



## BACKGROUND NOTE

# Green SME Financing, Including Post–COVID–19 Aspects

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# Green SME Financing, including Post–COVID-19 Aspects

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Small and medium-sized enterprises (SMEs) are important to the economic development of any country. In Asia, SMEs account for more than 95% of all firms, contribute to 50%–70% of employment, and occupy 30%–60% of gross domestic product in some countries.<sup>1</sup>

What is more, SMEs are increasingly getting involved in green projects that have positive outcomes for the society. The “public goods” they create are expanding access to clean and reliable energy, raising productivity, and preserving crucial natural areas and other lands.

Therefore, as countries plan significant new spending in efforts to recover from the impact of the coronavirus disease (COVID-19) pandemic, SMEs must get the attention they deserve. In this regard, the Republic of Korea (ROK) may offer some useful insights.

## Barriers to Small and Medium-Sized Enterprises Financing

SMEs in many countries face major challenges in accessing affordable finance. Bank loans to SMEs average just 11.6% of gross domestic product and 18.7% of total bank lending in the region—declining on the latter measure since the global financial crisis—according to the Asian Development Bank (ADB).<sup>2</sup>

This is because information asymmetry has made it difficult for banks to assess the creditworthiness of SMEs, which lack solid accounting systems, documentation, and credit histories. This instills a caution toward the sector among banks, even though those banks remain the primary source of financing for these small and medium-sized firms. The end result is that many SMEs are subject to loans with high interest rates or costly collateral requirements.<sup>3</sup>

## Green Small and Medium-Sized Enterprises Financing

The green benefits that SMEs bring are difficult to quantify however, and lenders and private investors rarely count them as profit or cash flow. Moreover, the market lacks awareness or understanding of these projects because of their novelty. As a result, economically viable green projects of SMEs are often left unfunded.

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<sup>1</sup> Asian Development bank Institute (ADBI). 2018. The Role of SMEs in Asia and their Difficulties in Accessing Finance. *ADBI Working Paper Series.*, <https://www.adb.org/sites/default/files/publication/474576/adbi-wp911.pdf>.

<sup>2</sup> ADB. 2014. *Asia SME Finance Monitor 2014*. Manila. <https://www.adb.org/sites/default/files/publication/173205/asia-sme-finance-monitor2014.pdf>.

<sup>3</sup> [ADBI \(2018\)](#).

The high-risk perception applies to both the borrower and the lender. Borrowers lack comfort with the new technologies and the uncertainties surrounding project cash flow. Lenders have trouble fitting such projects into normal credit risk assessment frameworks. They also lack the capacity to assess the technical aspects of these projects.

### **Green Small and Medium-Sized Enterprises Financing through Credit Guarantee Schemes**

Public financial agencies have been pivotal in popularizing green finance, doing so through credit guarantee schemes for green projects or companies. A credit guarantee scheme aims to encourage lenders to provide financing to a specific target group or to increase their exposure to such a group by sharing the credit risk. Over the medium to long term, these schemes enable the financing of projects without a guarantee after the program ends. In short, the guarantee bridges the initial phase of uncertainty, when financial institutions without experience in successfully financing the sector may perceive the target group as too risky.

And, in some cases, as noted, the need for the guarantee may end once a banking relationship has been established with the sector. This is the case when the perceived risk mainly comes from lack of knowledge about a new technology. In other cases, a guarantee may still be needed to enhance the creditworthiness of certain borrowers and projects, mitigating structural barriers such as the absence of an asset-based lending framework.

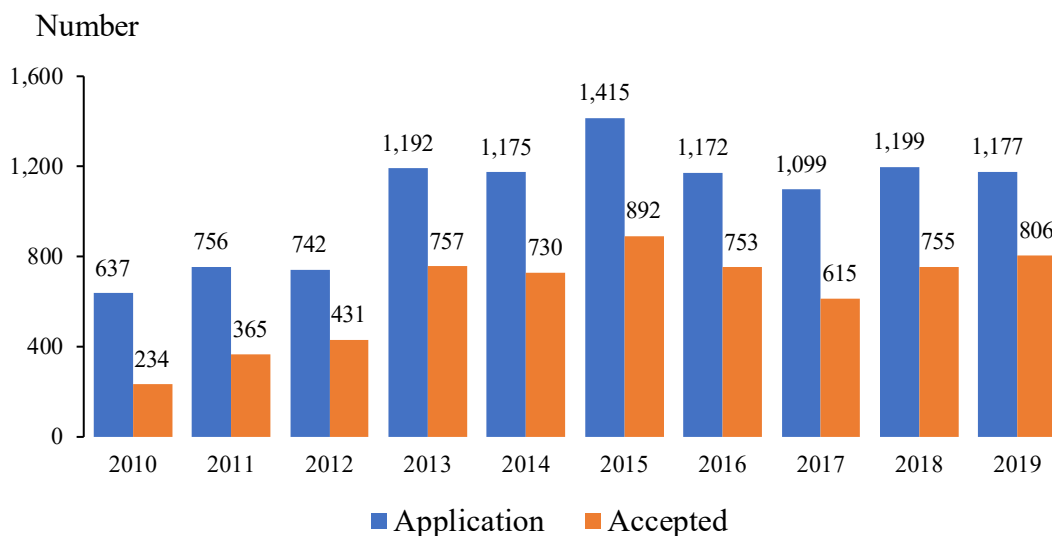
### **Lessons from the Republic of Korea**

In the ROK, for example, the Korea Credit Guarantee Fund (KODIT) and the Korea Technology Finance Corporation (KOTEC) have facilitated SME access to funding for green projects through credit guarantees and advisory services. By spurring bank participation, the KOTEC and KODIT guarantee is very important in financing start-ups.

Under green certification, meanwhile, government certifies the green technology, business, and company and is fundamental to implementing green financing. In the ROK, the Korea Institute for the Advancement of Technology is implementing such certification, which can be of the following three types:

- (i) **Green technology.** The government has chosen 10 categories of 1,263 technologies.
- (ii) **Green business projects.** The government has chosen 9 categories and 92 business projects.
- (iii) **Green companies.** 30% of revenue should be obtained from green technologies or projects for this certification.

**Figure 1. Issuance of Green Technology Certification  
by the Korea Institute for the Advancement of Technology**



Source: Korea Institute for Advancement of Technology.

Most commonly, companies with green technology certification can gain support through a loan guarantee by credit guarantee schemes, and through financial services from public banks to SMEs with certified green business projects.

In certification, government support varies for each step of the process: the most popular support for green technology certification is the loan guarantee by public financial agencies and the participation of national research and development projects. The public finance sector mainly provides the public loan to the certified green business projects for green projects and companies that have been already certified.

As seen from the figure above, from 2010 to 2019, the Korea Institute for the Advancement of Technology received 10,564 green technology applications and certified more than 60% of them.

### **Korea Green New Deal Program**

As noted, and like in much of the world, COVID-19 has hit the ROK's economy hard. Its export industries dropped by 24% in May 2020 as demand plunged for the nation's mainstay products, such as cars, semiconductors, machinery, petrochemicals, and steel. At the end of April 2020, 26.9 million Koreans were reportedly employed, down by 392,000 from a year earlier.

In response to this economic downturn, the Government of the Republic of Korea launched the "Korean New Deal" in July 2020. The \$135 billion investment in green and digital is being

funded by \$96.3 billion from the Treasury, \$21.2 billion from local governments, and \$17.3 billion from the private sector.

The “green” part of the plan, known as the Green New Deal, involves \$61.9 billion for the creation of 319,000 jobs by 2022 and 659,000 jobs by 2025.

Apart from a plan to invest in advanced technology initiatives to create jobs, the Green New Deal will spend about \$1.5 billion to finance green SMEs, support technology development for environment and energy SMEs, and build green industrial clusters.

In rolling out the financial package to support the Korean New Deal program, the Korea Development Bank and credit guarantee schemes, such as KODIC and KOTEC will inject \$86.2 billion into related areas through loans and guarantee.

These efforts, in addition to helping SMEs overcome efforts to gain access to finance, can provide useful insights for other countries in Asia and the Pacific as they formulate their own post-COVID-19 economic road map and grapple with the challenges in getting promising SMEs the funding they need.