

Financing SDG 12 – Supporting MSMEs’ access to finance for sustainable consumption and production in Asia

Ideas for better technical and financial
cooperation

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About SWITCH-Asia: The EU has become a pioneer regarding the promotion of sustainable lifestyles. Under the European Green Deal and, in particular, the new Circular Economy Action Plan, a sustainable product policy legislative initiative was announced to make products fit for a climate-neutral, resource-efficient and circular economy. Such priorities are also to be reflected in the EU's external cooperation. In response to this quest, SWITCH-Asia has provided more than EUR 350 million in grants to 143 technical assistance projects since 2007. Projects focus on helping micro, small and medium-sized enterprises (MSMEs) adopt cleaner technologies and more sustainable industrial practices, and to access the necessary financing.

Executive summary

Micro, small and medium-sized enterprises (MSMEs) account for around 97% of all enterprises in Asia and 69% of the Asian labour force. Compared to large companies, they are more often low-tech and depend on inefficient production processes, which is visible in their low productivity – for example, they are responsible for less than 30% of value added and exports in most ASEAN countries. Helping MSMEs become greener and cleaner is thus a major component in the effort to make economies more sustainable. ‘Sustainable Consumption and Production’ (SCP), a concept that aims to redesign how products are created, consumed, and disposed of as part of a circular economy, can guide the transformations of MSMEs.

One of the critical barriers preventing MSMEs from adopting SCP practices is the lack of financing. Available sources of financing – including bank lending, microfinance, equity investments, lending from friends and family and others – are not currently meeting MSMEs’ financial needs. The gap in MSME financing, particularly SCP financing, exists for several reasons. Micro and small MSMEs often do not comply with financial institutions’ borrowing requirements (e.g. proof of creditworthiness, environmental clearance, due diligence and issue of governance) or cannot afford their financing terms. Moreover, MSMEs may lack awareness of available schemes for SCP finance. Financial institutions (FIs) are thus unable to build a pipeline for SCP financing. FIs, in turn, lack the experience to evaluate SCP measures and are hesitant to finance investments that are perceived as risky. How heavily such challenges weigh varies between different types of MSMEs, sources of financing and local contexts.

In response to these challenges, the EU SWITCH-Asia SCP Facility has developed recommendations and ideas for improving technical and financial cooperation based on the programme’s experiences. The ideas presented in this study are meant to support development cooperation agencies, business consultants, associations, researchers and Development Finance Institutions (DFIs) in designing successful interventions for MSMEs.

Technical cooperation / MSME advisory and support

- Assess and address the target group’s **actual financing needs**, also considering country contexts: whereas well-established MSMEs might have access to standard financing but need support for investing in SCP (especially if operating in countries with high financial market readiness), many other MSMEs require basic finance readiness support (or do not want to access external financing at all)
- Develop project ideas and business cases **together with the financial sector** in order to address financial institutions’ needs and create ownership
- Make access to finance an **integral component** of MSME support projects, by ensuring that key experts have financial expertise and by demonstrating how each work package contributes to an improved access to finance, and this includes continuous support of MSMEs **after financing has been approved** to ensure that SCP projects are implemented successfully plus a design exit strategy for the project
- Support **sustainable transformations** more broadly, for example by advising policymakers and legislation; and highlight the need for a systemic shift that involves all economic actors across programmes, thereby making SCP investments more common

**Financial
cooperation /
Development
Finance
Institutions**

- Identify the **value of SCP** for DFIs' and partners' priorities in order to increase demand for SCP-related interventions and financing
- Better **mainstream SCP** into development finance by integrating it into country plans, credit lines and financing for large corporate clients
- Provide **SCP-specific** financing for on-lending, requiring local financial partners to address SCP specifically rather than only indirectly
- Finance **R&D, consumption and ecosystem building** in order to bolster demand for MSMEs' sustainable products and services
- Work on **standardizing** SCP, e.g. by developing impact metrics, case studies and pilots
- Foster more **effective technical assistance** (TA) by ensuring that DFI-funded TA providers consider the recommendations presented in this paper
- Take on **calculated 'new' risk** by investing in new technologies or practices, thereby making SCP investments that are not currently favoured by DFIs' risk return ratios that do not encourage investment into innovative technologies
- Build (new forms of) **partnerships**, especially by coordinating more closely among donors and aligning priorities, but also by placing greater emphasis on partnering with dedicated green financial intermediaries
- Strengthen **policy work** and lobby for better SCP policies with governments

This report builds on insights from past and ongoing projects and assignments under SWITCH-Asia, the European Union's (EU) programme to promote SCP in Asia and Central Asia. .

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1. Introduction: Why is SCP finance important?

1.1 Sustainable Consumption and Production

Economic growth has lifted many countries out of poverty. Historically, such growth has depended heavily on natural resources and nature's ability to absorb the residues of production and consumption, for example by cleaning the air, filtering water and decomposing waste. Yet, the rate at which nature is used often exceeds its regenerative capacity and leads to environmental depletion, pollution and destruction.

Several of the so-called 'planetary boundaries' have already been surpassed, increasing the risk of mass environmental impact (Stockholm Resilience Centre). Nitrogen and phosphorus flows to the biosphere and oceans through fertilizers are well beyond their safe operating limits, as is the release of toxic and long-lived substances into the environment – from heavy metals to industrial chemicals and other substances. Greenhouse gas emissions and the resulting changes in the global climate have also reached dangerous levels. Animals and plants are becoming extinct or are being severely decimated, throwing whole ecosystems out of balance. The current economic model comes at a high cost that is borne by society, and threatens the very systems on which the future of human wellbeing depends.

It will be crucial to change unsustainable economic practices. Sustainability today is no longer simply about increasing efficiencies or complying with regulations. It is about making fundamental changes in the way business is done, on the side of production as well as consumption. Results can be achieved only by rethinking business models and supply chains and designing new policy frameworks to enable sustainable consumption and production patterns.

Sustainable Consumption and Production (SCP) aims at decoupling economic growth from resource consumption and environmental degradation (UNEP, 2022). Its principles apply to all economic activities and actors, from resource extraction to manufacturing, end consumers and policymakers, to improve the environmental performance of products throughout their life cycle and drive more sustainable lifestyles. **One of the most important approaches of SCP is facilitating a 'circular economy' in which resources are used and re-used in an efficient manner and waste is minimized.**

Promoting SCP has been part of the international development agenda for more than 30 years. SCP is a keystone of the United Nations Sustainable Development Goals (SDGs) and is expressed as SDG 12, 'Ensuring Sustainable Consumption and Production' (UNEP, 2018); SCP-related targets are also integrated into 12 additional SDGs (SEI, 2018 and SDG 12 Hub). The SDGs seek to improve human wellbeing while using resources more responsibly and minimising the disruption of planetary systems. Following through on these goals will require a fundamental re-imagining of how we produce and consume, moving away from linear economic models and towards circularity.

Box 1 illustrates just how significant changes in consumption and production patterns can be.

Box 1: SCP facts and figures

- Each year, an estimated one third of all food produced – equivalent to 1.3 billion tons worth around \$1 trillion – ends up rotting in the bins of consumers and retailers, or spoiling due to poor transportation and harvesting practices.
- If people worldwide switched to energy-efficient light bulbs the world would save US\$120 billion annually.
- Should the global population reach 9.6 billion by 2050, the equivalent of almost three planets could be required to provide the natural resources needed to sustain current lifestyles.



Source: UN Photo / Martine Perret

Source: UN Sustainable Development Goals

1.2 Asian MSMEs and the need to foster access to finance

While steep growth trajectories have increased general well-being and life expectancy in many Asian countries, the negative side-effects of this development are clearly visible. Urbanization and agricultural and industrial expansion have resulted in extensive biodiversity loss, both on land and in marine ecosystems. Unsustainable water extraction has resulted in water insecurity in 29 Asian countries. The demand for timber and land has resulted in the clear-cutting of natural forests, reducing the world's forest coverage by 10% (UN ESCAP, 2018). These are just a few examples of the ways that increased production and consumption have affected Asia's biosphere. Asia now uses half of the world's resources, and its average per capita material footprint continues to rise rapidly (UNEP, 2016). It is necessary to promote the effective use of resources in the Asia region and to mitigate resource depletion and environmental destruction.

Although circumstances clearly differ from country to country, large corporations operating in Asia have frequently already been in contact with SCP principles through their investors and customers, or because of SCP-relevant national policies and international standards. Large firms generally have a higher capacity to adopt SCP practices and adhere to new SCP policies than small businesses.

Meanwhile, micro, small and medium-sized enterprises (MSMEs) represent the majority of businesses in Asia. They account for around 97% of all enterprises in Asia and employ 69% of the Asian labour force (ADB, 2020). Compared to large companies, they are more often low-tech and dependent on inefficient production processes (ADB, 2021), which is visible in their low productivity – for example, they are responsible for less than 30% of value added and exports in most ASEAN countries (OECD-UNIDO, 2019). Given their impact and economic importance it is safe to say that SCP-related goals will not be achieved if MSMEs are left out of sustainability efforts. Moreover, as key players in value chains both for the Asian and international markets, supporting MSMEs can contribute to greening international value chains by growing their capacity to innovate.

One of the primary difficulties for the switch to more sustainable business models, processes and products is the difficulty in obtaining financing for needed investments. The general financing gap for MSMEs in emerging economies is estimated at USD 5.2 trillion annually, with South Asia, East Asia and the Pacific accounting for 52% of this gap (World Bank, 2022). The gap is significantly higher when informal businesses are considered and when SCP measures are included.

Financing is an important issue for the scaling up of SCP-relevant process optimisation and business models. SCP finance in this regard is closely related to Green Finance, as defined by the G20:

Financing of investments that provide environmental benefits in the broader context of environmentally sustainable development. These environmental benefits include, for example, reductions in air, water and land pollution, reductions in greenhouse gas (GHG) emissions, improved energy efficiency while utilizing existing natural resources, as well as mitigation of and adaptation to climate change and their co-benefits (G20 Green Finance Study Group, 2016).

Yet MSMEs across Asia generally face numerous obstacles for accessing the financing they need and want. These obstacles are even greater for companies using new technologies and innovative business models as proponents of SCP.

1.3 Focus of the report

Although it is important to make sure that MSMEs can switch to more sustainable processes, products, and business models, finding the necessary financing for this switch is difficult. It is thus necessary to understand existing barriers and work on reducing them.

Development cooperation – including technical and financial cooperation – has long played an important role in fostering access to finance for MSMEs and supporting local stakeholders in greening production and consumption patterns. It is time to reflect on past approaches to determine how future cooperation could be shaped so as to maximize its positive effects.

This report intends to do exactly this: summarize and reflect on experiences from MSME advisory projects and research assignments financed by the SWITCH-Asia programme, the European Union's (EU) programme to promote SCP in Asia and Central Asia. The resulting insights are meant to inspire development cooperation agencies, business consultants, associations, researchers and development finance institutions (DFIs) and help them design successful interventions for improving MSMEs' access to SCP-relevant financing. The following chapters aim to:

- summarize the type and volume of **financing that MSMEs need** to become more sustainable, and present the barriers that keep them from obtaining such financing (chapter 2)
- illustrate how **technical assistance** could be designed to successfully improve the financial situation of MSMEs with SCP ambitions (chapter 3)
- provide ideas for how **financial assistance** could leverage public funding to increase the availability of private financing for SCP (chapter 4).

Since 2007, SWITCH-Asia has provided more than EUR 350 million in grants to 143 technical assistance projects that help MSMEs adopt cleaner technologies and more sustainable industrial practices and access the necessary financing. Stimulating demand for better products and supporting a conducive policy framework are additional focus topics of the SWITCH-Asia grant projects. Many of the recommendations for improving technical cooperation presented in this report have already been successfully proven in SWITCH-Asia projects, and ideas for increasing the impact of financial cooperation have been discussed with DFIs.

2. The SCP financing needs and challenges of Asian MSMEs

This chapter seeks to establish a sound understanding of the current gaps in SCP financing for MSMEs. The following sections provide an overview of the financing that MSMEs may need for their SCP ambitions, the financing that is available for MSMEs in Asia, and the challenges and solutions for accessing available sources of funding.

2.1 Typology of measures in support of SCP

Companies can choose from a wide variety of measures to improve their environmental impact, although of course depending on their sector, size and maturity, and on other factors such as the availability of SCP-related service providers, general market maturity, legal frameworks and industry standards. Relevant measures can range from small-scale adjustments to large changes in a firm's operations. Experiences made by SWITCH-Asia projects show that the following types of SCP-relevant projects can be distinguished, allowing for a first understanding of respective 'price tags':

Type 1: Incremental adjustments that make production more efficient

SCP-related measures can be comparatively small, requiring only minor changes in a firm's processes or management approaches. Agricultural and industrial production can, for instance, be made more efficient by repairing leaks or reusing process water. Improvements can also be achieved by educating the workforce, e.g. through training on efficient equipment use. SCP measures of this type typically do not require large investments, and are financed directly by the company or by financial institutions (FIs) often without specifying that SCP impact is achieved. Efficiency improvements often reduce costs in the production process, thus amortising the investment over time. This shows that such low-cost measures can be economically sound in a large variety of sectors.

Table 1: Examples of type 1 SCP measures

Company	SCP intervention	Investment
Steel production firm in Bangladesh	Saving electricity through compressed air leakage reduction	EUR 1110 for repairing and optimising pipelines and valves; EUR 300 per year for upkeep
Steel production firm in Sri Lanka	Harvesting rain water for cleaning and cooling	EUR 700 to install rainwater collectors; EUR 200 per year for upkeep



METABUILD metal production project

Sources: SWITCH-Asia 2021a, METABUILD 2020

Type 2: Changes leading to significant sustainability improvements

Improving production or service delivery can also mean significant changes to MSME operations, such as renovating a building or upgrading production machinery. Such measures sometimes need to be taken because of changes in regulatory requirements, to achieve certification or to satisfy clients' requirements and saving costs by improving efficiency or lowering maintenance and replacement costs. These types of projects require planning and preparation to ensure that they are successful and that implementation does not overstrain company resources. Often, new technology or innovative approaches optimising

for efficiency of resource use and waste minimisation are used. These more significant measures are costlier and, if not financed by the company, require financing specifically tailored to the project in terms of amount and repayment modalities. Financing providers typically assess the investment before approving financing, e.g. to calculate risk-return and determine adequate collateral requirements.

Table 2: Examples of type 2 SCP measures

Company	SCP intervention	Investment
Individual rickshaw drivers in India	Substituting fuel-based auto-rickshaws by electric auto-rickshaws	EUR 2800 – 3800 to buy an electric auto-rickshaw
Wire manufacturer in Nepal	Installing variable frequency drives (VFD) in motors to improve output speed	EUR 80,000 to install VFD



INDTUK auto-rickshaw project

Source: SWITCH-Asia 2021a

Type 3: Providing SCP-relevant products and services

Whereas Type 1 and 2 measures target the production process, another type entails setting- and scaling-up business models that provide sustainable products and services or that support other companies' efforts to become more sustainable. Such companies often need seed funding to launch their product or service, or working capital to pay for their daily operations. They often also need funding for larger investments. Finance providers with specific SCP expertise will be more likely to understand and value the business models of such MSMEs and be able to provide financing.

Table 3: Example of type 3 SCP measures

Company/household	SCP intervention	Investment
Bamboo processing firm in India	Producing bamboo as an alternative material to timber, plastic, steel and others	EUR 900 per month to cover working capital requirements
Local solar technology providers in Cambodia	Providing solar energy to MSMEs in the agri-food sector	Seed funding for establishing solar energy provision enterprises – EUR 30,000 for each provider



India bamboo production project



SWITCH to Solar project

Source: SWITCH-Asia Switch to Solar 2021a

2.2 SCP Financing for MSMEs in Asia

As illustrated through the different types of SCP measures, the financing needs of MSMEs for SCP-relevant projects vary widely. The costs of SCP measures often exceed MSMEs' internal financing capacity, making it necessary to revert to external financing (such as through banks or equity investors) if the planned measure is not to be dropped entirely.

A report by the OECD found that global sources of financing for MSMEs have increased over the past several years (OECD 2019). Whereas the primary sources of financing have historically been bank loans, loans from friends and family, and microfinance loans, there has been a significant expansion in options such as supply chain finance and venture capital funding.

Table 2 presents an overview of funding sources available to different types of MSMEs and their SCP¹ measures/business models. It was compiled based on several SWITCH Asia publications (SWITCH Asia 2021b/c/d) and external literature (GIZ 2022, OECD 2015, ADB 2021, and more).

Table 2: Institutions providing financing to MSMEs in Asia

Functioning	Target group	Examples from South Asia ²
Commercial banks		
Commercial and public banks provide loans, credit lines and sometimes other financing options, such as factoring. ³ Traditional bank loans may have higher amounts and longer repayment windows with respect to micro-loans.	Mostly well-established medium-sized SMEs, with a credit history and secured cash flows (e.g. family-run business, perhaps with second-generation management)	<ul style="list-style-type: none"> Commercial banks in Bangladesh successfully set up a micro-credit system based on group guarantees with the aim of increasing MSME financing, though this was not specific to SCP projects. Banks are the primary sources of financing for MSMEs in India, but green financing from commercial banks is limited and typically focused on energy projects.
Microfinance institutions (MFIs)		
MFIs provide small loans to MSMEs to finance projects that are typically expected to generate a return in a short window of time.	MFIs are set up to cater directly to the needs of micro and small enterprises, by being easily approachable and not requiring typical loan security.	<ul style="list-style-type: none"> Microfinance institutions are a significant source of MSME financing in Pakistan and served over 7 million borrowers by the end of 2019. In India, microfinance is seeking to fill financing gaps, and numerous non-SCP-specific programmes are available.

¹ Please note: some financing providers have funds available for 'green' measures or 'sustainable energy'. Both are relevant for SCP projects as they fall under the umbrella of green projects, and can also consist of energy efficiency measures or installation of renewable energy systems/sources.

² Examples refer to the "Finance briefs" of Bangladesh, India and Pakistan by SWITCH Asia (SWITCH-Asia 2021 b, c, d) or are sourced from central bank websites

³ "Factoring, receivables factoring or debtor financing, is when a company buys a debt or invoice from another company." <https://tradefinanceanalytics.com/what-is-factoring>

Non-bank financing institutions (NBFIs)

NBFIs can include MFIs, credit cooperatives, finance companies, and other institutions. NBFIs may offer loans, insurance, leasing, and other services to MSMEs. Unlike banks, NBFIs cannot accept deposits, and they typically have fewer regulatory requirements.

A broad variety of financial institutions fall into the category of NBFIs, so target groups can range from micro enterprises to well-established medium-sized enterprises.

- NBFIs were responsible for 12% of green financing in Bangladesh from 2014 to 2019. Financing is provided in a variety of ways, including refinancing programmes and open lines of credit to be used specifically for green activities.
- NBFIs provide significant debt financing to MSMEs in India, but only a few NBFIs offer options for green financing.

Development financial institutions (DFIs)

National, bilateral and multilateral DFIs provide loans, investment capital and risk hedging mechanisms, such as loan guarantees.

Direct target groups include local banks, investment funds and large companies, which in turn on-lend to (M) SMEs. Some DFI programmes provide funding directly to large SMEs in Asia.

- The state-owned Infrastructure Development Company Limited in Bangladesh has lines of credit open for sustainable energy projects and has partnered with many microfinance institutions to distribute credit to MSMEs.
- Foreign development institutions are funding green projects in Pakistan. Some are providing financing to MSMEs, with some of the funds being earmarked for sustainable projects.

Investors

Investors such as private equity funds and venture capital funds are typically interested in exchanging capital for equity in a company. Financing from investors and venture capital groups in Asia is limited but growing.

Start-ups with entrepreneurial setup run by professional management. Financing from investors is generally not accessible to small and micro enterprises.

- India's venture capital sector is very active, but only a few funds offer financing to MSMEs seeking to improve sustainability.
- Venture capital is limited in Bangladesh, but as of 2018, fifteen venture capital firms were working on green projects, and the first green bond directed at MSMEs was launched in 2021.

Government Institutions

Governments run funds or schemes directed at MSMEs. Additionally, governments sometimes provide financing through state and central banks.

Schemes may be targeted at different types of MSMEs

- The government of Bangladesh provides green finance through two funds. MSMEs are not directly eligible but profit from the project finance made available.
- The Indian government has a variety of SCP schemes for MSMEs.

Supply chain finance

Buyers and large partner firms in a supply chain may offer factoring, leasing, warehouse receipts, and other forms of supply chain finance to MSMEs in their supply chain.

Supply chain finance is only applicable to MSMEs in the supply chains of large buyers or partner firms.

- Reserve Bank of India reported seven factoring companies providing financing to MSMEs in 2020. Factoring companies provided roughly EUR 172,000 in loans to MSMEs, approximately four times more than they did in 2015 (ADB 2021).

Family and friends

Social support systems such as family members and friends are a primary source of informal financing for MSMEs, and are often the only source of financing available for low-capacity enterprises.

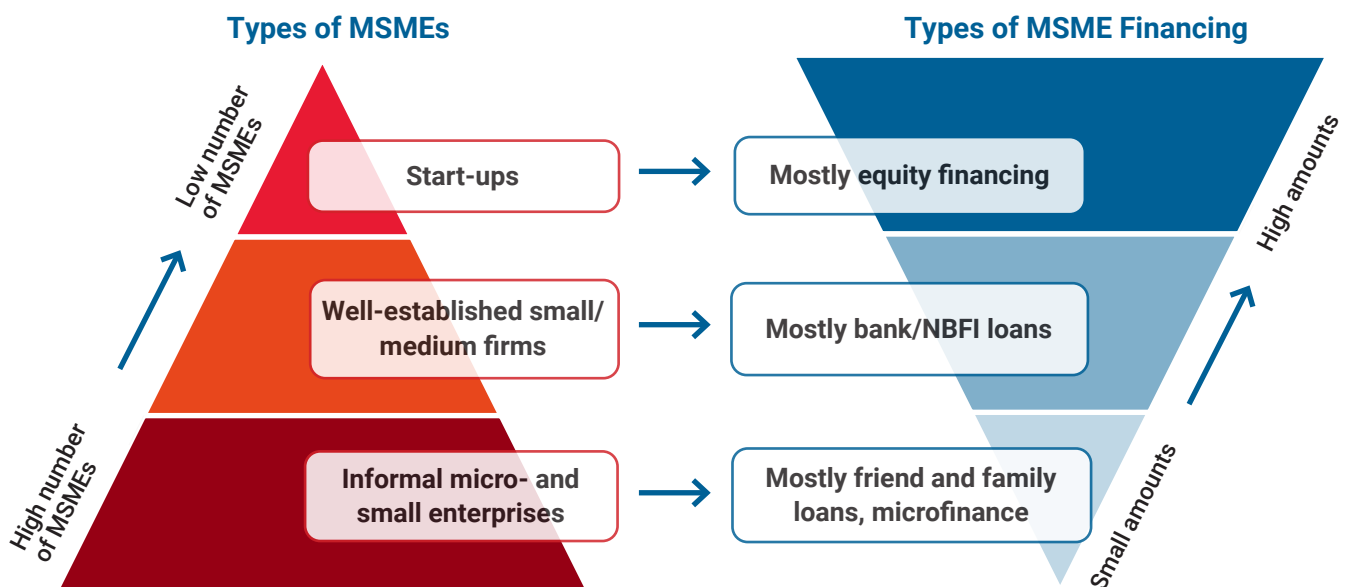
Financing from family members and friends is particularly relevant for micro and small enterprises which do not have access to formal methods of financing.

- The Nepal central bank reported that family wealth and inheritance accounted for 33% of initial financing for MSMEs in 2020–2021 (NRB 2021).

As table 2 shows and as experiences from SWITCH-Asia projects prove, MSMEs can thus be broadly categorized into three groups with different degrees of access to external funding. Interest and ability to access external financing differs according to the type of enterprise.

- **Start-ups run by professional management with a steep growth trajectory** have as their primary source financing from investors (e.g. [international] equity investors), although they may also have the necessary requirements in place to secure a bank loan. They are clearly interested in external finance as it helps them attain market readiness level and grow into full-fledged modern enterprises. However, (equity) financing for start-ups is only starting to emerge across many Asian countries, limiting the opportunities for entrepreneurial companies to secure funding for SCP innovation.
- **Well-established small- to medium-sized firms** have proven business case and a successful financial history, which makes it possible for them to secure bank loans. In addition to qualifying for financing from commercial banks, they may also qualify for financing from government schemes and DFIs, either directly or through bank loans. Additionally, such businesses may be able to access NBFi funds and potentially supply chain finance, depending on whether the business is in the supply chain of a large partner firm.
- **Informal micro and small businesses** face significant challenges in accessing finance, and are often dependent on loans from family and friends. Microfinance loans can be a potential option, as well as other NBFi initiatives, such as credit cooperatives and leasing. Business owners may also be able to access funding from certain government schemes aimed at small and micro businesses. Their interest in taking up significant amounts of formal external financing is often limited by cumbersome borrowing requirements. Given that funding is essential for scaling up and replicating business cases that have been proven to work, having to rely solely on informal sources can limit the impact potential of SCP-related investments or business cases.

Figure 2: The “pyramids” of MSME financing



Source: SWITCH-Asia / adelphi

2.3 Challenges preventing MSMEs from obtaining external funding

MSMEs often face considerable barriers for accessing finance, both in general and for SCP measures. Such challenges are typically rooted in inadequacies on both the demand- and the supply-side of finance, meaning that both the MSMEs demanding financing and the FIs supplying financing need to work on themselves to increase the flow of funding for MSME business investments.

Tables 3 and 4 present a compilation of the most evident demand- and supply-side challenges. They build on insights from SWITCH-Asia projects and external literature (SEED & ACODE 2022, Finance Watch 2022, IFC 2017, OECD 2019, etc.). Which hurdles an MSME will actually face ultimately depends on its preparedness level and on the local context, e.g. the general development of the local financial market and the readiness of FIs to finance MSMEs.

Table 3: Demand-side barriers

Challenges to SCP financing

Awareness of financing: MSMEs may lack awareness of available schemes for SCP finance, particularly micro and small enterprises that lack experience with securing external financing.

Challenges to general MSME financing

Reservations about taking on debt: MSMEs often operate in contexts of instability and economic, political, social or other uncertainty. Such conditions can cause MSMEs to be overly risk-averse and to avoid financial commitments, especially if inflexible repayment schedules are attached. Hence, demand for external financing actually remains quite low.

Lack of (perceived) creditworthiness: MSMEs are often deemed to be not credit-worthy for many reasons, as follows.

- **Informality:** Many MSMEs in developing countries are informal, which means that they are not legal subjects and thus cannot enter into formal contracts.
- **Insufficient financial management:** Enterprise owners may not know how to prepare financial proposals. Many MSMEs conduct only short-term financial planning, or do not plan at all. Financial records are often incomplete and do not comply with accounting standards.
- **Lack of adequate collateral:** MSMEs may have few assets or may not be able to prove their ownership of assets that could serve as security/collateral for FIs. While the former most likely depends on the size of the company, the latter is often a result of the informality of the MSME and/or an underdeveloped public system, such as in countries/regions that do not have a proper land registration system.

Difficulties planning projects in advance: Banks may take several weeks or months to process a loan, obliging MSMEs to plan for financing significantly in advance of receiving it. This can be a challenge for micro- and small-sized firms that plan their financial resources on a short-term basis.

These challenges affect different types of MSMEs to varying degrees. For micro-enterprises, informality and insufficient financial management are the main barriers to accessing financing. For established small and medium-sized firms, hesitation to take on external debt and low awareness of relevant financing options are larger challenges. Both of these types of MSMEs also struggle to meet collateral requirements for bank loans. For fast-growing start-ups, attracting investment is less of an issue, but acquiring financing to reach the growth stage is a challenge due to a lack of credible accelerators and incubators, especially in the environmental sector.

Table 4: Supply-side barriers

Challenges to SCP financing

Preference for short pay-back periods: SCP investments may take several years to amortise, and thus MSMEs may ask for longer pay-back periods. Banks are typically averse to providing long-term debt as it may be seen as riskier.

Preference for profit-generating projects: The main objective of 'standard' business investments is often to generate higher revenues, e.g. by increasing production capacity. However, SCP measures often create cost savings rather than additional revenue. This is particularly true for measures aiming to increase efficiency or reduce waste. Cost savings may be harder to quantify and set aside for loan repayment and banks may prefer projects that generate clear additional income streams.

Preference for standardized investments into proven technologies: FIs want to work cost-effectively with standardised loan appraisal processes. SCP technologies/business models are often new and unproven and thus come with higher perceived risk. Evaluating the viability of SCP investments implies additional procedures that are costly, especially as benchmark data is often unavailable. As a result, FIs typically prefer financing established technologies.

Lack of SCP-related expertise: Most FIs lack capacity to evaluate SCP measures. They are unaware of the risks of current consumption and production patterns and of the opportunities of SCP, and therefore lack the motivation to drive SCP-related finance. Given demand-side challenges and lack of tangible incentives for fostering SCP, many FIs are not interested in building up the skills they would need to better understand and address SCP-related challenges and business opportunities.

Challenges to general MSME financing

Inflexible risk mitigation: Commercial FIs are often very cautious of default risk when lending to/investing in enterprises without a previous financing history or securities. In response they levy high interest rates, require significant collateral (of a certain type, e.g. land or buildings, and exclude other types such as purchase orders) or exclude MSMEs from lending/investment altogether.

Many of these demand- and supply-side barriers are mutually reinforcing – such as when banks charge small companies high interest rates, thereby keeping them from borrowing the money they need to grow and become more creditworthy. Such interrelated barriers will have to be tackled in parallel.

Moreover, hurdles can be caused or exaggerated by inadequacies in the framework conditions under which MSMEs and FIs operate and collaborate, and thus require corrective action by policy makers. For example, many developing countries have small credit markets due to a weak rule of law and limited ability to prevent or penalize credit default. This limits the capacity of FIs to deal with the risks of MSME lending and to provide sufficient funding for the implementation of projects. It is therefore also important to address shortcomings in local ecosystems for MSME finance and SCP.

3. Supporting access to SCP finance

While there are many challenges preventing MSMEs from accessing financing for SCP measures, SME support projects such as those conducted with financial support from SWITCH-Asia have demonstrated that barriers can effectively be addressed.

The following sections are intended for development cooperation agencies, business consultants, associations, researchers, policy makers and other actors who provide advisory services to MSMEs or work on improving the framework conditions for SCP and MSMEs. They provide examples of successful support projects and derive recommendations on how to set up funded programmes and advisory schemes, and they also design suitable support measures.

3.1 Examples of successful projects

While there are many challenges preventing MSMEs from accessing financing for SCP measures, past support projects have demonstrated that these barriers can be effectively addressed. SWITCH-Asia's work assisting MSMEs to finance and implement SCP measures has shown that targeted, individualised solutions are successful at removing barriers. The following business cases provide examples of the challenges MSMEs face when seeking financing for improving production towards SCP – and of the solutions that helped them gain access to finance (source: SWITCH-Asia 2021a). They serve as the basis for the recommendations provided in chapter 3.2.

Box 3: Examples of successful interventions for increasing access to SCP finance

“INDTUK” project: Switching to a sustainable auto-rickshaw system in India



GOAL: Self-employed auto-rickshaw drivers invest in electric auto-rickshaws

CHALLENGES:

- Rickshaw drivers are not bankable: 97% have no bank account, let alone a credit history or collateral
- Electric rickshaws have not yet been approved as an asset class in the local financial market
- Bank policies are subject to change and have made local banks too unreliable to provide a stable source of financing

- The main challenge was to convince the drivers to move away from informal financing and seek formal financing that would offer more advantages

SOLUTIONS:

Demand side:

- Awareness-raising among rickshaw drivers through meetings and liaison with driver communities
- **Formalization** of the sector by forming **drivers' cooperatives**, giving drivers greater leverage to lobby for their interests and higher motivation to join technical assistance projects and successfully run their business to pay back the loan
- Basic **financial literacy training** and coaching
- Encouraging drivers to open **formal bank accounts and make savings** as a way of building trust in formal financing before introducing a loan product for auto-rickshaws
- Creating a simple **data collection app** for credit managers that allowed drivers to understand changes in their credit, and allowing family members to fill in data for drivers without a smart phone

Supply side:

- Creation of new green finance instrument: one of the local project partners obtained a Non-Banking Financial Company (NBFC) license to set up a **soft loan scheme** with highly **flexible repayment options** (weekly or even daily repayments) and up to 100% financing of asset costs
- Project consortium handled the soft loan process including due diligence, repayment tracking, etc.
- Capital was raised from **external institutions** in the form of investments

Tha Bar Wa project: Sustainable water and energy management in Myanmar



GOAL: MSMEs in the food and beverage sector invest in energy efficiency measures and renewable energy technologies

CHALLENGES:

- Lack of financial instruments available for MSME sector that target green investments
- Lack of knowledge among bank officers on evaluating potential savings of green technologies

SOLUTIONS:

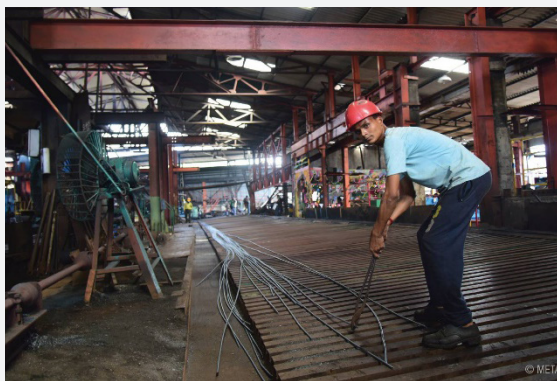
Demand side:

- **Training of local consultants** to conduct energy audits and suggest investments in energy efficient appliances or renewable energy installations
- **Business plan development** with MSMEs (e.g. bakeries, hotels) and targeted **matchmaking** between MSMEs and banks
- Project was introduced right after new environmental policy regulations were implemented, giving the project **political momentum**

Supply side:

- Working with four local commercial banks to **train loan officers** in efficient lending procedures for MSME clients with a focus on SCP technologies
- Advisory to banks on how to **restructure product portfolio**, leading to banks offering **cash-flow-based lending** not requiring any collateral
- Partner consortium had an **effective composition** which included green finance expert, conservation and environmental expert, and local key partner to reach out to the private sector

METABUILD project: Resource-efficient supply chain for metal products



GOAL: MSMEs adopt sustainable production processes in the metal products supply chain

CHALLENGES:

- Not many financial products available to implement resource-efficient and cleaner production (RECP) measures in 3 target countries
- RECP not well known in target industries, and even less in the financial sector
- Personnel changes in SMEs proved an obstacle

SOLUTIONS:

Demand side:

- **Training of local consultants** to implement capacity building for businesses on RECP, business plan development and green finance products
- Coaching MSMEs throughout the **loan application** process
- In-country partners had **established relationships** with MSMEs making it easier to coordinate with business owners

Supply side:

- Developed **clean-tech finance development toolkit** and conducted workshops with finance institutions (FI) to derive prototypes for **new financial products** targeting RECP
- Offered **one-on-one support** to those FI interested in further developing the prototype to be integrated into their portfolio

SWITCH OFF Air Pollution project: Financing energy-efficient insulation in households in Mongolia



Supporting sustainable consumption can help to create demand for sustainable the products and services of MSMEs, thereby improving the business case for SCP financing.

GOAL: Install energy-efficient insulation in homes, thereby reducing emissions from heating.

CHALLENGES:

- Households have limited cashflow, making it difficult to stimulate demand for energy efficiency measures

- Information gap between households interested in EE financing and FIs providing EE financing
- Bank employees are not trained to provide EE financing information to low-income households

SOLUTIONS:

Demand side:

- Engagement of households through **social media and call centres**
- Established an **easy-to-use webpage** for households to assess their eligibility, provide information on costs and materials, and inform FIs of interest in financing

Supply side and policy work:

- **Trained bank staff** to better understand suitable financial products for offering EE financing to households
- Helped local FI (Xac Bank) **access and on-lend funding from the Green Climate Fund**; this was achieved by supporting energy audits (GCF-backed loans require 20% enhancement of EE)
- **Developed standardized forms** for ‘assessment and quality implementation check’; these forms were included in the newly amended Construction Codes and Standards on Building Envelope Thermal Insulation of Mongolia

3.2 Recommendations for MSME support programmes

The following recommendations were derived from SWITCH Asia projects such as those described in the previous chapter, which be even more effective if interventions were also taking place at the market level, where buyers shift away from unsustainable practices in their value chains, or legislation (and implementation) outright prohibit practices that do not adhere to SCP approaches.

The following recommendations describe how to set up MSME support programmes in a way that makes them more successful and provide examples of specific activities to carry out.

- **Assess and address the target group’s actual financing needs in a targeted way, rather than through supposed or generalised needs.** Interest in and ability to access external financing differs between the type of enterprise and depends on local market conditions. It is important to carefully select the target group and understand its financial needs and options when developing an intervention logic. See Box 4 for two suggestions on whom to approach, and how to go about it.

Box 4: Addressing different financing needs

Option A: Scaling up SCP financing for established SMEs

In countries with **high financial market readiness** (e.g. in Asia: Thailand, Vietnam), MSMEs might already have access to standard business financing but struggle with SCP and related financing. The focus of support could thus be on populating the concept of SCP. The core target group for this kind of intervention consists of **enterprises that are formally established** (proof of business license, official registration) that generate stable cash flows and have a lending history and/or an established relationship with local FIs or finance intermediary.

Suggested project activities:

- **MSME:** Raise awareness about SCP technologies and financing schemes, for instance by developing handbooks and pamphlets on how to access SCP financing; developing or improving (existing) business plan and finance strategy (finance-readiness support).
- **Financial institutions:** Support banks or NBFIs to develop assessment criteria on SCP technologies for loan appraisal process; cooperate with financing agencies as intermediaries between MSMEs and banks.
- **Policy makers:** Raise awareness on regulatory issues concerning access to finance (e.g. lack of policy incentives/regulations for the private sector to invest in technology switch).
- **Cross-cutting:** Support matchmaking between MSMEs and banks; conduct multi-stakeholder consultation meetings on finance-related issues including policy makers, FIs, business associations to discuss both the barriers and the enabling factors of access to finance for MSME investment in SCP; train local consultants to provide finance-readiness support.

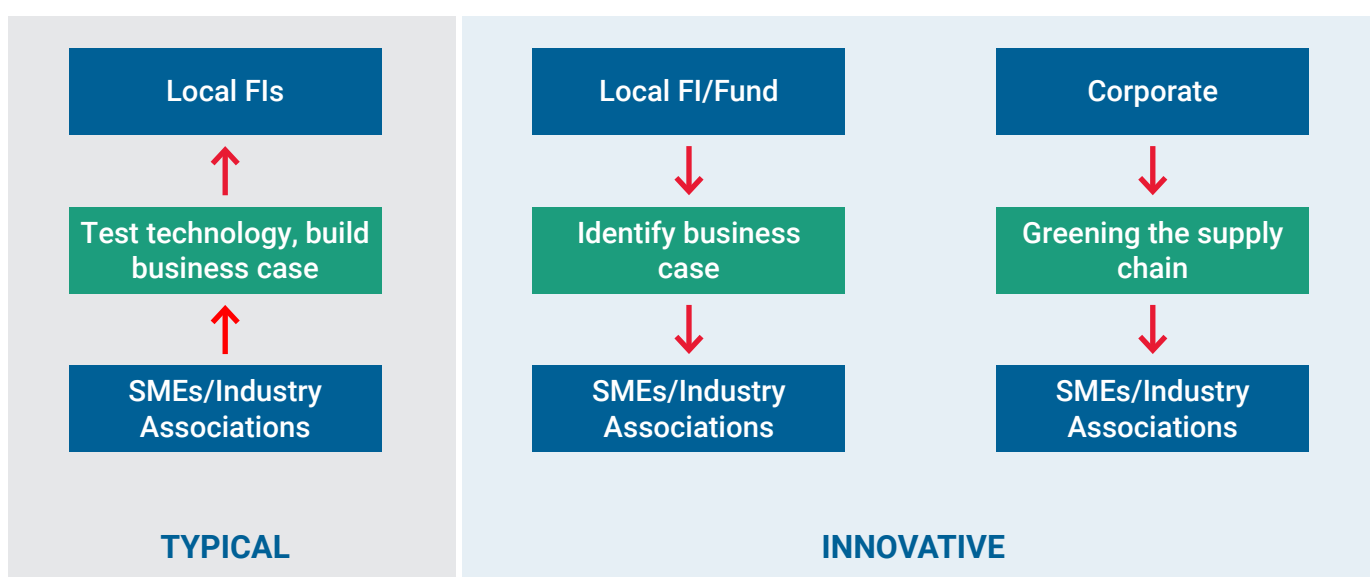
Option B: Building *basic access to finance* – including from informal sources

In all Asian countries – whether more developed or less – many MSMEs do not fulfil the conditions described under option A and require **basic support for financial management and access to finance**. This target group could be addressed through the following interventions.

Suggested project activities:

- **MSME:** Contribute to enhancing the bankability of beneficiary businesses, including by building financial literacy and knowledge of SCP practices, supporting business formalization and developing business plans; support businesses throughout loan application process; if possible, provide matching grants to MSMEs to strengthen finance-readiness (e.g. to acquire collateral as a prerequisite for commercial debt financing).
 - **Financial institutions:** Raise awareness and support FIs in development and piloting finance instruments for SCP and in identifying sources of co-funding or de-risking; provide forums for FIs to share their SCP finance strategies.
 - **Policy makers:** Raise awareness on regulatory issues on access to finance (e.g. lack of policy incentives/regulations for private sector to invest in technology switch); investigate opportunities for policy-based finance or risk-sharing instruments.
 - **Cross-cutting:** Conduct multi-stakeholder consultation meetings on finance-related issues including policy makers, FIs, business associations to discuss both the barriers and the enabling factors of access to finance for MSME investment in SCP; organise forums for banks to present financing programmes and MSMEs to present business proposals; conduct national awareness-raising campaigns and training programmes around green financing as well as pilot initiatives and demonstrator projects.
-
- **Develop project intervention logic together with finance providers:** MSME support projects are often centred around and developed based on an analysis of final beneficiaries only. Such projects can potentially foster access to SCP financing more successfully by developing their intervention logic together with finance providers (as advisors or consortium partners). FIs can be involved to develop a joint 'business case' for SCP financing, including identification of the SCP measures they might be willing to finance as well as support measures that help them in doing so. They might, for example, get involved in scorecard development to select MSMEs for SCP funding facilitation. In addition to banks, large companies with SMEs in their supply chains are a very good lever for fostering a greening of supply chains. Similar business cases could be developed with such buyer companies.

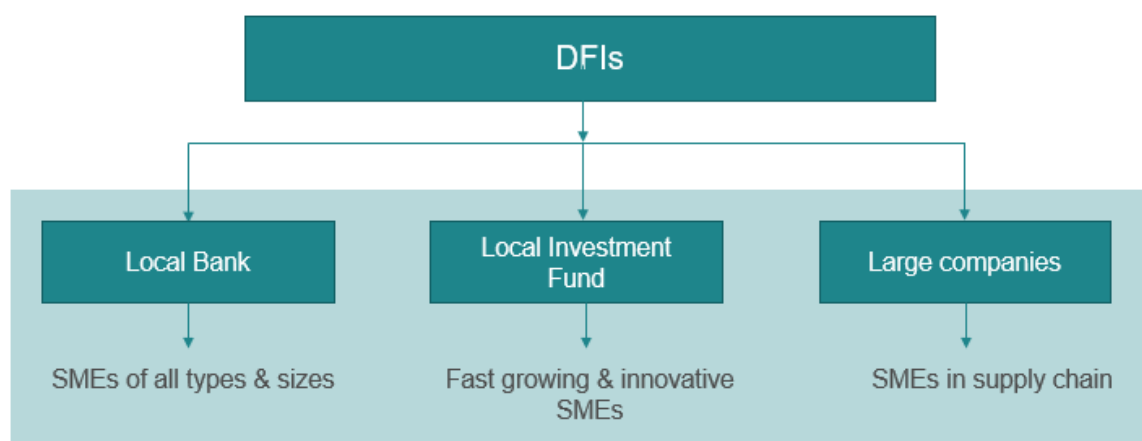
Figure 3: typical and innovative approaches to developing project interventions



- **Make finance an *integral* component of SCP projects:** Even when collaborating with FIs, MSME support projects should ensure that several or all of their core experts have finance-related expertise to make sure that financial challenges are considered from the start. Moreover, access to finance should not be limited to one specific work package or activity but form an integral part of the overall SCP project design including the Theory of Change. Projects should clearly demonstrate how each work package contributes to an improved access to finance and scaling-up of SCP activities in beneficiary businesses. Ambitious output and outcome indicators (e.g. the number of MSMEs that received loans, the number of good quality business plans developed) should be used to raise the overall level of ambition for access to SCP finance activities.
- **Work towards reaching scale (“pipeline building”):** FIs will be more inclined to finance new types of SCP measures if a pipeline of similar measures is available that justifies building up new expertise. Both MSME support projects and the MSMEs they work with should therefore develop strategies for scaling-up and replicating activities and business cases.
 - One way of doing this is to work towards **standardization**, e.g. by developing templates for SCP-related business or investment plans, establishing SCP-related labels and defining metrics/benchmarks for capturing/comparing the costs and benefits of SCP measures. Focus could also be on promoting digital credit application tools.
 - Another option is to work with **multipliers**, in particular by involving (large) MSME associations that can help to secure financing for large number of MSMEs and help to set the basis for continued MSME financing support past the end of the TA project.
 - If the project’s target group develops sustainable products for sale, it can be very helpful to strengthen the **consumption** side to create bankable business cases.
 - Upscaling **research and development (R&D)** for sustainable products or services can help to expand the range of available technologies and drive down costs.
 - Finally, pipeline building can also be supported by supporting **ecosystems** that are conducive to SCP, including start-up incubators, matchmaking programmes, capacity-building and networking programmes.
- **Continue supporting MSMEs after financing has been approved:** Implementing the SCP measure in a cost-effective way after financing has been secured may require additional support, and the scaling-up of the business model could fail if support is no longer provided post-investment. As such, creating a comprehensive exit strategy and planning for advisory services after financing is awarded is key to ensuring the sustainability of the project.
- **Strengthen policy work:** Working on policy aspects can further increase the attractiveness of SCP and raise the ambitions of FIs/funds/corporates ambitions. MSME support projects can help policy makers in establishing a conducive policy environment for SCP projects, e.g. by ensuring that environmental protection is a requirement and that existing laws are enforced. They can also accompany public authorities in setting up grant programmes for SCP-related R&D and in developing labels for SCP projects to support market development and the standardisation of SCP loans. These activities will make it easier to replicate and scale up SCP measures and to reach a wider group of MSMEs. Establishing government schemes/de-risking funds for MSMEs’ SCP investments (funded national sources or donor funding) is another field for which policy makers could use support from MSME advisors.
- **Support sustainable transformations more broadly:** Improving access to finance for SCP-relevant investments is important, but this must be part of a larger systemic shift. Although a market for environmental, social, and governance (ESG) investment is currently developing, this trend has not become relevant for MSMEs in Asia. At the moment, ESG investment is also far from constituting a paradigm shift, because financial returns continue to be the deciding factor. While committing to a sustainable finance policy framework in Europe and also Asia, e.g. in Bangladesh, can channel financing to a certain degree, this can only create lasting impact and a transformation towards a circular economy if policy joins forces with the financial sector, the manufacturing sector, and the overall economy.

4. Ideas for increasing the influence of financial cooperation

Financial assistance is another crucial instrument for supporting access to finance for MSMEs, and bi- or multilateral development finance institutions (DFIs) provide it in the form of concessional financing or risk hedging instruments. Rather than extending such financing to MSMEs directly, DFIs support local banks and funds which then provide capital to MSMEs. DFIs also work with large companies that often have MSMEs in their supply chains.



Source: adelphi for SWITCH-Asia, 2021i

DFIs are under increasing pressure from donors to improve the effectiveness of their financing and align it with objectives of national or international frameworks such as the SDGs and the Paris Agreement. Increasing financing to SCP-related activities can contribute to such priorities. The following broad ideas can help DFIs act on SCP and improve the impact of financial assistance.

Please note: The ideas described below have emerged out of past and recent exchanges with DFIs, but require refinement, taking into consideration two important facts: 1) Challenges and solutions vary between DFIs and are dependent on multiple factors such their size, local presence (through offices and networks), focus (on public or private sector finance) and technical capacities regarding SCP integration; and 2) while they are mandated to promote development, DFIs are also designed to be profitable. This means that their risk assessments are often not favourable for innovation, except if the funding is specifically dedicated to it (e.g. high-level tech fund, inter alia addressing plastic waste).

Integrating SCP into strategies and financing programmes

- **Identify the value of SCP for DFIs' and partners' priorities:** SCP intends to change the way value is created by economies: optimising the quality of life while aligning material use and output with ecosystem capacity. As such, SCP can contribute to many high priority environmental and social objectives in Asia. The effects of SCP range from mitigating climate change and reducing plastic pollution to protecting the oceans and, in some cases, creating jobs. In collaboration with consultants or researchers, DFIs can analyse how fostering SCP contributes to their own sustainability-related priorities or to the priorities of local partners. DFIs can discuss SCP with large private-sector companies to determine whether they can improve their reputation and competitiveness by greening their supply chains. If the results show that SCP contributes to existing priorities, DFIs could build internal SCP knowledge and increase capacities to integrate SCP into development financing (see the next point).
- **Better mainstream SCP into development finance:** DFIs can communicate the value of SCP for economic, environmental and social objectives and systems transformations to their partners, including governments, local financial institutions and corporate borrowers. This will generate greater awareness for SCP and demand for SCP-related financial assistance. The relevance of SCP can then be highlighted in annual country plans and when negotiating lines of credit with public or private clients. DFIs could further strengthen the role of SCP in development finance by establishing SCP-related eligibility criteria

and impact metrics. This can be done not only for dedicated MSME financing programmes, but also for financing targeted at urban development, sustainable agriculture, housing, etc. DFIs can provide guidance on sustainability in value chains (such as done by IFC for various manufacturing sectors) and place importance on the impacts of financing on MSMEs (incl. target setting and tracking of practices by MSMEs). In addition to corporate borrowers, DFIs can also explore opportunities for working with cooperatives and industry associations.

- **Provide SCP-specific financing for on-lending:** DFIs can set up financing schemes that provide concessional funding for SCP measures or (partial) credit guarantees to reduce the risk of lending to MSMEs. Particular attention could be placed on helping companies grow and reach maturity so that they can access conventional funding. When channelling funds through local institutions, DFIs can require dedicated credit lines for financing projects of high-impact SCP practices, for example waste management or wastewater treatment. Limiting the focus (at least in the beginning) makes it easier to establish required expertise and reach standardization.
- **Finance R&D, consumption and ecosystem building:** Financing is required not only for MSME's SCP investments but also for R&D on sustainable products or services. Moreover, supporting sustainable consumption is of equal relevance. Individuals and households can be nudged towards improving sustainability through financial incentives. For example, attractive financing schemes can strengthen interest by households in energy efficiency measures. This type of financing leads to market demand, thereby enabling MSMEs to invest and scale up their sustainable products or services, and would also include the provision of financial services in support packages provided to SMEs. Additionally, DFIs can explore how to engage with this type of ecosystem building, which is successfully done already outside of Asia (e.g. by the [Uganda Green Enterprise Finance Accelerator](#)).
- **Work on standardizing SCP:** Standardizing the credit-granting process for SCP measures can decrease administrative costs. As transaction costs arise for all transactions, big or small, relatively, they are higher for smaller investments or credits ('ticket sizes'), thereby disincentivising these. Standardisation decreases transaction costs, and therefore can make smaller ticket sizes attractive. DFIs can develop SCP metrics, case studies and pilots with the support of consultancies or academia and in collaboration with domestic FIs.
- **Foster more effective technical assistance (TA):** In support of their financial assistance (FA), DFIs provide funding for in-depth TA to local partner banks/FIs. They should make sure that the recommendations presented in chapter 3.2 are considered and reflected in TA design.

Widening the scope of DFI activities to strengthen SCP integration

- **Take on calculated new risk:** Currently, there is a limited pipeline of SCP-relevant projects beyond renewable energy. This is partly because these projects are considered either too small or too inherently risky, as the current market environment does not favour SCP impact. To initiate growth in this segment, DFIs could reconsider their current risk-averse programming practices and consider investing or co-investing, for example by partnering with venture capital funds. If possible, they could consider lending in the local currency to reduce risks for local FIs, or use mechanisms that can help minimise currency risks for both sides, which would also increase the likelihood of uptake of FA programmes in partner countries. This is all the more important as there are currently competing FA programmes active in Asia, and FA needs to be shaped in ways that makes it attractive for local banks and funds to buy into.
- **Build (new forms of) partnerships:** DFIs have long been working with various types of partners, including governments, other DFIs and consulting firms that provide TA. However, other forms of partnerships could be fostered to combine forces more efficiently and foster creativity.
 - **Coordinate with other donor-funded initiatives:** DFIs should coordinate technical and financial assistance with other donors to align priorities and allow for the development of a pipeline of SCP projects that successfully foster MSMEs access to finance. SWITCH-Asia will enter into its third phase in 2023 and is looking for opportunities to support project pipeline development in line with DFIs' needs and priorities. Future grant projects might be selected with early involvement by DFIs to ensure that they have high potential for DFI finance. Yet, priorities may differ and circumstances change. Therefore, regular consultation is required and thematic/geographic partnerships should be formed.

- **Collaborate with specialized finance providers:** A growing number of Asia-based banks/funds are set up to specifically promote and finance 'green' projects. DFIs could assess and enter new relationships with these providers in order to focus specifically on SCP financing. Partnering with such institutions will allow DFIs to benefit from the green FIs' relevant expertise, interested clients and established procedures for assessing environmental impact.
- **Strengthen policy work:** If possible, DFIs could contribute to strengthening policies for SCP financing with government and other ecosystem actors. This could include objective-setting and strategies, but also more technical aspects, like supporting the standardisation of SCP technologies/performance indicators and impact measurement. In cooperation with governments, DFIs could work towards establishing SCP funds/financing programmes with fewer restrictions than conventional funds, allowing for a broader coverage of financing options for SCP/cleantech MSMEs nationwide.

5. Conclusion: key lessons learned from SWITCH-Asia

SWITCH-Asia's long experience in supporting the SCP activities of MSMEs can be useful for development practitioners and DFIs as well as for local FIs. The following key lessons can be highlighted from the observations and suggestions described in previous chapters:

- Interest in and access to formal financing differs between different types of MSMEs and also depends on local market conditions. Micro and small-sized enterprises especially prefer informal to formal funding to avoid the hurdles linked to accessing and repaying funding provided by banks, funds or government agencies. At the same time, funding is key for scaling up and replicating business cases that have been proven to work. Relying on informal sources can limit the impact potential of SCP-relevant investments or business cases.
- MSME support projects involving financing should be based on a sound understanding of who is to gain access to financing and how, ideally counting on the participation of FIs from the start, e.g. as consortium members or advisors to the project. Financing needs to be a core component of SCP-related projects, not just an add-on that is addressed at the very end of the project.
- Hurdles for accessing (formal or informal) finance exist on both the supply and demand side of finance and are also shaped by financial and non-financial regulations/market conditions. Hence, projects should ideally address all actors in the financing value chain and involve policy makers.
- Fostering sustainable consumption, R&D for sustainable technologies, products and services as well as ecosystem building (including matchmaking, start-up incubation, etc.) can increase the business case of sustainable production for MSMEs and make it easier and cheaper for them to realize. This can be addressed through technical and financial cooperation in parallel, providing a combination of both capacity building and economically attractive financing to stakeholders in SCP that will make it easier for them to upscale, just as it does for MSMEs.
- Lastly, consumption and production do not occur in a vacuum; they are instead an integral part of existing economic, technological and social systems. Therefore, the barriers that inhibit transformation to SCP need to be overcome to stabilise the current development and growth that support today's 'winners'.

Other development organizations have likely learned similar lessons from their own experiences working with MSMEs. It is hoped that the lessons learned from the SWITCH-Asia programme presented in this report can contribute to the conversation on how to make MSME support part of technical and financial cooperation in Asia as effective and productive as possible.

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This report is mostly based on results of the following exercises conducted on behalf of SWITCH-Asia between 20xx and 2021. Further information was drawn from external publications, listed here.

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