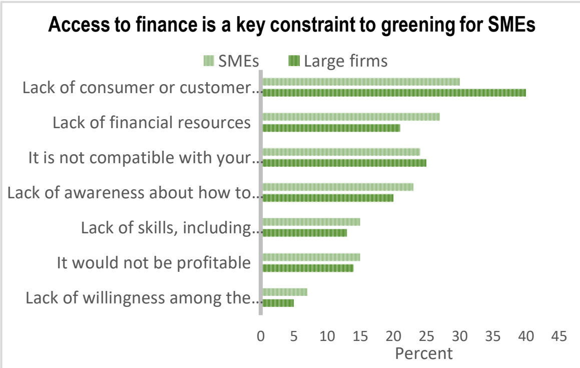
Financing SMEs for Sustainability: Drivers, Constraints and Policies

Sustainable finance is critical for the green transition of SMEs

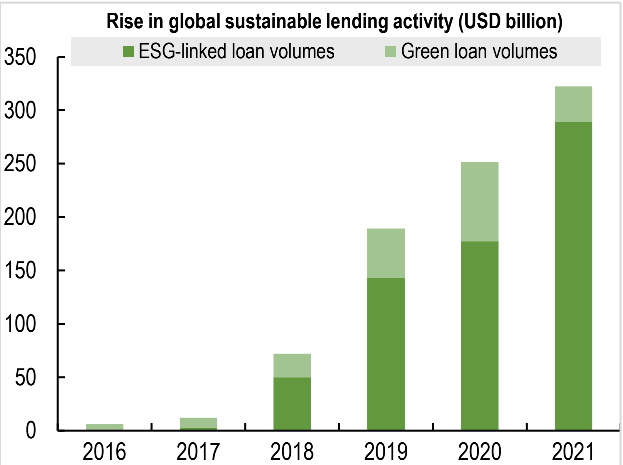
There can be no net zero without SMEs. Mobilising the business community - comprised mainly of small and medium-sized enterprise (SMEs) – to invest in energy saving and low carbon technologies, is essential to meet our climate commitments. SMEs have a significant aggregate environmental footprint (at least half of greenhouse gas emissions in the business sector) and need to adopt cleaner business models. As eco-entrepreneurs and eco-innovators, SMEs also have a critical role to play in devising innovative solutions to the climate crisis.

SMEs need the right incentives and advice to undertake net zero investments. The drivers for SME greening are growing, as SME participation in value chains, access to finance and competitiveness increasingly depend on businesses' ability to measure, report on and improve their sustainability performance[1]. However, the business case for green investments is not always apparent to SMEs, since they often entail high up-front costs, with uncertain returns over the long term, due to evolving market demand, regulatory changes and technological advancements. SMEs also often lack knowledge of the steps needed to achieve net zero, as well as the available financing options.



Source: Eurobarometer, 2020.

Finance is essential for investments in net zero, but SMEs face challenges in tapping into the growing pool of sustainable finance. The market for sustainable finance is growing rapidly. By one estimate, sustainable lending alone reached over USD 300 billion in 2021, accounting for more than 10% of total business lending[2]. Yet more than a quarter of SMEs surveyed cite finance as one of the top constraints to climate action. Finance is likely to present an even larger challenge for SMEs going forward, as financial institutions seek to comply with mandatory environmental reporting requirements. SMEs risk losing out on sustainability-linked finance due to their limited capacity to produce data on their sustainability performance, including ESG assessments. On the other hand, tapping into this large pool of resources offers opportunities for SMEs to accelerate their investments in net zero.



Note: In 2021, the figures are reported up to September
Source: European Corporate Governance Institute, 2022.

Key priorities to strengthen the provision of sustainable finance and greater uptake by SMEs

SMEs need access to appropriate forms of financing for their net zero investments. There is a growing range of sustainable finance instruments being developed by public and private actors. Some are used to finance green projects, while other ESG-linked instruments tie financing conditions to the sustainability performance of the investment or investee**.** Financial institutions can deploy these instruments directly or through intermediaries, which can be other financial institutions (e.g. commercial banks, venture capital funds, etc.) or non-financial actors (e.g. energy providers). Likewise, large multinational enterprises play an increasing role in providing finance to support their suppliers' greening efforts.

Governments have an important role to play in crowding in private sector financing for SMEs green transition, through the provision of credit guarantees for green or sustainability-linked lending, and by supporting the provision of equity finance for innovative green ventures through intermediaries and partnerships. They also support SME participation in green capital markets and provide financial incentives for SME greening, such as subsidies and tax incentives.

Financial support should go hand in hand with broader measures to raise awareness and stimulate demand for sustainable finance. Non-financial support is key to strengthen SME awareness about the steps towards net zero and provide the necessary tools that can enable them to embark and stay on the journey. This includes technical support, such as online tools, mentorship and consulting services, as well as access to data and information to help SMEs make more informed decisions and establish timelines for greening.

A tailored approach is needed to deliver support to the diverse population of SMEs. SMEs face different challenges and pathways to net zero, depending on their size, sector, business model and other characteristics. For interventions to be successful, policy makers and public financial institutions need to understand SMEs' diverse greening needs and tailor financial and non-financial support.

It is crucial to address persistent data gaps. Policy design and targeting can be improved by access to better data. Solutions should also enable financial institutions to collect granular data on SMEs without overburdening these businesses (e.g. a set of core sustainability-related indicators, and tools to measure SME sustainability performance). Public-private partnerships will be critical in this endeavour.

Mobilising all actors in the sustainable finance ecosystem is important to accompany SMEs effectively. SMEs need to interact with a growing number of actors in the ecosystem, including traditional actors – finance providers and policy makers – but also various sustainability-related intermediaries, including ESG ratings providers, auditing and advisory services, accountants and others. Fostering closer collaboration, networking, and dialogue between these different actors, at both national and international levels, is critical to strengthen both the supply of sustainable finance and uptake by SMEs. The ***OECD Platform on Financing SMEs for Sustainability*** provides such a global forum to advance knowledge and cooperation in this area.

Notes

[1] This reflects emerging non-financial disclosure requirements for large enterprises that indirectly affect smaller businesses in their value chains. SME demand for sustainable finance also reflects efforts to gain competitive advantage or market share by adopting sustainable processes, or efficiency gains and cost savings from greening their business models.

[2] Kim et al. (2022), "ESG Lending", ECGI Working Paper Series in Finance, European Corporate Governance Institute – Finance Working Paper No. 817/2022, available at SSRN: https://ssrn.com/abstract=3865147 or http://dx.doi.org/10.2139/ssrn.3865147.

Find out more:

OECD (2022), "Financing SMEs for Sustainability: Drivers, Constraints and Policies," *OECD SME and Entrepreneurship Papers*, No. 35, OECD Publishing, Paris, http://oe.cd/pub/4NT

Contacts:
Miriam Koreen (Miriam.koreen@oecd.org);
Marija Kuzmanovic (Marija.kuzmanovic@oecd.org)

OECD Platform on Financing SMEs for Sustainability