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RAISING GREEN CAPITAL

Small businesses are in dire need of green finance. Can public and private institutions work in tandem to build the supportive ecosystem they need?

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BIRD'S-EYE VIEW

Green capital for small and medium-sized enterprises (SMEs) is governed by a combination of factors—trends in sustainable finance, stringent regulatory frameworks and policy interventions

Green financing is helping the world fight climate change and mitigate its environmental depredations, showing extraordinary resilience even through periods of global turmoil. For example, it reached $1.46tn in 2022, despite the covid-19 pandemic, rising inflation and geopolitical tensions.

Money Matters

According to preliminary analysis, finance flows surpassed $1.5tn in 2023, driven primarily by renewable energy and low-carbon transport. In 2024, the Green Climate Fund (GCF) approved $686.8mn in financing to mobilise approximately $1.5bn for 11 projects across 42 countries, benefiting 115mn people.

India needs Rs 162.5tn by 2030 to achieve its Nationally Determined Contributions (NDCs). The proposed climate finance taxonomy in the Union Budget 2024-25 is a valuable step towards guiding India's economy towards a sustainable and low-emission future.

By setting clear definitions for green

investments and aligning them with national climate goals—like the updated NDC and the upcoming Adaptation Plan—the taxonomy will be instrumental in providing much-needed clarity, enhancing investor confidence, and driving the expansion of green and climate-related investments.

Green Stewardship

Beyond traditional financial metrics, several critical factors are leveraged to assess investment risks and opportunities. Investors committed to reducing their impact on the planet and promoting sustainability are inclined towards supporting companies with a similar vision and approach.

Environmental, social and governance (ESG) ratings are pivotal in enhancing investor confidence in sustainable assets as they offer a comprehensive evaluation of a company's or a financial instrument's sustainability profile by analysing its exposure to sustainability risks and its broader impact on society and the environment.

With capital markets increasingly integrating sustainability considerations, ESG ratings are playing a crucial role in shaping investment

strategies and fostering investor trust in sustainable financial products.

The ESG investing market, valued at $27,480bn in 2023, is projected to reach $130,880bn by 2032, growing at a 17.31% compound annual growth rate (CAGR) in 2024–32.

ESG-focused investors prioritise and prefer companies addressing climate change and integrating sustainable business practices. They conduct rigorous assessments of corporate strategies related to carbon footprint reduction, renewable energy adoption, energy efficiency initiatives and net-zero emissions targets.

Additionally, participation in carbon offset programmes serves as a key indicator of a company's dedication to environmental stewardship. The growing momentum behind ESG investing reflects a shift in investor priorities—seeking not only strong financial returns but also alignment with broader societal and environmental objectives.

Recent reports indicate a significant surge in ESG investments in India, rising from $330mn in 2019 to $1.3bn in 2023, highlighting the growing emphasis on sustainability-driven financial strategies. This heightened investor interest in ESG-focused companies has prompted regulatory interventions to enhance transparency and safeguard investors across jurisdictions.

In the UK, ESG regulations are embedded within multiple legislative frameworks, including the Corporate Governance Code by the Financial Reporting Council, which sets guidelines on board leadership, risk management and internal controls.

Additionally, the Companies (Strategic Report) Climate-related Financial Disclosure Regulations and Companies, Partnerships and Groups (Accounts and Reports) Regulations reinforce disclosure requirements, promoting corporate accountability and environmental responsibility.

Meanwhile, the US is transitioning from a voluntary to a mandatory ESG regulatory framework, aligning its approach with the European Union. The Securities and Exchange Commission's (SEC) proposal on Climate-Related Disclosures mandates public companies to report climate-related financial data, ensuring greater transparency and investor confidence in sustainability-linked decision-making.

Supportive Frameworks

Robust and stringent regulatory and policy frameworks play a crucial role in providing a supportive environment for advancing green and sustainable financing by incentivising environmentally beneficial investments and reducing greenhouse gas emissions.

The transition to a green economy is regulated by policies that incorporate environmental, social and corporate governance criteria, underscoring the importance of government backing.

A growing number of jurisdictions around the globe have acknowledged the importance of international harmonisation of standards for sustainability disclosures, taxonomies and financial instruments like green bonds and sustainability loans.

ESG integration is another aspect receiving significant emphasis for enhancing transparency and preventing greenwashing. The Sustainable Finance Disclosure Regulation (SFDR) was initiated as a decisive move by the European Union to ensure transparency in the financial investment sector. The SFDR sets out specific criteria for the classification of ESG products, which are crucial for financial market participants to understand and implement correctly.

In addition, the International Sustainability Standards Board (ISSB) is working towards creating global baseline sustainability disclosure standards.

India is also actively supporting its

green finance ecosystem by launching various policies like the National Green Hydrogen Mission and Production-Linked Incentive (PLI) schemes for renewable energy to promote renewable energy, electric vehicles (EVs) and sustainable infrastructure.

The Securities and Exchange Board of India (Sebi) has also issued regulations on green bonds and the RBI is focusing on climate-related financial risks.

Getting Everyone on Board

The expansion of sustainable finance has been accompanied by the development of specialised financial instruments and best practices, fostering a comprehensive ecosystem that supports environmentally and socially responsible investments.

This ecosystem comprises diverse stakeholders, including governments and policymakers (for setting conducive regulatory frameworks and policies and providing a roadmap with strategies and action plans), financial institutions like banks and insurance companies (for channelling capital and assessing and managing risks).

It also includes investors (to provide capital for green projects), corporations and businesses (for implementing green projects) and auditing and rating institutions (to ensure transparency).

Finally, it accommodates research and academic institutions, NGOs and civil societies (to provide knowledge and expertise and ensure accountability) and standard-setting bodies (to promote consistency and transparency through standards and guidelines), each playing a critical role in mobilising capital for sustainability-driven initiatives.

Therefore, the green capital landscape for SMEs is mostly governed by dynamic trends in sustainable finance, the integration of ESG principles, stringent regulatory frameworks and policy interventions and, most importantly, strategic collaboration among key stakeholders.

A comprehensive understanding of these elements is crucial for mobilising capital efficiently, accelerating decarbonisation efforts and advancing global sustainability imperatives. OB

THE HIDDEN FOOTPRINT

Small businesses bear a disproportionate amount of the burden of climate change, yet are often overlooked in discussions on mitigating and adapting to risk

Contrary to popular belief, SMEs are responsible for substantial greenhouse gas emissions, resource utilisation and pollution. The impact of climate risks on SME supply chains affects everything from sourcing of raw materials to distribution and financial stability. SMEs are particularly vulnerable because of their limited resources and bargaining power.

Burdening Greater Risk

Severe weather phenomena like floods, droughts, wildfires and hurricanes can damage infrastructure, halt or disrupt transportation and delay delivery of raw material and finished goods.

For instance, the floods in Kerala and Cyclone Amphan in eastern India wrecked SME supply chains, triggering crop losses and delayed harvests, which in turn starved food-processing

SME units and ravaged transportation networks that disrupted delivery of goods to markets, driving many SMEs out of business.

SMEs often rely on small suppliers who cannot weather climate-related disruptions, increasing their vulnerability.

A Difficult Transition

Climate-related resource scarcity can inflate prices of inputs like crops, metals and energy, damaging SMEs with thin margins. For instance, in 2020, Arabica coffee prices surged by over 20% as production dived in India and other coffee-producing hubs, hurting SMEs in the supply chain, like roasters and exporters, who could not pass on the higher costs to consumers.

Disruptions caused by climate change also drive up insurance, transportation, shipping and storage costs eroding the margins of SMEs.

Stringent government regulations to contain climate change like carbon taxes, emission limits and reporting, affect sourcing and transport of goods, burdening smaller businesses with limited resources.

For example, the ban on single-use plastics forced packaging, food processing and retail SMEs to invest in expensive alternative packaging materials. Many small businesses struggle to adapt to new regulations or cater to the growing demand for transparency and sustainability in supply chains from customers and large businesses due to lack of awareness and resources.

Larger companies balk at working with SMEs not aligned with sustainable practices, leading to loss of business opportunities and damage to existing

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partnerships. Tata Motors, for example, has raised the sustainability bar for its supply chain partners, which may see the exit of several auto component makers without the resources to adopt green practices from its supplier network.

Thus, while climate risks have a profound impact on SME supply chains by disrupting operations, increasing costs and creating regulatory challenges, they also present opportunities for SMEs to innovate, adopt sustainable practices and build resilience. OB

COST OF CAPITAL

If small businesses are to adopt more sustainable practices, institutional support—financial and expertise to navigate the climate finance market—will be essential

The 3I framework—Instruments, Institutions and Initiatives— can serve as a compass for SMEs to effectively capitalise on climate finance. For SMEs, accessing loans, bonds and equity investments, or climate finance, is key to cutting costs and staying competitive in transitioning global supply chains.

Crafting Resilience

India's shift to a low-carbon economy is driven by institutions supporting SME sustainability efforts. Public and private sector banks and non-banking financial companies (NBFCs), provide long-term credit plus financial guidance.

The government-run department of industries and district industries centres promote sustainable industrial development and infrastructure for SMEs.

Nationally, the Small Industries Development Bank of India (Sidbi) provides affordable energy efficiency and green finance schemes, while the Bureau of Energy Efficiency promotes

energy-efficient technologies.

The National Bank for Agriculture and Rural Development (Nabard) supports rural SMEs with financial and policy-driven interventions for sustainable agriculture and business practices.

Support Systems for SMEs

The MSE Green Investment and Financing for Transformation (MSE Gift) Scheme helps SMEs adopt green technology through interest subvention and credit guarantees, benefiting around 12,000 MSEs and leading to energy and cost savings.

The MSE Scheme for Promotion and Investment in Circular Economy (MSE-SPICE) supports SMEs in adopting circular economy practices, particularly in waste management sectors.

The Climate Change Fund (CCF), managed by Nabard, is a major climate finance mechanism, funding mitigation and adaptation projects while fostering climate resilience and awareness.

The Policy for Financing Transmission Projects ensures financial assistance for integrating renewable energy into the power grid. The Loan Against Securitisation of Future Cash Flow of Renewable Energy Projects helps developers secure funding by leveraging future revenues, improving liquidity and accelerating renewable energy deployment.

The Special Product for Funding Renewable Energy Projects provides financial solutions through bonds, bank loans and other instruments, fostering sector growth.

International institutions also contribute significantly to climate finance. The Vivriti Capital Climate Finance Project has secured a $25mn investment to finance EVs, solar and wind energy and waste management.

The Asian Development Bank (ADB)-backed India Infrastructure Finance Company Limited Project has received a $500mn loan to support sustainable infrastructure. This includes a sustainability unit, an environmental scoring framework and long-term capital.

Blockchain technology is emerging as a game-changer for decarbonisation by improving visibility and traceability in supply chains. By recording transactions in an immutable digital ledger, it enables companies to monitor energy consumption and emissions accurately. OB

MAKING THE TRANSITION

Governments, investors and customers increasingly prefer businesses that align with sustainable goals. But SMEs need more than just policy support to reduce their environmental impact

The transition to a low-carbon economy necessitates robust policies and regulations that help SMEs embrace eco-friendly practices. Since they are crucial to global economic systems, it is vital to introduce favourable policies, simplified regulatory compliance and joint initiatives to reach broader sustainability targets.

Government bodies and global organisations can significantly contribute to this shift by offering financial rewards, technical support and skill-development programmes.

Batting for Green Operations

In developing nations, SMEs employ half of the workforce and two-thirds of non-agricultural workers. Large companies must assess their entire supply chain, which often comprises small businesses.

India has introduced several initiatives to promote sustainability and foster women-led entrepreneurship. The Zero Defect, Zero Effect (ZED) Scheme incentivises eco-friendly manufacturing and is free for women-led MSMEs, with the government covering certification costs.

The Raising and Accelerating MSME Productivity (Ramp) Programme has launched three sub-schemes to improve environmental sustainability, financial accessibility and operational efficiency. Of them, the MSE Scheme on Online Dispute Resolution for Delayed Payments employs legal expertise, IT solutions and AI to resolve payment disputes efficiently, improving liquidity for micro and small enterprises.

Ramp also enhances synergy between central and state governments in MSME promotion, advances technology adoption and facilitates financial market access. The Support for the Commercialisation of Intellectual Property (MSME – SCIP) Programme helps entrepreneurs scale their innovations, contributing to India's knowledge-driven economy.

Compliance Hurdles

While these policies enhance sustainability, SMEs struggle with compliance due to limited resources and expertise. The complexity and cost of adhering to stringent regulations can be daunting. To mitigate these challenges, governments and financial institutions offer grants, low-interest loans and technical assistance.

Simplifying reporting requirements and offering clear guidelines can reduce SMEs' administrative burden. The International Sustainability Standards Board (ISSB) advocates proportional reporting standards, ensuring scalability to the size and capacity of enterprises, making sustainability reporting more accessible.

Public-private partnerships (PPPs), however, can accelerate SME sustainability, fostering collaboration

between governments, corporations, financial institutions and SMEs. Initiatives like the World Economic Forum's SME Sustainability Accelerator, in partnership with Schneider Electric, provide tailored insights and strategic guidance to help manufacturing SMEs navigate sustainability transitions.

Similarly, the Organisation for Economic Cooperation and Development's (OECD) Platform on Financing SMEs for Sustainability facilitates global knowledge-sharing, improves access to sustainable finance and drives green technology innovation.

By aligning policy, capital and technical expertise, PPPs enable SMEs to overcome sustainability barriers and integrate climate-friendly solutions.

The Way Forward

Achieving scale in climate finance requires a collaborative, multi-stakeholder approach. India has made progress in fostering synergies between

regulators, financial institutions and the private sector.

By developing tailored climate finance frameworks, it is proactively addressing its challenges in conformance with global best practices, ensuring a competitive yet locally relevant ecosystem.

A well-defined climate finance taxonomy is crucial, providing clarity and consistency in financing sustainable initiatives. While the government's efforts to establish this framework are promising, timely implementation is essential to sustain momentum and translate policy commitments into measurable impact.

To unlock new capital flows, enhance investor confidence and accelerate SMEs' transition to a low-carbon economy, several strategies must be prioritised. Developing financial instruments tailored for SMEs' capital needs is vital.

Capacity-building initiatives can enhance awareness and financial literacy on sustainable investments. Establishing government-backed incentives and risk-mitigation mechanisms, such as guarantees and concessional financing, will encourage greater participation in green initiatives.

Strengthening partnerships between financial institutions and SME support ecosystems will improve funding access. Standardising sustainability reporting frameworks will drive transparency and facilitate green investment decisions. Leveraging technology to streamline reporting processes will improve data collection and accuracy. OB


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