ABAC
APEC Business Advisory Council

SFDN
Sustainable Finance Development Network
Hosted by UNDP FC4S

Virtual Roundtable

Leveraging Private Sector Investment to Promote

MSME TRANSITION

16 June 2022

ROUNDTABLE REPORT

Roundtable Summary

The importance and market share of Micro, Small and Medium Enterprises **(MSMEs)** in Asia-Pacific Economic Cooperation **(APEC)** were central to the discussions in the roundtable. This is not only evident in the economic impacts that MSMEs have but also in the strategic and unparalleled role MSMEs play in resilience building, innovation, and access to communities. As such, transitioning MSMEs is imperative in meeting the climate goals and towards achieving the Sustainable Development Goals **(SDGs)**.

Participants at the roundtable noted the lack of inclusion or consideration of MSMEs particularly when designing national sustainable finance roadmaps, fiscal and monetary policy, taxonomies, and approaches, focusing instead on larger corporations instead. Some notable challenges include complexity of policies, cost of implementation or transition, access to capital, lack of standardization, capacity or knowledge limitations, a lack of scalable models, limited access to accredited providers and more.

While the role of regulators is paramount and irreplaceable, the private sector also can support MSMEs to transition. The roundtable explored the leverages that each sector has in helping MSME to transition particularly the banking sector in of its approach to risk management, access to capital, use of innovative financial instruments, awareness building and most importantly, the use of tailored approaches for MSMEs. Some solutions that were highlighted include digitization, prioritization, the use of innovative instruments such as blended finance, or inclusion of MSMEs in supply chains and knowledge sharing. All of which have potential to accelerate transition.

Some notable case studies and efforts in APEC were highlighted in the roundtable. These included successful implementation of FinTech in the region, MSME financing models, use of incentives, leveraging available local data and piloting of concepts or models. These cases showcased the unique conditions, challenges and opportunity that were present within APEC economies that could possibly be replicated elsewhere in supporting MSMEs to transition.

Welcome Remarks

The roundtable underscores opportunities that are highly relevant to the global imperative to transitioning to a more sustainable and balanced economy to cope with high uncertainties found today in the global economy. APEC is focused on bio circular and green concept aiming to drive the economy in the framework of inclusiveness and sustainability as a priority area. The basic concepts call for development based on innovation to added value, inclusiveness, and sustainability embracing frameworks to decarbonize economies reducing consumption and promoting energy and production efficiency. The roundtable takes stock of the progress of MSMEs while sharing ideas and knowledge on how member economies cooperate to bridge the gap to a betting target.

Lenders and investors are increasingly coming under pressure from stakeholders to align their policies with the SDGs which have a growing role in lending and investment decisions impacting the ability of the region's economies to attract capital from both within and outside the region. To do so companies will need to increasingly align their practices with the SDGs. In the Asia Pacific region, there are several challenges that face both businesses, lenders, and investors. Firstly, is a lack of a common approach to Environmental, Social and Governance **(ESG)** taxonomy or criteria, which defines what assets and activities are to be considered aligned with sustainable economies. The lack of agreement on taxonomy or common criteria and divergences in measurements are major obstacles to the scaling up of sustainable developers, especially in the region with its many smaller emerging markets. Another important issue is ESG data and disclosure. Firms are navigating multiple types of disclosure frameworks, incentive structures, data collection methods, and external assessments developed and implemented in various markets by both the public and private sectors. The various corporate reporting and disclosure barriers including perception and development of competencies need to be addressed. There are now ongoing efforts to find solutions to these challenges. Significant collaboration is already taking place with various initiatives led by multilateral institutions to engage governments, regulators, and international initiatives to actively involve the global institutional investor community.

The Sustainable Finance Development Network **(SFDN)** was established as a collaboration platform among the public and private sector including multilateral institutions in supporting the finance ministers in the process to promote sustainable finance. SFDN has attracted the participation of key organizations that play active roles in the quest for a global framework that will enable lenders and investors to effectively incentivize transition. For ESG finance to become an effective tool to accelerate transition, especially in the region's emerging markets, taxonomies need to be principle based rather than prescriptive, globally consistent, flexible in approach, acknowledge different shades of green and brown instead of a binary choice, dynamic, consider sustainability of assets and activities

due to technological developments, adaptable and easily implementable. ESG finance also must allow broad coverage of activities and financial products, inclusive and adhering to the global pledge that no one should be left behind.

To achieve this, paying attention to MSMEs is crucial as they make up a large portion of businesses and contribute enormously to the labour market. MSMEs also include new business ventures and start-ups that have become the main driving forces of innovation and sustainability in the economy. Given the scale of MSME's economic activity, they have huge potential to contribute to the achievement of SDGs across sectors from agriculture to manufacturing and services, and most importantly, in underserved, rural and remote locations. Thus, helping MSMEs transition towards a more sustainable and low carbon path is both a developmental and business opportunity.

The roundtable is important in that it seeks to identify ways of unlocking the potential of sustainable finance and leveraging it to incentivize MSMEs transition. The roundtable explored the challenges faced, the role that policy, regulatory bodies and private sector play as well as lessons from current ongoing efforts within APEC member economies.

SESSION 1: Fireside Chat

The Challenge to MSMEs And The Role Of Policy And Regulatory Bodies In Facilitating MSME Transition

The session delved into the Sustainable Banking and Finance Network **(SBFN)** and its role in promoting sustainable finance especially concerning MSMEs. The network covers 62 countries and 72 members which consist of financial sector regulators, central banks, ministries of finance and industry associations providing a platform to exchange best practices, policies, and discuss how to build a common and global agenda for financial systems to better manage and reduce environmental, social and governance risks, including climate risks. Also, the network has knowledge and experience of interesting interventions and their members have contributed to over 200 state finance related frameworks including sustainable finance roadmaps, taxonomies ESG, related lending platforms, Green Bank frameworks, frameworks for MSME guidelines and others. SBFN supports their member institutions and countries in developing and implementing their National Sustainable finance frameworks while building on their experiences. SBFN also develops common global level frameworks that can be used by new entrant members or members beyond the network, this helps to facilitate dialogue between members both cross border but also between the private and public sector.

MSMEs need to be part of the sustainable finance discussion, not only because they represent most of the businesses worldwide and number of jobs, but for their granularity, representation on big value chains, closeness to communities and ecosystems.

Emerging markets have demonstrated high levels of ambition and good progress in developing sustainable finance frameworks, despite facing unique constraints due to size and maturity of their markets. Some of the findings are that building sustainability into financial systems not only helps manage environmental, social, and climate risks, but also de-risks markets to enable greater investment flows and deepened financial market development. Also, emerging markets are aligning and integrating their sustainable finance efforts with lending to MSMEs and women, investing in agriculture and financial inclusion as essential components for resilience. In lower-middle income countries, agriculture represents a much higher percentage of the total economic output. Emissions and social issues occur in agriculture, and if they occur within MSMEs in aggregate, MSMEs make up the bigger component. A recent assessment suggests three lessons for supporting agriculture and MSME finance within sustainable finance frameworks. Firstly, regulators can set minimum investment targets or targeted credit schemes to promote green activities within the agriculture and MSME

sectors. Secondly, countries can leverage sustainable finance initiatives to upgrade key systems and implement initiatives to support financing to key sectors. Lastly, countries can look to integrate sustainability into traditional support approaches for MSMEs.

A good flow of communication, between more traditional and green related approaches, is also needed to achieve impact. Several policies and programs have been put in place to support agriculture and MSME finance in multiple levels to promote communication. To expand finance, minimum targets for investment for banks have been set up, implementing credit schemes and funds. To address market failures, refinancing facilities for eligible loans has been established, including risk sharing systems for agricultural loans, which had the effect developing key finance infrastructure. To address programmatic approaches, entrepreneurship programs and collaboration with international partners have been conceptualized. There are two specific instruments that can be utilized to make sure that integration happens. Firstly, is the development of taxonomies ensuring the demand of the lower income population is met including MSMEs. The other is developing sustainable finance roadmaps, that can help countries build a national sustainable finance strategy including angles from MSMEs, gender, and all other cross-cutting issues. MSMEs are more vulnerable to climate risk, which means they represent more business opportunities to mitigate risk and introduce more resilient technology, which is important that taxonomies and incentives introduced reflect the needs, possibilities, and the increasing demand of MSMEs. Another challenge is keeping the taxonomy understandable for MSMEs and bankers as well. It is beneficial to start with a relatively simple taxonomy, by first understanding which sectors present opportunities and building on it, adding more sectors and complexities. Another challenge or constraint is the high transaction costs, derived from verification and/or assessment of a green project. Financial institutions do not have the skills yet or the capacity or resources to do so. This however could be abated by developing standardized projects such as a technology screen or list to which institutions can refer to approved green loans. FinTech, the internet of things, as well as the internet of finance, could speed the process having the capacity to monitor remotely the different systems, managing energy use, pollution control and other important environmental and social indicators that relate to workplace, health, safety, emissions, and others. It is paramount to encourage innovation in the aforementioned areas.

Finally, the focus should be on integrating MSMEs access to finance, gender, other cross cutting issues, with taxonomies, national sustainable finance roadmaps and monetary policies. Access to finance should not be exclusive to the banking sector but include microfinance institutions, capital markets, FinTech companies, and a broader universe of financial sector participants that are vital to the discussion on transitioning MSMEs.

SESSION 2: Panel Discussion

Private Sector's Support MSME Transition: Tailored Approaches To MSMEs

The most fundamental challenge for MSMEs from a banker's perspective is the lack of accurate and timely information. Many MSMEs are struggling to grasp their own GHG emissions, especially in getting the right information and having sufficient human resources or capital to invest in climate-friendly equipment. For many MSMEs transition is not a top priority. One of the things that the banking sector can do is to facilitate MSMEs in setting up targets and plans for mitigation and adaptation.

The finance sector ecosystem has been developing sustainable finance frameworks that have not adequately served MSMEs particularly well because they are expensive to access, difficult to do due diligence and hard to finance in a profitable way. The incentive structures applied today are not helping MSMEs which form a very important majority to transition. Technology and innovation can greatly enable and help accelerate transition. To seize business opportunities banks are now interested in understanding how MSMEs can also step up and get into this movement to green a portion of their portfolios.

A large amount of capital needs to be directed towards MSME to transition them effectively and achieve NetZero. This is more challenging for MSMEs because of the constraints described earlier and the lack of available financing and capital, which calls for significant amounts of investments. A different type of capital is needed, in terms of the risk profiles of the capital that is available, versus the risk profile of the capital that is needed. There is an opportunity here to also think about how to bridge the gap between these risk profiles. Here innovative instruments can be deployed to provide risk mitigation or do co-investments with the private sector wanting to green their supply chains. In short, a systems approach must be taken to transform and better understand the complexities surrounding the MSME sector.

Another reason it has been harder for the banking sector to make MSME transition on the end user side, is the lack of awareness on the end users on how to make the transition on their own business. As MSMEs are mostly sole proprietorships, raising awareness on that end is also needed, compared to corporates that are being pressured by regulators and governments.

MSMEs needs for support for the transition is so diverse that there is no one-size-fits-all solution. To meet these diverse needs, an open and inclusive ecosystem is needed with various types of service providers and partners. Through a problem-solving and solutions-oriented platform such as that undertaken by Mitsubishi UFJ Financial Group **(MUFG)**, MSMEs can get access to the needed services

and providers. Another case example is the GHG emission measurement system provided in Japan by a start-up named Zeroboard. This example of service provision to MSMEs in Japan is rapidly growing through bank's network. This is an example of how banks can respond to the diversified needs of MSMEs in collaboration with other companies.

As the world is moving into a digital financial world, there is a potential to lower transaction costs, increase market penetration, and capacity building. Through digitalization, MSMEs can be encouraged and educated to create a digital footprint that can serve them, for example, in providing basic accounting tools, such as stock management tools or to facilitate payments. It is important to start gathering data, delivering education, and then driving change. Having an ecosystem view can reduce the fragmentation problem existing in MSMEs sector. Also, it is important to start working on how global banks can start supporting national or regional banks to create that secondary market to really improve the velocity and liquidity reducing transaction costs and interest rates. Another thing that fragmentation brings is the different segments found in MSMEs and the challenge on how banks or the private sector can address this with solutions tailored to these different segments. Addressing carbon credits and leveraging them with digital tools, measuring carbon footprints, could develop a carbon credit at the individual level. The latter can also become a financial instrument to financial institutions that can help either lower the cost of doing business or increase the profit margin for the banks. Blended finance is also an alternative to help mitigate some of these bottlenecks.

One challenge seldom covered, is the scale of MSMEs which drives high transaction costs for the private sector. Addressing scale issues through technology could drive transaction costs down. Other solutions could include the likes of supply chain financing, particularly with corporate customers who are facing a lot of emissions in their supply chain. Blended finance is a critical solution creating financing facilities that are at scale, with some innovative risk management mechanisms, such as first loss mechanism, insurances, and guarantees of which the capital can then be deployed towards MSMEs.

Transforming a business model also involves significant uncertainty to which climate change related risks is adding and funding for this transformation is key. Commercial banks have started taking more risks to support MSMEs and start-ups to contribute to new industries and local communities. Innovation can support commercial banks unleash these types of solutions to resolve capital needs making a difference in MSMEs transition.

All parts of the ecosystem must be able and enabled to do their part to contribute to a healthy system survival. Big corporates and technology can help MSMEs to move ahead. Additionally, MSMEs are close to communities and enable large corporations to understand MSME's needs and priorities. The banking industry can really contribute by providing tailored advisory services to a range of MSMEs to enable them to understand and brace for transition. Technological solutions can provide

platforms that can enable MSMEs to measure their product or services' footprint, and potentially go beyond that. The ecosystem solution will bring together market participants providing knowledge exchange, technological solutions, peer to peer learning, facilitating investments and providing advisory services to banks and end users.

Policymakers, financial institutions, and industry groups are focused on transition of large companies, however, achieving the decarbonization while maintaining social stability is only possible by a more gradual transition of MSMEs. There is an opportunity to innovate more, giving MSMEs more access to capital while unlocking the myriad of channels that are part of the large ecosystem.

SESSION 3: Panel Discussion

MSME Transition In Action: Efforts In Transitioning MSMEs In APEC Member Economies

In 2020 and 2021, APEC ministers and representatives focused on building resilience and inclusion of MSME in APEC communities emphasizing digitalization, innovation, and technology. APEC ministers endorsed a working group strategic plan 2021 to 2024, which outlined priority areas to support MSMEs such as the focus on improving business environment for start-ups and entrepreneurs, fostering innovation to strengthen their competitiveness, increasing capacity in access to global value chains as well as collaboration with large enterprises. In 2022, the APEC ministerial MSME meeting key theme was; Inclusive recovery of APEC MSMEs through BCG bio-circular-green economy and high impact ecosystem, through accelerating BCG adoption, inclusive digital transformation, financing, and debt restructuring, and coping with evolving markets landscapes. Moreover, the United Nations has published a policy guidebook for MSMEs development in Asia and the Pacific in response to COVID-19. The guidebook echoes the concern of policymakers across the globe. Effective enforcement of law and policies is needed to maintain access to markets for MSMEs. Meanwhile, across the globe, government procurement has played an increasing role as mechanism to promote MSME access to market.

In 2015, the first digital banking in China was started and was one of the first banks to establish a core banking system entirely on the cloud improving accessibility. Today, there are a lot of great ideas about sustainable finance, helping MSMEs transform the digital mindset, understanding how technology can be used for longer term gains, and how easy it can be to use digital financial services. China for example, has 310 models for MSME financing, which offer collateral free business loans that takes approximately three minutes to apply, less than a second to approve and zero human interaction. This is not only important for MSME to reduce transaction costs and be dynamic in interaction with service providers but also for the financial institution to understand their customers better.

Larger firms have access to sustainability experts or consultants to bring on board, which is not the case for MSMEs. There are many MSMEs that understand sustainability as an actual key business driver in the long run but find it challenging to implement some of the very practical changes that are needed to have access to capacity or funding. For greening their portfolios, big MSMEs can issue green bonds or access green loans, but that is impossible for small businesses due to high transaction costs. Therefore, there are several actions to be implemented, one is to work alongside MSME sector to bring them the

knowledge and the understanding of sustainability, and why they need to be thinking about these challenges. Afterwards, building financing frameworks that MSMEs can access in a way that is credible, that aligns with goals and use of proceeds that are acceptable by the market, but that they do not require them to have a second party opinion **(SPO)** and their own sustainable finance framework. There is an example of these frameworks in a bank in Singapore. They have implemented frameworks around six areas: real estate, smart cities, circular economy, green and sustainable trade finance, liabilities, and transition finance. Underpinning all these financing frameworks, the "ecosystem place" was introduced, consisting in three areas: U-Solar, U-Energy and U-Drive. This is an ecosystem of partners that a MSME can work with, clear partners that the bank is comfortable doing business with. In the case of U-Solar, MSMEs can get those solar panels on their rooftops, look at more energy efficient solutions for their operations, while the bank will provide the financing. For another bank the main challenge continues to be scale and the need of bonding products mainly to lower carbon footprints.

The roundtable also delved into the use of an internet open platform, which works to enable consumers and small businesses to have equal access to financial and other services through technology called Ant Forest which was launched in 2016. Ant Forest users are encouraged to record their low-carbon footprint through daily actions like taking public transport or paying utility bills online. For each action, the end users receive 'green energy' points which can accumulate and after a certain number of points, an actual tree is planted. Users can view images of their trees in real-time via satellite. In addition to tree-planting, users can choose to protect certain size of conservation land. Ant Forest is also exploring innovative solutions to alleviate poverty and improve the lives of local people by leveraging the power of digital technology. The application was able to help change user's mindset and behaviour. Taking advantage of the momentum in green financing, Ant Group have started to build a green evaluation framework system. This framework system can identify and collect a variety of green operational practices without manual intervention. The algorithm utilized can pick up all green operations and categorized MSME by their level of green operational practices and once the MSME is recognized as a green company it is automatically entitled to receive a discount on a loan. Another innovation was the creation of the zero-payment day. MSMEs selling certified green products online can receive their payments immediately with no need for customers to confirm receipt of the goods or services. This now gives MSMEs a short window liquidity.

Another example of an innovation to reduce the difficulty of granting loans in hard-to-reach areas, especially in the agriculture sector, is the utilization of satellites to monitor farmers assets. Satellites can measure the size of the farm and identify which crops are planted on it enabling the bank to carry out its assessment with an accuracy rate of over 93% and can better estimate the value of the farmers future harvest based on industry prices, climate projections and using dozens of risk control models. The technology can monitor crop

growth in real time and analyse farmers' immediate demand for funds to achieve accurate risk control. On the side of traditional banks, all these mechanisms have been faced with a lot of scepticism, and the need is to start building proof of concepts with selected customers to afterwards carry it to communities.

Some challenges for building an ecosystem are in getting MSMEs to comprehend sustainability and its opportunities, and in implementing education systems that consider the regulatory changes and requirements needed such as governmental incentives. This is a continuous form of learning that needs to be maintained not only by MSMEs but also on the private and public sectors.

In terms of cross border trades and payments it is important to partner with several regional/local wallets. Sharing know-how technology with these platforms will enable to build good direct relationship with their users and some of them could be MSMEs. These local partners could be banks, e-wallet players, to help them on the credit tech solutions to improve the accuracy on non-performing loans. Banks can still be the entity extending these loans, and then the data could be shared from the wallets.

Another mechanism that was recently announced and is at a concept stage is Proxtera. Proxtera is an online Business-to-Business **(B2B)** marketplace that facilitates cross-border trade between MSMEs with financing and fulfilment services. It was jointly developed as an initiative by the Monetary Authority of Singapore **(MAS)** and Infocomm Media Development Authority **(IMDA)** to drive digital and financial inclusivity for MSMEs.

In conclusion, the most critical turning points for MSMEs to finance the transition are the need for partners, working in an ecosystem, and being able to respond to climate change with pragmatic and practical solutions understanding the risks they face if continuing with the status quo. In terms of policy measures, governments should give clear signals to the audience about policy and direction commitments from a national policy perspective to green transition. Case studies successes can help show the path. Education is not to be left behind especially of MSMEs not only in terms of sustainability and green economy but also in terms of digitalization and how technology can help them.

Closing Remarks

The roundtable discussed the challenges of transitioning MSMEs including the policies and the regulatory instruments that would be critical in this process and the supporting role the private sector can play. There is clear need and appetite for MSMEs to transition towards lower emissions and to a more sustainable economy.

There were convincing case studies and examples or pathways for MSMEs to advance in transitioning. To transition to net zero emissions by 2050, a huge amount of capital will be needed, and this presents an opportunity for investing in long term growth and innovation.

Many regulators and banks are now actively seeking to expand their knowledge and understanding on how to integrate ESG critical criteria into banking guidelines, regulations, and practices, mainly in emerging markets. Partnership between public and private sector is critical in developing tangible, actionable and achievable strategic initiatives. There is also a huge need in this space for knowledge and capacity building that must be addressed.

Data availability is another critical factor, and Task Force on Climate Related Financial Disclosures **(TCFD)** provides a framework to help companies see the risks and opportunities and manage them. However, there is still much to be done to improve the quality of disclosure, which, in general is not yet sufficient and/or effective.

Finally, it is important for financial institutions, as well as policymakers and regulators to start coordinating to create opportunities in sustainable finance. Financial institutions need to incorporate sustainability as much as climate related issues and, policymakers and regulators on their part, need to shift away from a focus on punishment to a focus on rewarding sustainable practices. While doing this, a lot of attention must be paid to enabling the transition of MSMEs, as they most of the operating businesses in the region and they employ over half of the labour force. This roundtable provides a valuable guidance on how to come forward to effectively enable and accelerate the transition of MSMEs in the region.

APEC Business Advisory Council

The APEC Business Advisory Council (ABAC) was created by the APEC Economic Leaders in November 1995 to provide advice on the implementation of the Osaka Action Agenda and on other specific business sector priorities, and to respond when the various APEC fora request information about business-related issues or to provide the business perspective on specific areas of cooperation. ABAC comprises of up to three members of the private sector from each economy.

Sustainable Finance Development Network

The Sustainable Finance Development Network (SFDN) was set up within the Asia-Pacific Financial Forum (APFF) as recommended by the APEC Business Advisory Council (ABAC) in 2020. It serves as an international platform for private-public sector collaboration, accelerating the convergence of sustainable finance policies among APEC economies and strengthening the region as they develop a common global sustainability framework. This is done primarily through activities supporting the APEC Finance Ministers' Process and assisting ABAC in developing its high-level recommendations to the Finance Ministers. The United Nations Development Programme (UNDP) Financial Centres for Sustainability (FC4S) provides the secretariat for the network.