

# Engaging Micro, Small, and Medium Enterprises in developing countries

## ENHANCED DIRECT ACCESS AND THE GCF PRIVATE SECTOR FACILITY

### Working Paper<sup>1</sup>

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## 1. Introduction

*‘The Fund will allocate a significant share of its resources to finance private sector activities. It will proactively promote the participation of local private sector actors, including small- to medium-sized enterprises (SMEs).’<sup>3</sup>*

The aim of this Working Paper is to highlight the connection between the concept of Enhanced Direct Access (EDA) and ideas put forward by the GCF Secretariat and the GCF Private Sector Advisory Group (PSAG) on engaging developing country [Micro,] Small, and Medium Enterprises [M]SMEs, and to assess the implications for the prospects of an EDA Pilot Phase (EDAPP) adopted at the recent Barbados meeting of the Green Climate Fund Board (see Section 3.3 below).

Following a brief introduction of the concept of EDA and of the GCF Private Sector Facility (PSF), Section 2 analyses the most recent thinking on the engagement of developing country MSMEs, as reflected in the documentation prepared by the GCF Secretariat for the eighth GCF Board meeting in Barbados (October 2014). Possible synergies between the PSF and the EDAPP are discussed in Section 3, which starts by looking at some examples of how local intermediaries (banks) are being used to provide finance for MSME mitigation projects before turning to argue for the need to have public sector financial flows consolidated at the national level. The Section ends with a proposal combining the two approaches – namely a proposal for nationally consolidated and locally devolved access programmes as the type of project that should be tested under the EDAPP. The Working Paper ends with a Question and Answer Post Script which follows up some of the questions that were raised in the review of a draft version of the Working Paper.

### 1.1. The concept of ‘Enhanced Direct Access’

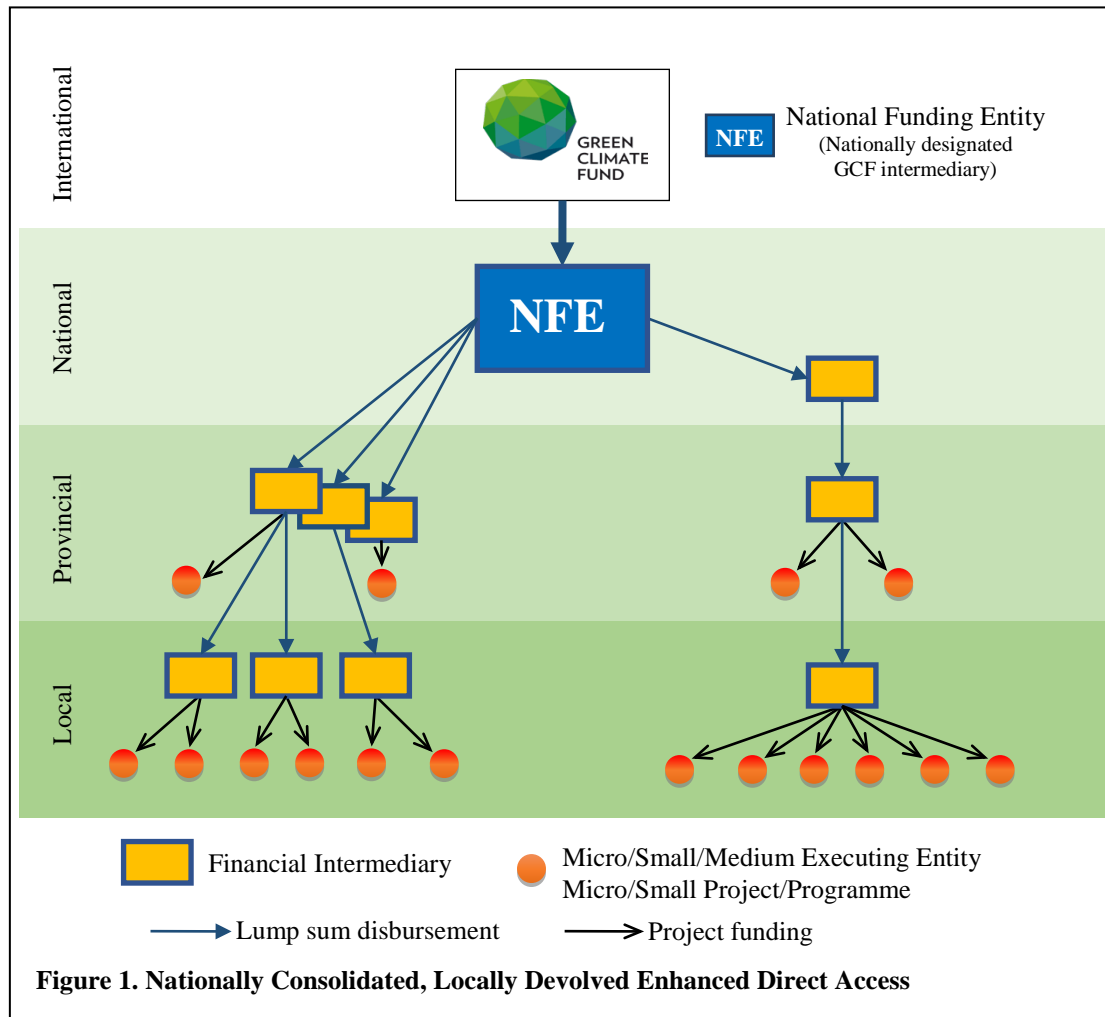
The idea of ‘enhancing direct access’ referred to in paragraph 47 of the GCF Governing Instrument is derived from the (‘ordinary’) direct access modality of the Adaptation Fund (AF) which delegates the programme management function associated with implementing entities to a ‘National Implementing Entity’ (NIE) designated by the recipient country.

‘Enhanced Direct Access’ was originally conceived as going beyond the AF model by **further devolving funding decisions** for particular activities (i.e. project/programme approvals) to a nationally designated intermediary. Following the AF example, the idea was that there would be a single ‘**National Funding Entity**’ (NFE) to serve as the national gateway for (public sector) climate finance flows into the country and for blending them with national public sector climate funding. In order to carry out the latter and to facilitate national mainstreaming of these consolidated funds, it was intended that NFEs should have a national governing body involving all relevant sectors of society and government.

There is a considerable body of literature on EDA as regards NFEs accessing foreign public sector sources (multilateral funds, bilateral donors etc.).<sup>4</sup> However, relatively little has been written on how NFEs should themselves be accessed domestically – one notable exception being a paper by Anju Sharma’s ‘Devolving climate finance to vulnerable communities in India’,<sup>5</sup> which proposes that in-country funding decisions should not (all) be centralized but, where appropriate, should be devolved to sub-national intermediaries in the manner illustrated in Figure 1.

<sup>3</sup> [‘Green Climate Fund Opens Online Accreditation System For Implementing Entities and Intermediaries’](#), GCF Press Release, 17 November 2014.

<sup>4</sup> See, for example, the



### 1.2. The GCF Private Sector Facility (PSF)

In paragraphs 41-43 the GCF Governing Instrument stipulates that:

- The Fund will have a private sector facility that enables it to directly and indirectly finance private sector mitigation and adaptation activities at the national, regional and international levels.
- The operation of the facility will be consistent with a country-driven approach.
- The facility will promote the participation of private sector actors in developing countries, in ***particular local actors, including small- and medium-sized enterprises and local financial intermediaries***. The facility will also support activities to enable private sector involvement in SIDS and LDCs.

The Governing Instrument also tasked the GCF Board with developing ‘the necessary arrangements, including access modalities, to operationalize the facility’. Since then, the Board has constituted a ‘Private Sector Advisory Group’ (PSAG), but little progress has been made in establishing the required access modalities; it is hoped that this Working Paper will facilitate this process in a manner that is acceptable, particularly to recipient countries, many of which have hitherto been rather sceptical of the PSF.

## 2. The Barbados MSME Documentation

Three documents prepared by the GCF Secretariat for the Barbados meeting are of relevance in the context of this Working Paper:

- GCF/B.08/14, '[Working with Local Private Entities, Including Small and Medium-Sized Enterprises](#)' ('The SME Paper')
- GCF/B.08/40, '[Recommendations from the Private Sector Advisory Group: Private Sector Facility: Engaging Local Private Sector Actors, including Small-and Medium Sized Enterprises](#)' ('The Recommendations')
- GCF/B.08/22, '[Simplified Processes for the Approval of Proposals for Certain Activities, in Particular Small-scale Activities](#)' ('The Simplified Approval Paper')

The main document in this context, the SME Paper, raises a number of issues, ranging from: a discussion of the bodies that could be involved in engaging SMEs (implementing entities, intermediaries, executing entities), to what instruments/activities could be used/eligible, and the types of financing/access modalities (direct/indirect). Its main focus, however, is 'four types of support that the Fund can provide to private sector actors in developing countries', namely:

- (a) Concessional resources to MSMEs;
- (b) Project development and capacity-building resources;
- (c) Use of financial instruments; and
- (d) Streamlined approval processes for the private sector.

The focus of this Working Paper, however, is on the proposed 'access architecture', that is to say on who is to be involved in accessing GCF funding for the purpose of engaging developing country MSMEs, and in the type of access/financing modality. Let us now turn to the way in which this topic is dealt with in these documents.

### 2.1. Who is to be involved?

There is a discussion of the 'Key private sector actors in developing countries' in Section 3.1 of the SME Paper. A distinction is first drawn between two categories of entities: **Implementing Entities** and **Intermediaries**, on the one hand, and **Executing Entities** on the other (See Box 1 for an explanation of these terms), each divided into two sub-categories:

#### *Intermediary/Implementing Entity level*

- (a) *Private financial intermediaries and implementing entities in developing countries that are accredited by the Fund, such as investment and commercial banks; insurance companies; leasing companies; and investment funds.*
- (b) *Microfinance entities, both formal and informal microfinance institutions. If these are not accredited by the Fund, they would need to operate through an accredited intermediary.*

#### *Executing Entity level*

- (a) *Project sponsors and commercial enterprises in developing countries that operate in the formal economy.*
- ( ) *Micro, small, and medium-sized enterprises (MSMEs) [see Box 2 for definitions used]; both those in the formal economy and at the household or informal economy level.*

**Box 1. Types of Entities**

**Executing Entity:** Project developer, final recipient of funding.

(GCF) **Implementing Entity:** An entity accredited (by the GCF) for project management purposes (satisfying the GCF specialized fiduciary criteria listed under [1] in the table below).

(GCF) **Intermediary:** An entity accredited (by the GCF) for the purpose of approving grants or loans (satisfying the GCF specialized fiduciary criteria listed under [2] and [3] respectively).

<b>Specialized Fiduciary Criteria</b>	
<b>[1] Project management</b>	• Project preparation and appraisal (from concept to full funding proposal).
	• Project oversight and control.
	• Monitoring and evaluation.
	• Project-at-risk systems and related project risk management capabilities.
<b>[2] Grant award and/or funding allocation mechanisms</b>	• Grant awarding procedures.
	• Transparent allocation of financial resources.
	• Public access to information on beneficiaries and results.
	• Good standing with regard to multilateral funding (e.g. through recognized public expenditure reviews).
<b>[3] On-lending and/or blending</b>	• Appropriate registration and/or licensing by a financial oversight body or regulator in the country and/or internationally, as applicable.
	• Track record, institutional experience, and existing arrangements and capacities for on-lending and blending with resources from other international or multilateral sources.
	• Creditworthiness.
	• Due diligence policies, processes, and procedures.
	• Financial resource management, including analysis of the lending portfolio of the intermediary.
	• Public access to information on beneficiaries and results.
	• Investment management, policies, and systems, including in relation to portfolio management.
	• Capacity to channel funds transparently and effectively, and to transfer the Fund's funding advantages to final beneficiaries.
	• Financial risk management, including asset liability management.
	• Governance and organizational arrangements, including relationships between the treasury function and the operational side (front desk).

<b>Box 2. IFC Enterprise Definitions for Micro, Small, and Medium Enterprises</b>			
Global Financial Markets categorizes its clients' sub-borrowers according to the following definitions:			
(1) Microenterprise if loan < USD 10k at origination.			
(2) Small Business if loan < USD 100k at origination.			
(3) Medium Business if loan < USD 1m at origination (USD 2m for more advanced countries).			
Technically, the above definitions are a proxy for the official IFC definition, based on an enterprise qualifying under two of the following three indicators, as follows:			
<i>Indicator</i>	<i>Micro Enterprise</i>	<i>Small Enterprise</i>	<i>Medium Enterprise</i>
Employees	< 10	10 < 50	50 < 300
Total Assets	< USD 100k	USD 100k < USD 3m	USD 3m < USD 15m
Total Annual Sales	< USD 100k	USD 100k < USD 3m	USD 3m < USD 15m

Source: IFC, [International Private Sector Advisory Services](#), [Environmental and Social Framework](#), [SME Paper](#), p.3

It is noteworthy in this context that a curious implicit segregation in the Barbados Documentation appears to exist between private sector and public sector entities, and that apparently only private sector entities are meant to be involved in the activities of the PSF to engage MSMEs. However, the fact that 'the PSF has been designed to work with the private sector'[SME Paper, p.3] should not preclude it from using public sector intermediaries (such as agricultural/development banks), which in most cases have an excellent track record in working with MSMEs through their local branches. In other words, although the PSF has been particularly designed to provide finance to developing country private sector entities, this does not mean it cannot also work with public sector entities to do so.

## 2.2. Under what financing (access) modalities?

The Barbados Documentation does refer to 'access modalities', chiefly in the context of the distinction between 'direct-' and 'indirect financing', as referred to in paragraph 41 of the GCF Governing Instrument:

*The Fund will have a private sector facility that enables it to directly and indirectly finance private sector mitigation and adaptation activities at the national, regional and international levels.*

However, it is important to point out that the interpretation of 'direct-' and 'indirect financing' in these documents is not exactly the same as having 'direct-' and 'international access' as defined in the GCF Governing Instrument (GI).

### 2.2 Direct financing

According to the Recommendations, the PSAG envisages *two approaches for engaging with the private sector*:

- (i) *the indirect approach, where the Fund works via accredited national, regional and international implementing entities and intermediaries; and*
- (ii) *the direct approach.*

Given that the first of these approaches covers both direct and international access in the GI sense, the question that remains is what exactly the second 'direct approach' could be. Perhaps the idea was

the elimination of all the “middle men” between project developers (Executing Entities) and the Fund’s PSF. Indeed, the SME Paper suggests that for large project developers, ‘due diligence can be executed at the approval level rather than the accreditation level to ensure actors meet the Fund’s financial, environmental and social standards’.

The idea thus seems to be that large corporations would be able to receive funding directly from the GCF for a particular project/programme without having to go through a formal/general accreditation process, provided they satisfy the relevant standards. While the Board may indeed at some stage wish to consider this option (as suggested by the SME Paper) it should be fully aware of the implications: the task of project/programme management – which includes project oversight and control, monitoring, evaluation, and risk management (see Box 1) – would still have to be carried out, and obviously not all parts of this task could be delegated to the project developer. This means that, in the absence of any “middle men”, the GCF itself would have to acquire the required capabilities in-house. In other words, in order to provide ‘direct finance’ in the suggested manner, *the GCF would have to become an implementing entity*.

It is at least debatable whether this would be desirable. Having said this, it might be worth highlighting that for mitigation there actually is a way to provide this sort of direct financing, namely through Quantity Performance “–4Q)cG[3,3O4Q)cG[3,)oGOO,3Q4,qqQ7)fGOO,O‘4q)oG3,O‘–4Q)mG[3,37—73  
programme[3,Oj‘Q7Q)pG3,O‘–4Q)rG3,4jj4‘q)oG3,O‘–4Q)gG[3,OQjQ4‘)rG3,4jj4‘q)aG[3,OO‘OQ)mG[O3,7q3Q)mG[

*(b) Indirect financing through Intermediaries*

The description of MSMEs as Executing Entities in the SME Paper contains a passage that is very pertinent in the context of this working paper:

‘Given the small unit size of MSMEs and the high transaction costs as a result of interacting directly with such actors, it will be difficult for the Fund to interact directly with such players. The Board may wish to establish a programme-based approach to reach these players in a way that is cost-effective through intermediaries that would be responsible for approving and assuming the administrative management of the exposure to each MSME.’

**2.3. The PSF MSME and Capacity-Building Programmes**

As indicated in the introduction to this section, the SME Paper proposes two support programmes that are of particular relevance in the context, namely:

- [1] an **MSME Programme**, providing concessional resources to MSMEs to offset lack of access to financial markets;
- [2] a **Capacity-Building Programme**, providing project development and capacity-building resources.

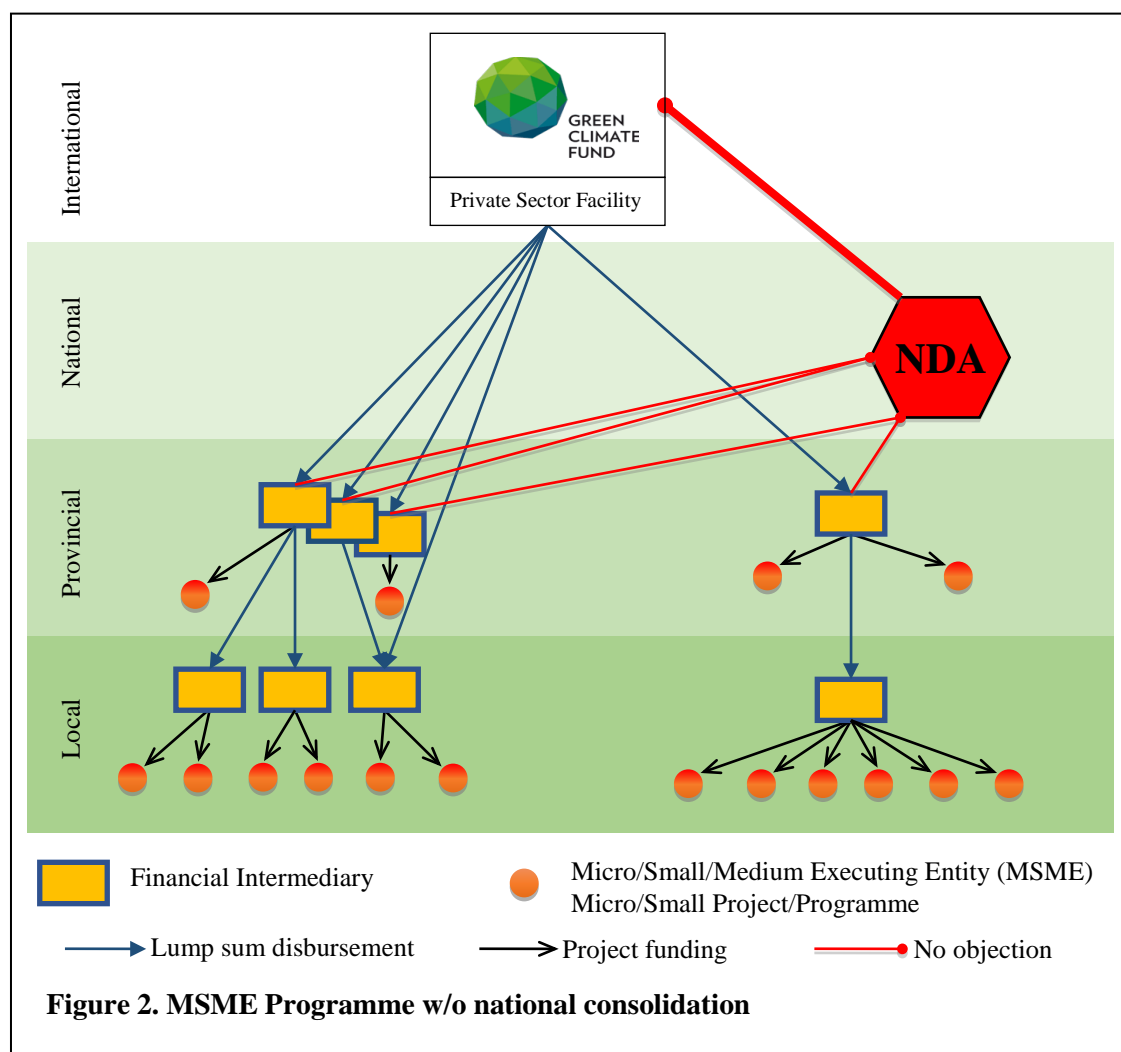
Box 3. PSF Programmes		
	DESCRIPTION	EXAMPLE OF USE
MSME Support Programme	Provision of concessional resources to MSMEs through accredited intermediaries on a programme/portfolio basis.	Examples: <ul style="list-style-type: none"> <li>• Concessional resources for conversion from biomass (wood fuel) to solar or electrification.</li> <li>• Concessional resources for solar water heaters.</li> <li>• Concessional resources for energy efficiency programmes.</li> <li>• Concessional resources for irrigation, to enable farmers to adapt to climate change.</li> </ul>
Capacity-Building Programme	Fund to provide capacity-building and project development.	Examples: <ul style="list-style-type: none"> <li>• Capacity-building grants to provide project development skills.</li> <li>• Project/programme pipeline development.</li> <li>• Prototyping new pilots in developing countries.</li> </ul>

Box 3, lifted from the SME Paper, provides summary descriptions and usage examples for these two programmes. From these, it is clear that both programmes could be operationalized as a form of the nationally consolidated, locally devolved EDA programmes depicted in Figure 1. But it is equally evident that they could take a different format, for example by involving international intermediaries. Even if only in-country intermediaries are contemplated, the model could differ substantially from that proposed in Figure 1, in particular with respect to the use of a National Funding Entity as consolidating gateway.

Figure 2 depicts a possible appearance of such an unconsolidated access model. It illustrates, in particular, the necessary initial no-objections for the relevant programme proposals of any of the different in-country GCF/PSF intermediaries by the National Designated Authority (NDA). It is



important to keep in mind that these initial no-objections are the only tool countries would have to generate coherence between these PSF supported programmes. It stands to reason that recipient countries would thus need to insist on much more tightly specified programme proposals than if they were able to give guidance in the course of the programmes through consolidating NFEs. This is why the model depicted in Figure 2 would arguably not only create less country ownership, but would also be less effective than the consolidated nationally integrated model depicted in Figure 1.



#### 2.4. Simplified procedures for the Fund's programmatic approach

Section VI ('Simplified procedures for the Fund's programmatic approach') of the Simplified Procedures Paper provides a useful and concise argument for EDA that is worth quoting in detail in the present context:

43. In order for the Fund to be able to achieve its objective of promoting the paradigm shift towards low-emission and climate-resilient development pathways, the Fund must be able to finance a large number of climate change activities. Funding programmes as well as projects, will therefore be important for achieving the Fund's objectives, as provided in paragraph 36 of the Governing Instrument. To do so efficiently and effectively, the Fund will need to delegate the authority of funding decisions on individual eligible projects or activities within a programme

to the relevant intermediary so that more resources can be deployed for climate change activities.

44. As outlined in document GCF/B.06/15 [‘Additional Modalities That Further Enhance Direct Access, Including Through Funding Entities’], an intermediary can take responsibility of an approved programme, where the funding decisions on individual eligible projects or activities are delegated to the entity in question. Such an approach would allow the Fund to finance a large number of activities and would enhance opportunities for country ownership of projects and programmes by recipient countries, particularly under the Fund’s direct access modality. Such an approach would effectively enhance country ownership through decision-making capacity over funding for specific projects or activities within the scope of an approved programme.
45. Under a programmatic approach, the Fund will be able to design and implement programmes so that:
  - (i) Moral hazard is mitigated;
  - (ii) Credit risk is in line with the Fund’s risk appetite; and
  - (iii) The resources made available by the Fund are utilized to meet the Fund’s objectives.

In this case, at the time of programme approval, the Board or approving authority would set requirements as to which types of projects the intermediary could fund, taking into account the Fund’s investment framework and environmental and social safeguards (decisions B.07/06 and B.07/02 respectively), and expected monitoring and reporting standards would also be outlined. The Board or approving authority would monitor [the] impacts of such projects and programmes *ex post* through portfolio management.

### 3. The EDA Pilot Phase and the PSF Programmes: Synergies

There are already a number of initiatives which have significant experience in using local intermediaries to fund MSME mitigation projects in developing countries. The aim of this section is to give summary descriptions<sup>7</sup> of two of them, in order to suggest possible ways in which the EDA Pilot Phase (EDAPP) could be used in combination with the PSF MSME and Capacity-Building Programmes as a laboratory to test modalities that ‘promote the participation of private sector actors in developing countries, in particular local actors, including small- and medium-sized enterprises and local financial intermediaries.’[Paragraph 43, GCF Governing Instrument]

#### 3.1. Funding MSME projects through local intermediaries: Existing examples

##### *Just in case of a future transition to Energy Financing*

Over the last decade, the *Agence Française de Développement* (AFD), a French public sector development finance agency, has committed around EUR 15 billion (both in the form of *ex ante* grants or loans) for climate finance.

In order to facilitate the implementation of local public policies, AFD has put in place a framework of innovative **SUNREF** (‘Sustainable Use of Natural Resources and Energy Financing’) tools; these include both technical (capacity strengthening, institutional support, training, MRV, etc.) and financial (loan, grant, guarantees, equity, etc.) tools which aim to address the various barriers that small- and medium-sized public and private green investments developers are facing. Under this framework, AFD has developed programmes in collaboration with about 40 local intermediaries (banks) in 25 developing countries.<sup>8</sup>

The first aim of these programmes is to seek to reach local project developers (AFD cannot reach these directly because of size barriers); the second aim is to ensure the sustainability of spillover effects created through the initial successful green investments.

The ultimate recipients of the SUNREF loans are (usually) private companies – Small and Medium Enterprises (SMEs), Energy Service Companies (ESCOs) – as well as individuals. The investments are made either in renewable energy projects, or in energy efficiency projects (in industry, agriculture and buildings). Through these programmes, the local intermediaries can avail themselves of a number of complementary products:

- **Lines of credit** to local banks/financial institutions with long-term maturity and concessional conditions to overcome the liquidity barrier. The local bank/financial institution lends on the funds to finance small- and medium-sized climate-related projects of public and private developers. Loans granted to project developers provide them with incentives (e.g. maturity, interest rate) to invest.
- **Investment grants** to improve the financial yield for some investments, often with high development added value. This creates an incentive for an early investment and enhances creditworthiness, from the point of view of the financial intermediary.

<sup>7</sup> A more detailed description can be found in the annexes to this Working Paper.

<sup>8</sup> China, Egypt, India, Indonesia, Jordan, East Africa Regional programme (Tanzania, Uganda, Kenya), West Africa Regional programme (Senegal, Togo, Cote d’Ivoire, Burkina Faso), Indian Ocean Region (Mauritius, Madagascar, Seychelles, Mozambique, Comoros), Mexico, Peru, Armenia, Georgia, Morocco South Africa, Thailand, Tunisia, Turkey.

- **Technical Assistance (TA)** to local banks and project developers in order to facilitate the origination, appraisal, implementation, and MRV of good projects. By providing free assistance to the first adopters of new green energy investments, TA generates knowledge concerning the measure or product; this in turn facilitates access to such products for those who follow, thus sustaining the new market.
- Use the AFD **risk-sharing facility** ARIZ.

The SUNREF programmes initiate the involvement of local banks in new sustainable energy markets. They give sufficient technical and financial incentives to overcome different barriers such as: lack of knowledge and capacities of the local banks in these sectors, project development challenges (feasibility study sufficiently strong to meet the local banks' standards), and lack of sufficient equity and soft financing to close the financing plan. After having worked on projects through a couple of credit lines with AFD, and having benefitted from the technical assistance, local banks will usually have acquired sufficient capacity to continue developing the market **without any further international support**.

Key factors in the success of the SUNREF operations are: (i) definitions of eligibility criteria which are balanced between the level of ambition and the market/local banks' capacity, and (ii) the monitoring of results at partner bank level.

## 2.2.2.2 Energy Efficiency Investment

The FEEP objective is to increase demand for energy efficiency investment in targeted MSME clusters and to build their capacity to access commercial finance. FEEP is GEF funded and implemented by the **World Bank**, and managed in India by the **Bureau of Energy Efficiency (BEE)**, and the **Small Industries Development Bank of India (SIDBI)**.

The mission of the BEE, which was established by the Energy Conservation Act of 2001 as part of the Indian Ministry of Power, is to develop policies and strategies with an emphasis on self-regulation and market principles, with the primary objective of reducing the energy intensity of the Indian economy.

SIDBI was set up on April 2, 1990 under an Act of Indian Parliament and is the principal financial institution for the promotion, financing and development of the Micro, Small and Medium Enterprise (MSME) sector and for Co-ordination of the functions of the institutions engaged in similar activities.

The project is centered around five geographical **energy intensive MSME clusters**, four of which focusing on a particular type of enterprise: foundries, forging, limekilns, and chemicals. The project carries out two types of activities:

- Activities to build **awareness** of, and **capacity** to carry out EE measures in MSMEs (assistance with Energy Audits, Detailed Project Reports (DPRs)<sup>9</sup>, and to **manage the knowledge** generated.
- EE investment (enhancing) activities, in particular with regard mobilizing financing from the Indian local banks.<sup>10</sup>

<sup>9</sup> A DPR is prepared by a BEE certified energy auditor after carrying out baseline energy audits in an MSME. It documents/captures the baseline performance of the MSME, includes the recommendations of the energy auditor to improve EE in the MSME and a detailed analysis of technologies or techniques proposed by the energy auditor for improving energy efficiency in the MSME.

At the heart of the EE investment activities

- **Performance-based Financial Intermediation**

Based on this preparatory work, in particular with respect to energy audits and the development of IG-DPRs, SIDBI – being the principal financial institution for the promotion, financing and development of the micro, small and medium enterprise sector and for co-ordination of the functions of the institutions engaged in similar activities in India – has been chosen to act as financial intermediary for eligible MSME project proposals.

- **Financial Instrument**

FEEP uses *ex-post* (“back-ended”) **Performance Linked Grants** (PLG) to incentivize the participation of MSMEs. To receive a PLG, the MSMEs have to undergo **Detailed Energy Audits** through BEE certified energy auditors and prepare IGDRPs (investment grade detailed project reports) through agencies engaged by SIDBI (such as [TERI](#) or [DESL](#)).

The **level** of the PLG is based on whichever is lower: the actual **capital investment** made by the MSME in implementing the EE measures identified in the IGDRPs, or the **estimated cost** of the measures in the IGDRP:

- If this investment/cost is between INR 2 to 10 Lakh (EUR 2.8k/USD 3.2k to EUR 14.5k/USD 16k), a PLG of 15% of the investment/cost is provided to the MSME.
- If it exceed Rs 10 Lakhs (EUR 14.5k/USD 16k) then 20% of the investment/cost (subject to a cap of Rs 10 Lakhs/EUR 14.5k/USD 16k) is provided to the MSME as a PLG.

- **Procedures**

To be eligible for a PLG, MSMEs have to provide a “letter of consent” to the agencies hired by SIDBI for implementing the EE recommendations of the IGDRP. The approval of a PLG depends on whether the MSME, through the SIDBI agencies, is able to implement within an agreed timeline at least 75% of the savings estimated in their respective IGDRPs, subject to verification by an independent M&V agency, such as [Confederation of Indian Industries](#) (CII), engaged by SIDBI.

Once verification is provided, SIDBI may approve the PLG. The PLG amount is initially spent by SIDBI out of its own budget and is later reimbursed by the World-Bank utilizing the GEF grant from time to time.

The PLG is released directly into the MSME’s bank account by SIDBI, within 30 days of completion of M&V process. MSME units have to be in compliance with the environmental and social requirements of World Bank ESMF Framework.

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<sup>10</sup> For example, training support through Indian Bank Training Institutes is provided to increase capacity at local branch offices in identifying and appraising EE projects. Efforts are being made to formalize the participation of local banks in the project, either through their participation in the training programs, or project-executed consultancies supporting banks’ own efforts in EE lending.

### 3.2. *The Need for National Consolidation*

These examples of local intermediation demonstrate that there is a good case for access to funding from National Funding Entities (whether under EDA or not) being devolved to intermediaries at the local level. But why should there be a national consolidation of (public sector) climate finance, from both foreign and domestic (budgetary) sources?

‘[T]he idea of consolidation at the international and national level and decentralized funding decisions through devolution to the recipient countries’<sup>11</sup> has been at the heart of a proposal for a reform of the UNFCCC Financial Mechanism which gave rise to the idea of EDA.<sup>12</sup> In August 2009, an ecbi meeting on ‘Key Issues on Governance of Climate Change Finance’ discussed at some length the ideas put forward in this proposal, particularly the consolidation of (public sector) funding streams, both at the national and the multilateral level.<sup>13</sup> The following points, as reported in the [proceedings](#), were raised at the meeting:

- Consolidation must not be confused with centralization, i.e. ‘a consolidated fund is not a centralized fund but a pass-through mechanism ... with allocation and disbursement decisions made by separate bodies responsible for doing so under rigorous allocation criteria’.
- Consolidation provides for a very effective way of ensuring coherence and consistency in the funding system.
- Consolidation allows for a simple way of ensuring both a thematic balance and an equitable distribution of the funds among the eligible stakeholders.

As mentioned in the Section 2.3 above, consolidation allows for the most effective implementation of national strategies as well as mainstreaming into national policies. With the right governance structure, the consolidating body can generate the sort of ‘country ownership’ that can be key to the success of the funded programmes. Consolidation through a national gateway (Figure 1) also drastically reduces the GCF’s transaction costs in engaging MSMEs, in comparison to the model currently suggested for the PSF MSME programme (Figure 2). It thus stands to reason that the best way forward for the GCF/PSF would be to use nationally consolidated and locally devolved programmes to engage MSMEs, and to do so as part of the EDAPP.

### 3.3. *Terms of Reference for the ‘EDA Pilot Phase’ (EDAPP)*

In Barbados, the GCF Board decided that Terms of Reference (TOR) for ‘a pilot phase that further enhances direct access’ (i.e. EDAPP) should be drawn up by the time of its next meeting (March 2015) and listed six items that should be specified in these TOR (see Box 4). The aim of this final section is to put forward, and to give illustrations of, some ideas of what these TOR could, and indeed should, be – not least to bring about the above-mentioned synergies with the MSME and Capacity-Building Programmes of the GCF Private Sector Facility.

<sup>11</sup> Benito Müller, ‘[The Reformed Financial Mechanism of the UNFCCC: Post Copenhagen Architecture and Governance](#)’, April 2010: p.3.

<sup>12</sup> Benito Müller and Luis Gomez-Echeverri, ‘[The Reformed Financial Mechanism of the UNFCCC. Architecture and Governance](#)’. Part D ‘Climate Change Funds: National Climate Change Decision and Funding Hubs’.

<sup>13</sup> As a matter of fact, many of the arguments apply to both levels in equal measure.

**Box 4. The Barbados EDAPP Decision B.08/09**

The Board, having considered document GCF/B.08/09 Additional Modalities that Further Enhance Direct Access, Including through Funding Entities:

- (a) Requests the Secretariat, under the guidance of the Accreditation Committee and in consultation with relevant stakeholders, to prepare terms of reference for modalities for the operationalization of a pilot phase that further enhances direct access, which will include relevant readiness support if requested by subnational, national and regional entities, for approval by the Board at its ninth meeting; these terms of reference will launch the pilot phase; and
- (b) Clarifies that the terms of reference will specify, inter alia:
  - (i) The objective of the pilot phase;
  - (ii) The type of entities to be involved;
  - (iii) The specialized fiduciary standards required;
  - (iv) The type of activities to be undertaken;
  - (v) The timeframe of the pilot phase; and
  - (vi) The financial volume of the pilot phase.

[Source: GCF/B.08/45](#)

Enhanced Direct Access (EDA), in the broadest sense of the term, is access to GCF resources through entities that have been endorsed by a National Designated Authority for accreditation as a GCF intermediary. So if the objective of the EDAPP were to pilot EDA in general, then presumably any programme of activities proposed by such an intermediary would have to be seen as part of the EDAPP. This, however, would be tantamount to putting a cap on the amount that accredited developing country intermediaries would be allowed to receive from the GCF if, as suggested in the Barbados Decision (Paragraph b.vi, see Box 4), resources for the EDAPP are to be capped. It stands to reason that in the absence of similar caps on bilateral and multilateral intermediaries, recipient countries would regard this as a case of unacceptable discrimination.

This can be avoided if the objective of the EDAPP is conceived in a narrower, more focused manner, say as testing ('piloting') *a certain type of domestic programme put forward by these nationally designated intermediaries*. In that case, the potential cap on the EDAPP would not be a general cap on direct access programmes, but only on the EDAPP-eligible programmes. This means that the nationally designated intermediaries, like all other GCF intermediaries, would then be able to submit other types of programmes outside the EDAPP.

What type of national programmes should be piloted under the EDAPP? In light of the points made earlier in this Working Paper, the EDAPP could focus on testing *nationally consolidated but locally devolved in-country access models*, where:

- 'nationally consolidated' refers to the use of a nationally designated intermediary with a governance embedded in national decision making – and as such is referred to as '*National Funding Entity*' (NFE), and
- 'locally devolved' means that the NFE provides funding to 'local actors, including small- and medium-sized enterprises, [through] local financial intermediaries'. [GI para. 43]

As discussed in Section 3.2 above, these national pilot programmes must be strategically guided at the national level to ensure not only coherence with national strategies and priorities, but also to establish country ownership over them (in line with GI para. 47). Ideally, the NFE should therefore be a national body that effectively engages all key sectors/ministries relevant to climate change, and provides in-country strategic governance to climate finance. Such an NFE should not only be designed to meet the requirements of the GCF, but also to work effectively with national policies, processes, and (sub-national) institutions.

National climate funds (with such a national governing body) established by a growing number of developing countries could serve this purpose. Under the proposed type of national pilot programme they would further outsource the channelling of funds to the sub-national level through (multiple) existing channels, such as:

- existing budgetary channels for sub-national and local governments and authorities,
- national financial institutions such as national (agriculture/development/ industrial) banks,
- private banks with a nationwide reach, and/or
- civil society networks and organizations.

However, as not all countries have a national climate fund, interim arrangement for the duration of the EDAPP could be envisaged. Countries could designate an interim operator (such as the Ministry of Finance) as being eligible for accreditation as GCF intermediary to manage the national pilot programme, with the proviso that the programme funding is overseen by a national governing body as referred to above.

It is important to reiterate that having a national supervisory body as described above is what turns a nationally designated intermediary into an NFE. Countries are obviously entitled to designate entities for accreditation as GCF intermediaries in the absence of such a national governing body, but in that case they would simply be intermediaries and not NFEs, in the sense proposed here. It is with this clarification in mind that the proposal for the EDAPP to involve NFEs should be read.

*entities, activities, and restrictions*

**Type of entities.** Given the understanding of EDA referred to in 3.3.1 above, the EDAPP would only deal with national, sub-national, or regional entities which will have been accredited by the GCF as intermediaries, and as such are eligible to carry out programmes of activities with GCF funding. This means, in particular, that the EDAPP would not involve multilateral or bilateral GCF intermediaries, or for that matter a GCF Implementing Entity (unless it is also accredited as an intermediary and has the above-mentioned governance to serve as an NFE).

**Fiduciary standards.** The specialized fiduciary standard requirements for NFEs are the ones applying for any GCF intermediary.

**Type of activities.** The objective of the EDAPP is to test in-country devolved access models, and not the activities that are being funded. This is why it might be prudent to restrict eligibility to activities for which there are tried and tested methodologies, such as those portrayed in Section 3.1. However, the identification of these activities need not be part of the EDAPP TOR; this could be done as part of drafting the call for EDAPP national pilot programme proposals.



*4 e t e r e n n n e v o u e*

**Time frame.** Given that the proposed national pilot programmes will require a considerable amount of start-up time (for selecting local intermediaries and generating local project pipelines) it is unlikely that these programmes could be evaluated meaningfully after anything less than three years' duration.

**Financial volume.** It might be appropriate to limit the number of pilot programmes per country to one or two, and to limit the size of programmes, possibly differentiated by country size, for example:

- Small countries: up to USD 5million per programme;
- Medium sized countries: up to USD 25 million per programme;
- Large Countries: up to USD 50 million per programme.

(The amounts listed are just for illustration. The sums will need to be calibrated by the level at which the different bands of countries would become interested.)

Alternatively, and in some ways preferably, these figures could be used solely for internal/illustrative purposes to calculate the overall financial volume of the EDAPP, without explicitly imposing caps on pilot programmes. This would leave it open to countries to decide what size of pilot programme is viable for them.

## 4. Postscript: Q & A

A draft version of this Working Paper was sent out for peer-review in the course of which two questions came up that warrant a short post script.

### 4.1. *Question 1: Enhanced Direct Access vs Regular Direct Access*

It might be useful to further elaborate the difference between the “enhanced direct access” modality vs. the regular “direct access”, by clearly delineating the practical implications/boundaries of each. If EDA is about programmatic approaches with devolved access, how is this different from programs that may be submitted to the Fund under the “direct” access modality?

### 4.2. *Answer to Question 1*

At the heart of the idea of EDA is the devolution of funding decisions, i.e. approval of in-country activities (projects/programmes) to the national level. As such, EDA is inextricably linked with in-country (GCF) *Intermediaries* carrying out/managing *GCF approved programmes*. My understanding of ‘Regular Direct Access’, in turn, is based on the Adaptation Fund operationalization of the term which involves in-country *Implementing Entities* managing *projects* that have been *approved by the AF Board*.<sup>14</sup>

This interpretation of ‘Implementing Entity’ and ‘Intermediary’ (see Box 1) reflects a difference between the three GCF types of specialized fiduciary criteria – viz. ‘project management’, ‘grant award and/or funding allocation’ and ‘on-lending and/or blending’ – regarding the authority to approve activities: Intermediaries, being accredited under the latter two, have that authority, Implementing Entities, as accredited for project management, do not.

Using this terminology, any GCF approved programme managed by an accredited in-country intermediary would hence be a case of EDA. However, this does not necessarily mean that the programme in question would have to be counted as part of the Pilot Phase. Why? Because, we are not testing whether EDA in general should be practiced by the GCF, for this has already been settled when it was agreed that there will be intermediation through in-country entities.

All we can and should test under the Pilot Phase are *particular types of* (national) *pilot programmes*. This means, in particular, that in-country intermediaries are free to submit other types of programmes to the GCF *outside the EDA Pilot Phase*. This is of importance not least because it ensures that the financial cap on the Pilot Phase is not a cap on activities by in-country intermediaries in general, but only on pilot programmes designated as eligible for funding under the Pilot Phase.

### 4.3. *Question 2*

It would be useful to consider if other national entities that are not necessarily “NFEs”, but which could play a similar role, could also be considered, since it might also be preferable to work with already established institutions rather than promote the creation of new ones. You mention that the entity should be: “a national body that effectively engages all key sectors/ministries relevant to climate change, and provides in-country strategic governance to climate finance.” Some national entities (like a national development bank) may not have this specific mandate or reach but could

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<sup>14</sup> They are referred to as ‘National Implementing Entities’ because they have been designated by the national authorities, and because there is only one per country.

play a similar role and contribute to the coordination of climate finance in the country. The question arises what would be the role of the NDA vis-à-vis the entities eligible to implement EDA, and a strong link could help to strengthen the NDA's role in the process of accessing the Fund and coordinating project proposal and implementation. Similarly, these EDA entities could be reformed or strengthened to work with climate change national processes/policies.

#### 4.4. Answer to Question 2

Regular Direct Access can, and should be enhanced beyond its minimal core characteristics: viz. the devolution of activity approvals to the country level. For example, countries could – as advocated in this working paper – adopt an in-country architecture which is on the one hand, ***nationally consolidated and guided*** and, on the other, ***domestically devolved*** in its activity approval processes.

‘National consolidation’ here refer to the fact that public sector climate change funding both from foreign and national sources are collected at the national level. ‘Domestically devolved’ means that the approval of domestic activities (projects/programmes) is delegated to the lowest possible level, in accordance to the well-known principle of subsidiarity.<sup>15</sup> Note that generally, this should be achieved through existing channels, such as the country's fiscal transfer channels and/or public/private banking networks.

However, the key component of this of ‘NFE’ architecture with respect to Question 2 is the need for ‘national guidance’. The idea here is that there needs to be a ***national body, representing all the key stakeholders*** (the relevant line ministries, the NDA, civil society, private sector etc.) ***to give strategic guidance*** on the use of these nationally consolidated funding streams. Many countries have already established such bodies (‘national climate change committees’) in the context of implementing national climate change strategies, and/or in the governance of national climate funds.

While I think this national guidance would best occur in the context of a national climate fund (used for the consolidation of funding streams), for the purposes of the Pilot Phase, other types of national Intermediaries (such as the Finance Ministry or, as mentioned, a national development bank) could be used *ad interim* for the purpose of carrying out a national EDA pilot programme, provided that the programme itself is overseen by a national body that can give the said sort of guidance and therewith create the desired buy-in/ownership at the national level.

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<sup>15</sup> ‘[T]he principle that a central authority should have a subsidiary function, performing only those tasks which cannot be performed at a more local level’ [[www.oxforddictionaries.com/definition/english/subsidiarity](http://www.oxforddictionaries.com/definition/english/subsidiarity)]

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## Annex A. Sustainable Use of Natural Resources and Energy Financing

### Introduction

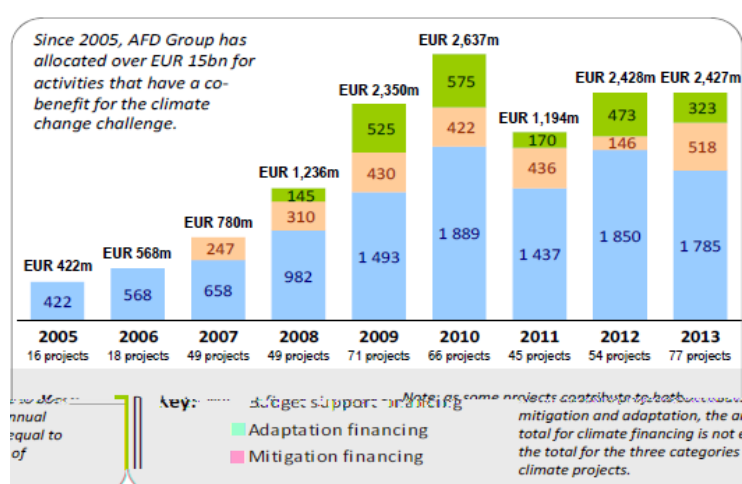
The Agence Française de Développement (AFD) is a French public sector development finance institution that has worked to fight poverty and support economic growth in developing countries and the French Overseas Territories for 70 years. Through offices in more than 70 countries, AFD provides financing and support for projects that improve people's living conditions, promote economic growth, and protect the planet. **In 2014, AFD committed over EUR 8 billion in Africa, Asia, the Mediterranean Basin, the Middle East, South America, and the French Overseas Territories.** AFD carries out its mandate through its financing, risk analysis and hedging instruments, and expertise in training and capacity-building, which it provides to both public and private stakeholders. In the poorest countries, primarily in sub-Saharan Africa, AFD mainly operates through grants and concessional instruments. In middle-income countries, it allocates soft loans and provides technical assistance, which strengthens the contracting authorities for the funded projects and develops cooperation on common challenges in these countries. In emerging countries, it allocates concessional and market-rate loans with a strong focus on financing projects that contribute to green growth and global public goods.

In 2010 AFD decided to reflect the growing importance of the fight against climate change in its operations by incorporating it in a core operational strategy, the so-called AFD 2012-16 Climate & Development action plan\*. This strategy is grounded on **three structural pillars**:

- (1) An objective to make climate-related financing commitments equal to **50 per cent of AFD's annual funding to developing countries and 30 per cent of AFD's private sector subsidiary, PROPARCO**;
- (2) A strong commitment to **systematic measurement of all projects' carbon footprints**, using a robust and conservative method and integration of climate vulnerability assessment on projects;
- (3) **A unique and innovative policy of selecting projects according to their climate impacts**, considering countries' development levels.

Since 2005, the AFD Group has allocated more than EUR 15 billion for activities that have a positive climate change co-benefit (EUR 2.4 bn in 2013). These amounts are calculated according to a restrictive and transparent climate finance tracking methodology.

Beyond these significant volumes of climate financing, AFD's accumulated experience in working on climate projects, programmes, and policies in a wide range of developing countries make it **a fully-fledged stakeholder in the architecture of international climate finance.**



\* Full document available here: [www.afd.fr/webdav/site/afd/shared/PORTAILS/SECTEURS/CLIMAT/pdf/Climat\\_GB\\_HD.pdf](http://www.afd.fr/webdav/site/afd/shared/PORTAILS/SECTEURS/CLIMAT/pdf/Climat_GB_HD.pdf)

### ***The SUNREF Programming Framework***

Developing and emerging countries are currently facing growing challenges in the field of energy and climate change that will require volumes of investments in renewable energy and energy efficiency orders of magnitude beyond donors' capacity. Moreover, many investments in these fields are small in size and need financing in local currency; this limits the ability of international finance institutions to provide appropriate financing directly. ***Local banks have a key role to play in scaling up climate change finance*** by catering for small-scale local investments. Despite the dynamism and profitability of these sectors, investors still face numerous obstacles: businesses and households are not aware of potential benefits, they overestimate risks, they lack access to appropriate funding, etc.

In order to facilitate the implementation of local public policies, AFD has put in place a framework of innovative **SUNREF** ('Sustainable Use of Natural Resources and Energy Financing') tools; these include both technical (capacity strengthening, institutional support, training, MRV, etc.) and financial (loans, grants, guarantees, equity, etc.) tools with the aim to address the various barriers faced by small- and medium-sized public and private green investment developers. The AFD Group's activities are based on its extensive experience with regard to climate change credit lines, stretching back to 2005, with commitments of about EUR 15 billion (loan and grant) since 2006 and about 40 partner banks in 25 developing countries.\* The average leverage effect ratio between the grant element mobilized and the total investment amount induced is above 15, illustrating the efficiency of the SUNREF framework. Moreover, SUNREF is estimated as being able to reduce between 5 and 7 million tonnes of CO<sub>2</sub> emission per year for the next 20 years, the order of magnitude of total annual emissions of a country like Sénégal.

### ***Objectives***

SUNREF programmes first seek to reach those project developers which AFD cannot reach directly because of size barriers: it is important to ensure that small actors are also mobilized and benefit from international finance, thus ensuring the scaling up of public policy effects. Secondly, they seek to ensure the sustainability of spillover effects created through successful initial green investments. This is why SUNREF aims to mobilize local banking and/or non-banking financial institutions, and is especially dedicated to developing and strengthening partnerships with local Financial Intermediaries, providing them with technical and financial products to address the needs of green investments developers.

### ***Framework Description***

#### ***Recipients and Project types***

The ultimate recipients of SUNREF loans are (usually) private companies – Small and Medium Enterprises (SMEs), Energy Service Companies (ESCOs) – as well as individuals. The investments are usually made either in renewable energy projects or in energy efficiency projects (in industry, agriculture, and buildings).

\* China, Egypt, India, Indonesia, Jordan, East Africa Regional programme (Tanzania, Uganda, Kenya), West Africa Regional programme (Senegal, Togo, Cote d'Ivoire, Burkina Faso), Indian Ocean Region (Mauritius, Madagascar, Seychelles, Mozambique and Comoros), Mexico, Peru, Armenia, Georgia, Morocco South Africa, Thailand, Tunisia, Turkey.

*Local Intermediaries*

The SUNREF framework provides local banks with special partnership conditions, allowing them to seize the opportunities of climate change finance. AFD and local banks work together in partnership to identify investment potential, select sectors with the highest potential,

### *Modalities*

The design and implementation of an in-country (local) programme under the SUNREF framework relies on three components:

- A ‘market’ study in order to ensure that the programme conforms to local public policy and AFD’s intervention framework.
- *Ex ante* project lending characteristics and investment eligibility criteria.
- An indicator framework and indicators used for monitoring and reporting, for the programme and its investment projects.

#### *The ‘Market’ Study*

In order to be eligible for investment under a SUNREF programme, projects must be (i) consistent with and support government policy, (ii) respond to demand, and (iii) meet the stakeholders’ needs and expectations. To ensure this, an initial ‘market’ study is undertaken to provide detailed information on:

- relevant national policies to ensure that it enables the investment environment in the relevant sectors;
- capacity of appropriate intermediaries in the region to support the project;
- investment potential, evidence of demand and flow of suitable subprojects to finance, potential project developers, and identification of the barriers that impede investment financing;
- identification and availability of the necessary products and services;
- financial and technical assistance framework necessary to create the investment opportunities;
- types of projects to be targeted and their anticipated financing.

#### *Ex ante project lending characteristics and investment eligibility criteria*

Eligibility criteria for project investments are contractually agreed between AFD and the partner bank, based on market studies and discussions with the partner banks.

The project sectors are usually: industrial investments, stand-alone small-scale renewable energy investments, commercial and residential buildings sector, and access to energy, depending on the particular country. The eligibility criteria could also include an exclusion list. The projects are evaluated with respect to financial and sector-specific criteria:

- Criteria for **energy efficiency projects** could involve the level of assumed *ex ante* energy savings, or the project type (retrofit, extension of capacity, buildings, etc.).
- **Renewable energy project** criteria could involve net present value, or the type of technology.
- **Financial criteria** could involve project loan amounts and total investment costs, tenor of the project loan, etc.

#### *Ex ante assessments, monitoring, and reporting*

An assessment form is used by the programme counterparty (the local intermediary) to provide information on requested allocations; this includes information on the recipient company or promoter, the project concerned, and the type of financing envisaged. This assessment will confirm overall project eligibility and compliance with size thresholds, the sectors retained in the scope of the facility and/or countries, types of individual promoters/final beneficiaries, etc. The degree of autonomy granted to the local intermediary (from a ‘no objection’ from AFD for all of the projects



to a direct assessment by the intermediary) depends on the size of projects and type of intermediary. It can be specified *ex ante* in agreement with the counterparty and should be translated into a manual of procedures.

For the disbursement, two options are currently being implemented by AFD:

- Financial intermediaries are provided with drawing rights on the credit line upon submission of information on the eligible projects. The disbursement is made once the financial intermediary submits detailed information on the related investments. Typically the investments concerned in this case are renewable energy projects (above EUR 250,000);
- For smaller sized investments, typically energy efficiency projects (worth EUR 25,000 - 250,000), disbursement is usually made in the form of advance tranches, the use of which is justified *ex post*, when the financial intermediary requests the next disbursement. Usually, a list of preselected equipment is used to facilitate and reduce the transaction costs of these small operations.

Documentation is also required on the use of AFD's funding, and the financial intermediary will complete a table listing the relevant on-lending operations with all required information. The use of funds is documented, *inter alia*, by a list of operations complying with the eligibility criteria, or by delivering copies of the loan application files. The reporting on the use of funds is used to demonstrate that the funds have been used in accordance with the eligibility criteria. Impact measures, relating to energy efficiency and CO<sub>2</sub>eq emission reductions induced by the investment operation, are also included.

During the implementation of SUNREF programmes, AFD controls the compliance with agreed periodic monitoring and reporting requirements; these measures are presented at the approval stage and include assessments of underlying projects, disbursements tracking, as well as programme and project completion documentation. Supervision missions are regularly performed by AFD's investment officers in order to control the monitoring of projects financed through SUNREF programmes and to ensure measurable results.

### *Lessons learned and conditions of success*

The SUNREF programmes are designed specifically to mobilize local banking or non-banking financial institutions (private or public) to finance climate-related investments by mobilizing their own capital and creating their own banking products in this market. This is why they have a significant leverage effect and create strong ownership by local financial systems and local project developers.

The SUNREF programmes initiate the involvement of local banks in new sustainable energy markets. They give sufficient technical and financial incentives to overcome the different barriers: lack of knowledge and capacities of the local banks in these sectors, project development challenges (feasibility study strong enough to meet the local banks' standards), lack of equity and soft financing to close the financing plan. After having worked on some projects through a couple of credit lines with AFD, and having benefitted from the technical assistance, local banks will usually have acquired sufficient capacity to continue developing the market *without any further international support*.

Key factors in the success of the SUNREF operations are: (i) definitions of eligibility criteria which are balanced between the level of ambition and the market/local banks' capacity, and (ii) the monitoring of results at partner bank level.

## Annex B. The India-MSME Energy Efficiency Project

by Sameer Pandita\*

### *Introduction*

#### *About BEE*

The **Energy Conservation Act of 2001** (EC Act) defines the powers of the Central Government of India to facilitate and enforce the efficient use of energy and its conservation. The Governments of the States, in turn, are required to select **State Designated Agencies** to coordinate, regulate, and enforce the provisions of the Act in each State. The State Designated Agencies are thus the strategic partners for the promotion of energy efficiency and its conservation in the country.

The mission of the **Bureau of Energy Efficiency** (BEE) – established by the EC Act under the Ministry of Power – is to develop policies and strategies with an emphasis on self-regulation and market principles, within the overall framework of the EC Act, with the primary objective of reducing the energy intensity of the Indian economy. This objective is to be achieved with the active participation of all stakeholders, resulting in accelerated and sustained adoption of energy efficiency measures in all sectors.

#### *Functions of BEE*

In performing its functions, the BEE, as the Central Government's nodal agency for implementing the EC Act, co-ordinates with consumers, agencies, and other organizations while recognizing, identifying, and utilizing existing resources and infrastructures. Apart from taking all measures necessary to create awareness and disseminate information for the efficient use of energy and its conservation, and notifying energy users as being 'designated consumers' under the Act, the BEE develops and recommends to the Central Government:

- norms for processes and energy consumption standards,
- minimum energy consumption standards and labelling design for equipment and appliances,
- specific energy conservation building codes.

#### *The relevant BEE portfolio*

The BEE is currently involved in a number of projects/programmes that could be of interest in the context of this paper, namely:

- Promoting energy efficiency and renewable energy in selected MSME clusters in India.
- The BEE-SME programme.
- Financing Energy Efficiency in MSMEs.

The first two activities are briefly introduced in this section. The third, because of its particular relevance, is more fully discussed in the second part of this Annex.<sup>†</sup>

#### *Promoting energy efficiency and renewable energy in selected MSME clusters in India*

In September 2011, UNIDO, with GEF support, initiated a five-year project on 'promoting energy efficiency and renewable energy in selected MSME clusters in India' in collaboration with the BEE and the Indian Ministries of Micro, Small and Medium Enterprises (MSMEs) and of New and

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† This Annex is based on <http://beeindia.in/content.php?page=schemes/schemes.php?id=7>

Renewable Energy (MNRE). The project focuses on developing and promoting a market environment for the introduction of Energy Efficiency (EE) and the enhanced use of Renewable Energy (RE) technologies for process applications in 12 MSME clusters under five energy intensive sub-sectors. Broadly speaking the project objectives are:

- Increased capacity of suppliers of EE/RE products/service providers/financing institutions.
- Increasing the levels of end-use demand and implementation of EE and RE technologies and practices by MSMEs.
- Scaling up of the project to national level.
- Strengthening institutional, and policy/decision-making frameworks.

#### *The BEE-SME programme*

Launched in 2009 and fully funded by the Government of India, the BEE national programme on EE and technology upgrading of SMEs (the BEE-SME programme) aims to improve the energy performance of SMEs. In the course of the XI<sup>th</sup> Five-year Plan (FY2007-12), the BEE carried out a number of activities beginning with a situation analysis in 35 SME clusters, out of which 25 (from 12 sectors) were selected for comprehensive energy audits and technology gap assessments. Under the XI<sup>th</sup> Plan, as a result of this programme:

- 375 Detailed Project Reports (DPRs) on energy efficient technologies were prepared and peer-reviewed.
- Information dissemination and awareness creation workshops were held in 51 clusters.
- The implementation of Small Group Activities was completed in nine units in three clusters.
- Capacity for Local Service/Technology Providers was built in 25 clusters.

By the end of the XI<sup>th</sup> Plan, energy savings from 988 units (in 26 clusters) were assessed at 5 ktoe/yr (approx. 24 ktCO<sub>2</sub>), with voluntary investments of INR 28 crore/EUR 4 million/USD 4.5 million\* made by the units. In order to enhance the attractiveness of the programme and to ensure widespread replication, the BEE is currently focusing on two activities:

- Implementation of 100 energy efficient technology demonstrations in five energy intensive clusters with the provision of a performance-based *ex post* ('back-ended') subsidy of 50 per cent of the units' technology cost (subject to a cap of INR 10 Lakhs/EUR 14,500/USD 16,000).
- Information dissemination and capacity-building workshops for SMEs across the country to disseminate the results in terms of energy savings achieved by these technology demonstration projects, to facilitate their widespread replication.

#### ***The Financing Energy Efficiency Project (FEEP)***

In India, barriers to energy efficiency in MSMEs include not just the market barriers typically seen in Energy Efficiency (EE) projects globally, but also additional constraints relating to MSMEs' access to finance. Indian MSMEs typically face constraints in accessing adequate and timely financing on competitive terms, not least due to a lack of understanding by local banks of ROI and cash flows pertaining to EE technologies. The ***Financing Energy Efficiency at MSMEs*** concept was developed into the Financing Energy Efficiency Project (FEEP) as a part of the Global Environment Facility (GEF) *Programmatic Framework for Energy Efficiency in India*.

\* INR 1 = EUR 0.0144461 = USD 0.0161655.

### *Objective*

The FEEP objective is to increase demand for energy efficiency investment in targeted MSME clusters and to build their capacity to access commercial finance. FEEP is GEF funded, implemented by the **World Bank**, and managed by the **BEE** and the **Small Industries Development Bank of India** (SIDBI). \* A Project Management Unit in SIDBI has been set up at New Delhi to channel the grant to the targeted beneficiaries.

### *Scope of the FEEP*

Under the project, the scope of activities is determined by five **energy intensive MSME clusters**<sup>†</sup> namely:

- foundries at Kolhapur,
- forging at Pune,
- limekilns at Tirunelveli,
- chemicals at Ankleshwar, and
- a mixed cluster at Faridabad.

For these clusters, FEEP carries out two types of activities:

- Activities to build **awareness** of, and **capacity** to carry out, EE measures in MSMEs (assistance with Energy Audits, Detailed Project Reports (DPRs),<sup>‡</sup> and to **manage the knowledge** generated.
- EE investment (enhancing) activities, in particular with regard to mobilizing financing from local Indian banks.<sup>§</sup>

### *Awareness and Capacity-Building Activities/Knowledge Management*

Through the capacity-building activities of the BEE, participants from 4000 SMEs and personnel from 1120 financial institutions have been trained.

The work was carried out through outreach to clusters, as well as capacity-building at industry associations, through marketing and general outreach on EE schemes, and dissemination of success stories (in five World Bank clusters and 25 BEE clusters).

There was training, BEE certification, and enlistment of energy auditors, as well as specialized support for banks and vendors of relevant technologies/equipment.<sup>\*\*</sup>

\* The Small Industries Development Bank of India (SIDBI) was set up on 2 April 1990 under an Act of the Indian Parliament; it is the Principal Financial Institution for the Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector and for the co-ordination of the functions of institutions engaged in similar activities. For more see SIDBI website at: [www.sidbi.com/](http://www.sidbi.com/)

† Cluster membership is determined by the relevant cluster associations.

‡ A DPR is prepared by a BEE certified energy auditor after carrying out baseline energy audits in an MSME. It documents/captures the baseline performance of the MSME, includes the recommendations of the energy auditor to improve EE in the MSME, and gives a detailed analysis of the technologies or techniques proposed by the energy auditor for improving energy efficiency in the MSME.

§ For example, training support through Indian Bank Training Institutes is provided to increase capacity at local branch offices in identifying and appraising EE projects. Efforts are being made to formalize the participation of local banks in the project, either through their participation in training programmes, or through project-executed consultancies supporting the banks' own efforts in EE lending.

\*\* For example, the suppliers of variable frequency drives, boilers, furnaces, motors, compressors, pumps etc. operating at local cluster level or elsewhere in the country.

Crucially, there was support to MSMEs in carrying out over 600 Detailed Energy Audits and producing over 500 *Investment Grade Detailed Project Reports* (IGDPRs), both of which key requirements in becoming eligible to participate in the Financial Intermediation arm of the FEEP (see below).

These FEEP knowledge-management activities, also carried out by the BEE, involve crosscutting analytic work, the collation of best practices and successful case studies of relevance for India, information on international EE benchmarks by sector, EE technology databases, dissemination of relevant information on EE programmes/projects, and policy development functions.

### *Performance-based Financial Intermediation*

Based on this preparatory work, in particular with respect to energy audits and the development of IGDPRs, SIDBI (the principal financial institution for the promotion, financing, and development of the micro, small, and medium enterprise sector and for co-ordination of the functions of institutions engaged in similar activities in India) has been chosen to act as the financial intermediary for eligible MSME project proposals.

### *Financial Instrument*

FEEP uses *ex post* ('back-ended') *Performance-Linked Grants* (PLG) to incentivize the participation of MSMEs. To receive a PLG, the MSMEs have to undergo *Detailed Energy Audits* through BEE-certified energy auditors and prepare IGDPRs (investment grade detailed project reports) through agencies engaged by SIDBI (such as [TERI](#) or [DESL](#)).

The *level* of the PLG is based on whichever is lower: the actual *capital investment* made by the MSME in implementing the EE measures identified in the IGDPRs, or the *estimated cost* of the measures in the IGDPR:

- If this investment/cost is between INR 2 to 10 Lakh (EUR 2.8k/USD 3.2k to EUR 14.5k/USD 16k), a PLG of 15 per cent of the investment/cost is provided to the MSME.
- If it exceeds INR 10 Lakhs (EUR 14.5k/USD 16k) then 20 per cent of the investment/cost (subject to a cap of INR 10 Lakhs/EUR 14.5k/USD 16k) is provided to the MSME as a PLG.

### *Procedures*

To be eligible for a PLG, MSMEs have to provide a 'letter of consent' to the agencies hired by SIDBI for implementing the EE recommendations of the IGDPR. The approval of a PLG depends on whether the MSME, through SIDBI approved agencies, is able to implement (within an agreed timeline) at least 75 per cent of the savings estimated in its respective IGDPRs, subject to verification by an independent M&V agency, such as the [Confederation of Indian Industries](#) (CII), engaged by SIDBI.

Once verification is provided, SIDBI may approve the PLG. The PLG amount is initially spent by SIDBI out of its own budget and is later reimbursed by the World Bank, utilizing the GEF grant from time to time.

The PLG is released directly into the MSME's bank account by SIDBI, within 30 days of completion of M&V processes. MSME units have to be in compliance with the environmental and social requirements of the World Bank's Environmental and Social Management Framework (ESMF).