

*Clean Energy Finance and Investment Roadmap*

**Workshop 1: MSME Energy Efficiency – Monday 14 March 2022**

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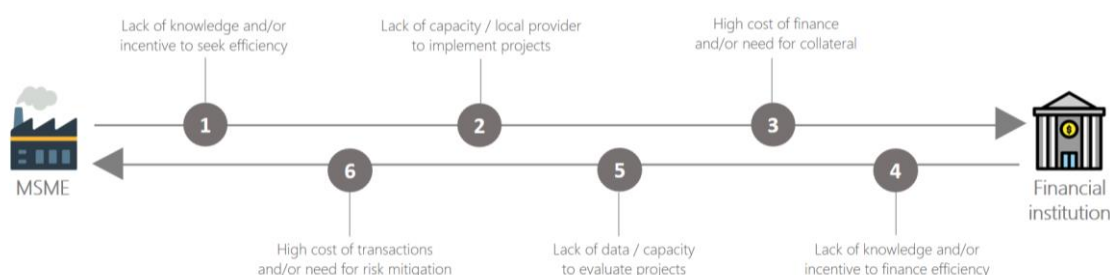
## Unlocking capital for MSME energy efficiency: workshop summary notes

Energy efficiency has been highlighted as a key aspect of India’s climate ambitions. At the 26<sup>th</sup> Conference of the Parties (COP26) to the United Nations Framework Convention on Climate Change, Prime Minister Shri Narendra Modi announced intentions to reduce India’s carbon intensity by 45% over 2005 levels by 2030, significantly raising the existing target of 33-35%. Higher ambition brings immense investment potential for energy efficiency in India, and creating the enabling conditions for the flows of capital required to achieve this 2030 target will be essential.

Micro, small and medium enterprises (MSMEs) are of particular importance in this context. MSMEs constitute more than 90% of all industrial units in India, employing over 111 million people and contributing to about 29% of India’s gross domestic product. Altogether, MSMEs account for a quarter of the total industrial energy consumption in India. Owing to their reliance on low efficiency technologies and poor operating practices, MSMEs also face substantial energy costs (as much as 35% of overall operating expenditures). Improving energy efficiency in MSMEs will thus not only reduce energy-related emissions but also reduce this cost burden.

The OECD Clean Energy Finance and Investment Mobilisation (CEFIM) programme and Natural Resources Defense Council (NRDC) presented findings from stakeholder consultations with actors engaged in efforts and initiatives seeking to address and improve energy efficiency finance and investment for MSMEs. Consultations pointed to a number of key challenges and opportunities:

### Illustrative schematic of the overall MSME energy efficiency finance and investment value chain



MSMEs often lack awareness and/or appetite to seek energy efficiency investments, especially if not tied to improvements in production capacity or export competitiveness. Where there is demand, lack of capacity to carry out efficiency measures (including by local service providers) can create additional bottlenecks. A number of initiatives have sought to address these barriers through training and capacity building support, for instance working with MSME clusters or segments, although this can be both time and resource intensive. Workshop participants also highlighted that available technologies, adapted to the Indian context, may equally require further training and capacity efforts to ensure



energy efficiency solutions are suited to the needs of MSMEs (e.g. through customisation) and can be appropriately operated/maintained to ensure their effectiveness over time.

Access to affordable financing is another critical challenge, particularly given MSME credit profiles and the common need to provide upfront collateral or equity to access finance. There also is an overall lack of suitable finance solutions, such as cash-flow based financing options, to support energy efficiency investments by MSMEs.

Barriers exist equally on the financial institutions' side of the equation. Part of this is due to lack of awareness and/or familiarity of energy efficiency technologies. Energy and asset performance data is also scarce, both at the unit or cluster level, contributing to an already high perception of risk by financial institutions. Lack of data also contributes to high transaction costs, for instance from due diligence to assess the expected return of measures on a case-by-case basis, and this can add to the challenges and/or lack of willingness to seek out and lend to MSME energy efficiency projects. Lack of standardised documentation and other issues, like hedging costs faced by international lenders, can further increase the overall cost of financing.

Several policies, initiatives and support schemes at both the national and cluster level have addressed these challenges. Consultations consistently pointed to the need to strengthen efforts in a way that ensures greater consistency and replicability of those efforts to address bottlenecks in the MSME energy efficiency finance and investment value chain. Given the effectiveness of previous initiatives working in a cluster-based approach, the Bureau of Energy Efficiency (BEE) proposed two possible initiatives for MSME energy efficiency. The first is exploration of a Common Facility Centres, in which community-based energy efficiency technologies can be made available to MSME clusters on a pay-per-use basis. The second is exploration of expansion of coverage to include MSME clusters under the Perform, Achieve and Trade (PAT) scheme. These may help address issues along the MSME energy efficiency finance and investment value chain, such as appetite for efficiency measures and available, suitable technology solutions. The proposed measures would also build upon existing BEE initiatives to address finance and investment in energy efficiency technologies, such as the new Energy Efficiency Financing Platform (EEFP).

### **Group discussion: identifying solutions and targeting interventions**

Several opportunities were highlighted during OECD and NRDC stakeholder consultations in preparation of the first CEFI Roadmap workshop on MSME energy efficiency, including:

- Increasing the continuity and replicability of past and existing initiatives, building upon lessons learned and working with the right market stakeholders to enable scale;
- Providing continued support through training and capacity building to prepare bankable projects and to carry out necessary steps, such as performing investment grade energy audits;
- Lowering cost of finance through targeted financing mechanisms like a first loss facility, potentially in combination with other concessional finance to leverage commercial capital;
- Improving data availability to boost lender confidence in MSME energy efficiency projects;
- Reducing transaction costs of financial institutions through elements like standardised documentation, which can also help to create a project pipeline (e.g. for aggregation and securitisation to access capital markets);

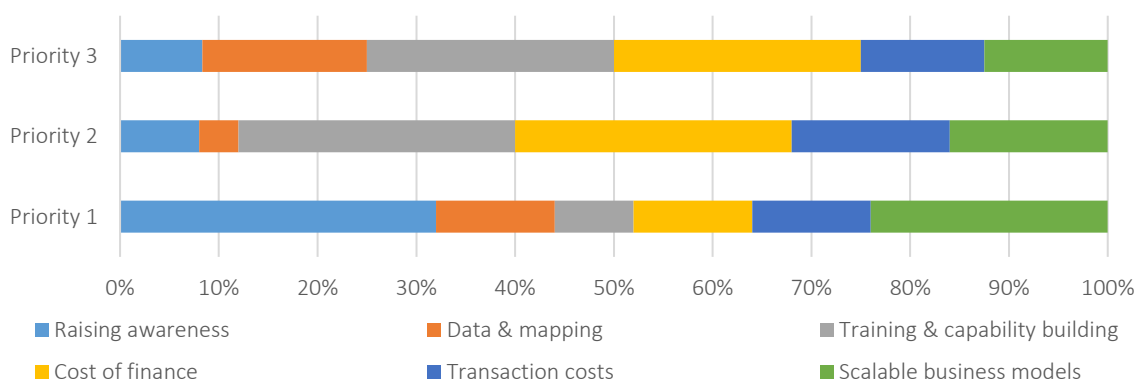


- Unlocking market-based solutions, including greater development of energy service companies (ESCOs) and innovative approaches such as the Smart Joules initiatives to offer efficiency services and/or products at suitable scales.

Group poll results during the workshop highlighted a number of these points as critical priorities for MSME energy efficiency. The top three priorities highlighted by the group (by individual order of priority) were: 1) raising awareness and addressing amount of “hand holding” to enable demand/appetite; followed by a tie for 2) training & capacity building (e.g. for preparing projects/documentation) and 3) cost of finance, including offering & terms of finance (e.g. need for upfront collateral; lack of cash-flow financing).

When taken collectively across the three priority areas (in terms of cumulative voting by area), the top three order changes to: 1) cost of finance; 2) training & capacity building; and 3) effective and scalable business models (including need for service/technology providers).

**Poll 1: What are the top three issues you see as critical priorities for MSME energy efficiency?**



Participants also indicated (beyond the above-listed six categories) other barriers/challenges for MSME energy efficiency finance and investment. One key priority that emerged was the development of customised technological solutions, for instance at the cluster level, supplemented by systematic demonstrations and adequate support to facilitate the local uptake of new solutions. Availability of trusted and skilled service providers to ensure smooth implementation and maintenance at the cluster level was further highlighted as a key success factor.

Respondents also reaffirmed multiple elements needed within the training and capacity building framework, including efforts to: create bankable opportunities; simplify documentation; and build capacity of bank officers at local/decentralised level. The need for involving more local actors (e.g. state designated authorities and MSME cluster associations) was equally noted as a way to build trust and achieve greater scale in interventions.

Written responses to the poll included additional proposals such as clearer policy and regulatory signals for MSME energy efficiency implementation. One such example discussed was to impose statewide energy efficiency targets to help accelerate technology upgradation in MSMEs, similar to the way state procurement obligations contributed to success in India’s renewable energy market. The use of incentives, penalties and possible green product standards could also be an effective strategy to promote energy efficiency uptake, particularly for export-oriented MSMEs or in public



procurement supply chains. Declaring energy efficiency as priority lending can also encourage banks to design and implement targeted MSME lending schemes for efficiency investments. Possible legal reforms were additionally proposed to enable entry of private ESCOs at the cluster level, as these were noted as key actors for bridging the technical and financial aspects of MSME energy efficiency.

Participants also proposed several measures to improve data availability, including: better monitoring, reporting & verification for disseminating success stories and enhancing trust; incentivising MSMEs to file energy returns to create a regularly-updated central data repository; and identifying opportunities for digitalisation in improving overall information on energy efficiency performance.

### **Group discussion: actions to unlock finance and investment for 2030 ambitions**

Remarks by participants highlighted several important elements for achieving 2030 ambitions, such as the critical role of quality data availability to boost investor confidence and the need to scale up financing through both new and existing risk mitigation measures.

It was noted that the full extent of banking finance channelled into MSME energy efficiency is not really known, given that efficiency is often a bi-product of technology upgradation loans. Identifying and tagging energy efficiency loans can involve complex baseline studies and auditing procedures. Defining simplified tagging criteria will thus contribute to improved information on MSME energy efficiency finance.

Several measures on risk mitigation were likewise proposed to create the suitable conditions for unlocking greater private capital for MSME energy efficiency finance. For instance, the flexibility and response time of first loss facilities such as the Partial Risk Sharing Facility (PRSF) can be improved. While these schemes offer a high risk coverage, their effectiveness is hampered by potentially significant delays in funds disbursement. There is also scope for developing performance-based contracting model with ESCOs, in combination with other innovative support measures such as a payment security mechanism or energy savings insurance. Overall, ensuring the simplicity and flexibility of these mechanisms was identified as a critical success factor for any financial support scheme.

It was further noted that the new Energy Efficiency Financing Platform could serve as a centralised facilitation centre for financial support. MSMEs will be able to register interest in energy efficiency projects by providing basic details through the platform, which will then automatically screen proposals and pass them on to BEE and empanelled financial institutions for further evaluation. This can help to bridge demand and supply in the energy efficiency financing market, although awareness raising and training and capacity building are still required to ensure that the benefits of the Platform are accessible to MSMEs and related stakeholders (e.g. ESCOs). Integrating additional features such as an up-to-date dashboard of indicators on financing activities and a monitoring, reporting & verification functionality were also suggested as further additions to the Platform.