangements with vendors and specialized professionals like technicians and engineers who can assist clients with installations and maintenance as external contractors.

PARTNERSHIPS WITH SUPPLIERS OF GREEN ECONOMY PRODUCTS AND SERVICES

Partnering with suppliers and vendors of sustainable solutions could be a good way to leverage their sales potential and interest to sell products, but most MFIs do not use this option very much. In general, MFI financing is too small and too limited to be attractive for the vendors who prefer to have a relationship with a bank. In addition, not all products sold by the vendors meet the required technical parameters to qualify for MFI loans which are typically funded by international investors. Also, there are big differences between countries in terms of availability of products and vendors. In some countries there is sufficient and varied supply of green products, and in others this may not be the case. That said, this is a potential opportunity for the future and some MFIs expressed interest in exploring such partnerships as they become better positioned in the green finance market.

INVESTMENT RESOURCES FOR GREEN MICROFINANCE

The source and the amount of funds determines the ability of MFIs to engage in certain activities such as green finance and sustainable economic activities. As mentioned earlier, most MFIs started green finance activities using external funding, and so far, very few MFIs chose to use their internally generated resources to finance such activities.

SUPPLY OF GREEN FUNDS

At this point, funds for green finance and sustainable products seem to be in adequate supply in relation to the demand from MFIs and their clients, although it is difficult to assess the total amount of financial resources available for green microfinance for MFIs in Europe.

While there are over a dozen microfinance funds and investment vehicles in Europe, not all are involved in green finance and sustainability. They endorse the social, economic, and environmental principles and international standards although in most cases climate change mitigation is not explicitly on the agenda of the microfinance investment funds.

The funding for green finance in Europe comes mainly from two funders (GGF and GEFF). If other microfinance funds which are domiciled in Europe offer capital for green economy activities, they do it outside of Europe. This concentration of resources in two large funds has the benefit of being able to provide a wide range of technical services in addition to funding and developing deeper expertise in green economy and finance.

The investors offer the MFIs credit facilities together with support from international consulting teams (engineers, marketing experts) to develop procedures, train loan officers and help with identifying eligible project applicants. The technical assistance is funded by donors, and it may take up to 2 years to secure funds for the technical assistance for a country. MFIs which are interested in the green finance facility from the investors, and which do not meet the eligibility criteria to participate receive dedicated capacity building.

It must be noted that neither GGF nor GEFF work solely with the microfinance market as they also fund banks in the region. MFIs appear to be performing better than banks in allocating the resources to green products.

GREEN INVESTMENT FOCUS

So far it is difficult to categorize the investment strategies used by the green finance funds which is understandable for the emerging green finance sector. In lieu of investment strategies it may be safer to speak of an investment focus which varies from fund to fund. Some funders focus more narrowly on energy efficiency while other funds like GEFF offer access to a broad range of sustainable products.

GREEN FINANCE CONDITIONS

Recognizing the early stage of green finance development and the relatively low demand for green finance loans, some microfinance investors strive to offer funds to MFIs on preferential terms although the lower interest may not be sufficient to create stronger incentives for clients. In addition to financial resources, some funders offer grants and technical assistance to MFIs and clients.

Green financing typically requires additional monitoring and reporting by clients and MFIs that relate to the environmental protection such as the amount of energy saved by clients, reduction of CO_2 emissions and the like. These requirements which are in some cases supported by online tools are one of the major burdens on MFIs and clients who are required to calculate impact numbers and provide numerous documents to justify the green loans.

Grants tend to be cumbersome to apply for and clients cannot be guaranteed to receive them, though they need to make the purchase decision and take a loan before having the grant decision. Even when clients receive a grant, the amount of the grant does not compensate for the cost differential between the green economy products and the regular products, especially when clients opt for cheaper products which do not qualify for the grant support.

Another issue raised by MFIs is the process by which a grant is approved and disbursed. In most cases, a grant is approved by the sponsoring donor or investor, and therefore the grant component is not connected in the mind of a client with an MFI, which weakens the role and the importance of the microfinance lender.

Finally, not all microfinance investors offer grants to clients, which creates a situation where some products are eligible for grant subsidy and others are not. This skews the demand towards to products with grants and weakens the demand for other products which do not have a grant option.

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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.