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Scaling-Up Green Finance for the Private Sector in Serbia in the Post-Pandemic World



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DISCLAIMER

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Key Findings and Recommendations

The demand for green finance is bound to increase substantially in Serbia as the transition to an inclusive, low-carbon and circular economy unfolds. Despite the fact that the COVID-19 pandemic has recently led to the postponement and downsizing of green investments, this development will be led by both policy and markets. In terms of policy, the EU Green Deal and the related Green Agenda for the Western Balkans will lay the basis for Serbia's growth strategy in the future, as the country continues to align its (environmental) policies with the EU. Markets, when allowed to work properly, will increasingly drive the green transition in the future as investments in energy and resource efficiency, renewable energy sources and other green technologies become more profitable than investments in their (formerly) conventional alternatives.

Green finance will increase in Serbia, driven by EU policy developments and increasingly competitive green investment opportunities

The role of the private sector in the transition to an inclusive, low-carbon and circular economy cannot be overestimated. Many MSMEs in Serbia have already invested in energy efficiency and renewable energy sources (e.g., solar panels) in the past, commonly in the process of replacing old and inefficient equipment. Future investments are likely to focus on energy and water efficiency, renewable energy sources and resource efficiency through the digitalization of business operations.

MSMEs continue to face barriers to green investments, some of which have been exacerbated by the COVID-19 pandemic, including lack of capital, insufficient skills and information about green technologies and financial products, and inadequate support from the regulatory environment. Some MSMEs criticize that commercial banks do not follow a particularly green approach and are not supportive of companies that plan green projects, for example, by asking for significant collateral on unfavorable terms. Similarly, regarding the regulatory environment, the lack of a functioning fiscal/financial framework does not incentivize MSMEs to reduce their environmental footprint.

MSMEs have ample ideas for green projects and business models and can already show some successes, but they have to be encouraged and supported along the way. Without adequate financial departments, many MSMEs are unaware of their options and still resort to expensive financial instruments such as short-term loans or even overdrafts. Financial institutions play a fundamental role in guiding MSMEs, by providing finance, education, training and technical support.

**De-risking mechanisms for successful green MSME projects:
Innovations + partnerships + internal funds + support +
technical assistance**

The majority of MSMEs still has a very limited overview of the support available for green projects. Only few have experience in using innovation support from public or other sources. It is thus important to create safe zones where ideas can grow, where businesses and technologies can incubate, and where the best ideas can be accelerated and financially supported.

**A formula for successful green MSME projects:
Long-term loan + guarantee + internal funds + grant +
technical assistance**

Almost three quarters of MSMEs are interested in taking loans to finance green projects. The vast majority would prefer loans to be connected with grants or subsidies. In fact, the preferred mix of finance for green projects turns out to be 20% grants or subsidies, 15-25% internal funding and 50-60% external funding. The most common instrument of external funding are loans. As regards borrowing conditions, MSMEs prefer interest rates of below 3%, a tenor of up to 10 years, a grace period of at least one year and a reasonable collateral and/or guarantee covering collateral requirements.

In addition, technical assistance is considered as a key enabler for green investments. Almost 50% of companies would accept technical support for the implementation of green projects, in particular regarding financial forecasts, legal requirements, feasibility studies, environmental and social compliance, as well as training in emerging technologies or technological processes relevant to the green economy. Moreover, businesses need to be enabled to report on environmental performance indicators regarding GHG emissions, air/soil/water pollution, resource use and waste generation.

**Local banks know local markets best, but they need a
long-term approach to green finance. IFIs can help banks
in building the capacities needed to assess and imple-
ment Green Projects of MSMEs on a continuous basis.**

Increasing demand for green finance must be met by an effective banking system which can provide sustainable finance and know-how to assess and implement green projects. Currently, with few exceptions, commercial banks operating in Serbia lack the long-term commitment to financing green projects, do not have the capacity to assess and implement these kinds of projects and often perceive related investments as unprofitable. To fully benefit from the potentials of the green transition, commercial banks need to train and invest in dedicated staff able to develop, assess and implement green projects of MSMEs on a continuous basis. Technical assistance and trainings provided by IFIs are essential in internal capacity building.

There are also numerous concerns voiced by the banking sector related specifically to the nature of MSMEs that continue to obstruct the accelerated implementation of small-scale green projects in Serbia. The three most commonly cited issues with MSMEs include insufficient equity, lack of collateral and a general inadequacy of project preparation and presentation by MSMEs. Insufficient equity can be addressed by fiscal policy and a larger role of private equity funds in Serbia. The general lack of collateral of MSMEs can be addressed by credit guarantees, currently dominantly provided by IFIs. Technical assistance by banks, IFIs or MSME associations is essential in building capacity of MSMEs to better prepare and implement green projects.

Once a green project is considered bankable, banks commonly quote a breakdown of funding to be roughly 30% equity and 70% external financing. The latter can consist of a mix of instruments, including credit lines, guarantees, grants, and/or technical assistance. In addition, loans by commercial banks may be supplemented by IFI loans. No green bonds have yet been certified in Serbia due to considerable drawbacks, which include high costs, dinar denomination and cumbersome regulation.

Regulation needs to be simplified, provide long-term incentives and predictable returns from Green Projects

As regards policy, uncertainties related to the regulatory framework need to be addressed, for example, by adopting a replacement for the expired Decree on feed-in-tariffs for renewable energy sources. In addition, the existing regulatory framework needs to be implemented with effective bylaws and directives to support the green transition. There also exist high administrative requirements for green investments. The procedure for environmental compliance needs to be clear, easy to assess and follow, less time consuming and asking for a minimum of documentation. In essence, regulation should support businesses, not restrain them. Regulations should provide investors and banks with predictable returns from green projects. In addition, the fiscal/financial framework needs to be improved to incentivize MSME greening, for example by linking eco-taxes to the polluter-pays-principle and by phasing-out subsidies on fossil fuels and other polluting industries in a socially acceptable manner.

1. Introduction

The outbreak of the COVID-19 pandemic in 2020 and its continuation in 2021 severely impacts societies, economies and business around the world. The World Bank estimates that the global economy contracted by 4.3 percent in 2020.¹ Although Serbia was less affected than its neighbors in the Western Balkans, the Serbian Finance Ministry still estimates a decrease in real GDP of 1.0 percent in 2020.² Micro, small and medium-sized enterprises (MSMEs)³ are particularly vulnerable to the economic consequences of the pandemic due to the fact that they cannot sustain long periods of revenue losses. Increasing worries about their liquidity position, jobs and eventual business survival have already led to the deferral and downsizing of much needed (green) investments, undermining the competitiveness of Serbian MSMEs on regional and global markets.

To counter the negative economic effects of the pandemic, recovery plans are being devised by governments around the world. It is widely understood that an economic recovery based on prevailing linear business models will lock-in high levels of greenhouse gas (GHG) emissions and natural resource consumption for decades to come, making it impossible to achieve internationally agreed targets such as the 1.5°C target stipulated in the Paris Agreement. For example, even though global fossil CO₂ emissions are estimated to have decreased by 6.7% in 2020 (compared to 2019) due to COVID-19-related lockdown measures,⁴ these reductions are not based on structural changes and thus likely to be short lived with emissions rebounding once the pandemic ends. Returning to business as usual after the pandemic is thus not an option in the face of the ongoing climate and biodiversity crises.

Already in April 2020, Achim Steiner, UNDP Administrator, urged to “insert the DNA” of a low-carbon future into stimulus packages.⁵ Indeed, there is no shortage of capital on the world’s capital markets to achieve this. The total stock of global financial assets has been estimated at close to USD 300 trillion. Also, international institutional investors — such as sovereign wealth funds and pension funds — hold an estimated USD 115 trillion in assets under management.⁶ Although an increasing number of

1 World Bank (2021), Global Economic Prospects, available at <https://openknowledge.worldbank.org/bitstream/handle/10986/34710/9781464816123.pdf> (accessed on 8 February 2021)

2 See <https://www.mfin.gov.rs/dokumenti/makroekonomski-i-fiskalni-podaci/> (accessed on 17 March 2021)

3 Micro, small and medium-sized enterprises (MSMEs) are defined in the EU recommendation 2003/361. They are determined by staff headcount (micro <10, small <50, medium <250) and either turnover (micro ≤ EUR 2 million, small ≤ 10 m, medium ≤ 50 m) or balance sheet total (micro ≤ 2 m, small ≤ 10 m, medium ≤ 43 m).

4 Global Carbon Project (2020), Global Carbon Budget 2020, available at <https://www.globalcarbonproject.org/carbonbudget/index.htm> (accessed on 8 February 2021)

5 Climate Home News (2020), UN development chief calls for green shift away from ‘irrational’ oil dependence, available at <https://www.climatechangenews.com/2020/04/24/un-development-chief-calls-green-shift-away-irrational-oil-dependence/> (accessed on 23 March 2021)

6 Achim Steiner (2017), Keynote speech at the High-Level Conference on Financing for Development and the Means of Implementation of the 2030 Agenda for Sustainable Development, Doha, Qatar, 18-19 November 2017, available at https://www.un.org/esa/ffd/high-level-conference-on-ffd-and-2030-agenda/wp-content/uploads/sites/4/2017/11/Opening_Achim-Steiner.pdf (accessed on 23 March 2021)

investors and private sector companies are investing in the Sustainable Development Goals (SDGs), there is still significant potential for increasing private investments in the green sector, especially in the Western Balkans.

As laid out in the UNDP Human Development Report 2020, people and planet are entering an entirely new geological epoch, the Anthropocene or the Age of Humans. This epoch is characterized by ever growing pressures of socioeconomic systems on the environment with life threatening consequences in terms of climate change, biodiversity loss, ocean acidification and many more. The 2020 report puts considerable emphasis on incentives and regulations which need to evolve to ease planetary pressures. Finance, prices and incentives for collective action are key to addressing these challenges.⁷

As a result, the concept of green recovery has emerged, with the aim to “build back better”, i.e., to increase the resilience of economies and societies in the face of the economic recession and accelerating environmental challenges.⁸ Key elements include environmental, regulatory and fiscal reforms aimed at injecting green finance in sectors such as energy, transportation, industry, housing, waste management, agriculture and forestry. The benefits of such investments are manifold, including economic growth and job creation in the short and long term, higher innovation and new market opportunities, a reduction of economic and social inequalities, as well as decreasing costs associated with pollution and environmental degradation, and – last but not least – a decent rate of return.

The 2020 COVID-19 Socio-Economic Impact Assessment published by the UN in Serbia and UNDP identified that a green recovery should also be the key priority in Serbia in order to increase the resilience of society and economy to future potential shocks while improving well-being and equality among its citizens. Therefore, future fiscal stimulus programs, developed by the Government, should be used to make progress on environment and climate change objectives.⁹

Green finance aims to increase the level of financial flows from banking, microcredit, insurance and investment to sustainable development priorities. In the widest sense, green finance refers to any structured financial product or service with the objective to achieve a better environmental outcome.¹⁰ The European Union (EU) applies a stricter definition, referring to an environmentally sustainable investment only if it focuses on climate change mitigation, adaptation, sustainable water use, circular economy, pollution prevention, or biodiversity protection.¹¹ As such, the principle aim of green finance is to nurture the green economy, an economy that results in improved human well-being and social equity, while significantly reducing environmental risks and ecological scarcities.¹²

Green finance needs to come from all sectors, including public, private and not-for-profit. Particularly in times of economic recovery, emphasis is often put on the public sector. However, the role of the private sector in the transition to a green economy is essential. Companies around the world are engaging in more sustainable business models, driven - amongst others - by the increasing supply of sustainable finance on capital markets. At the same time, MSMEs are trying to reduce their environmental footprint through business practices, products or services.

7 UNDP (2020), Human Development Report 2020, available at <http://hdr.undp.org/en/2020-report> (accessed on 23 March 2021)

8 See also OECD (2020), Making the green recovery work for jobs, income and growth, available at <http://www.oecd.org/coronavirus/policy-responses/making-the-green-recovery-work-for-jobs-income-and-growth-a505f3e7/> (accessed on 8 February 2021)

9 United Nations Serbia, UNDP, COVID-19 Socio-Economic Impact Assessment, available at https://www.rs.undp.org/content/serbia/en/home/library/crisis_prevention_and_recovery/covid-19-socio-economic-impact-assessment.html (accessed on 23 March 2021)

10 World Economic Forum (2020), What is green finance and why is it important?, available at <https://www.weforum.org/agenda/2020/11/what-is-green-finance/> (accessed on 8 February 2021)

11 European Commission (2021), EU taxonomy for sustainable activities, available at https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en (accessed on 8 February 2021)

12 UNEP (2021), What is an “Inclusive Green Economy”?, available at <https://www.unenvironment.org/explore-topics/green-economy/why-does-green-economy-matter/what-inclusive-green-economy> (accessed on 8 February 2021)

In Serbia, the green economy transition and the financing for recovery from COVID-19 is a major challenge and simultaneously an opportunity for changing unsustainable patterns of energy consumption and resource consumption of Serbian enterprises.¹³ Many MSMEs in Serbia are willing to invest in more energy-efficient and environmentally friendly processes, but they continue to face numerous MSME-specific barriers to green investments, including lack of capital, insufficient skills and information about green technologies and financial products, and inadequate support from the regulatory environment. One of the key questions is thus how Serbian MSMEs can be provided with sufficient finance and skills to undertake investments in low-carbon and circular business models, products and services.

This publication offers practical insights from Serbian MSMEs, commercial banks and international financial institutions (IFIs) into challenges and opportunities associated with sustainable finance for MSMEs. The results are based on surveys, questionnaires and interviews conducted between September 2020 through February 2021 by the consultants and staff of the EU Delegation and the UNDP Office in Serbia. More details on the methodology are provided in the Annex to this report. The results allow for drawing concrete conclusions for businesses themselves, for the domestic financial sector, as well as for policy makers aiming to scale-up sustainable finance for MSMEs in Serbia while supporting the post COVID-19 recovery of the economy.

¹³ See also Strategija održivog razvoja Republike Srbije do 2030 („Službeni glasnik RS“ br. 47/2019)

2. Policy Drivers for Green Finance in Serbia

The demand for green finance in Serbia is driven both by internal and external policy and capital market developments. It is set to increase substantially over the coming years and decades, driven by major political decisions aimed at speeding up the transition towards an inclusive, low-carbon and circular economy. On the international level, Serbia is a signatory and has ratified all major international environmental agreements, including the 2030 Agenda for Sustainable Development, the UN Framework Convention on Climate Change and its Paris Agreement, as well as the Convention on Biological Diversity. However, these international commitments are only slowly translated into concrete progress in Serbia and the green transition remains in its early phases. New impetus has been given by the EU and its European Green Deal, which will also constitute a game changer in Serbia, inter alia through the Green Agenda for the Western Balkans.¹⁴ These developments will impact Serbian MSMEs not only because the EU is the key market for the Western Balkans and Serbia, but also because they will increasingly find their way into domestic policy.

This section outlines the main policy drivers for the green transition in Serbia. The focus is on the Serbian and the EU policy level, as well as on some of the specificities regarding policy for greening MSMEs.

The Green Economy in Serbia: A Long Way to Go

Despite the fact that there is ample political commitment to the transition to an inclusive, low-carbon and circular economy, Serbia's green transition is still at an early stage.

The energy sector, for example, is still largely dominated by fossil fuels. Electricity generation continues to be dominated by coal (69% in 2019), which significantly contributes to GHG emissions and air pollution across the country. New renewables such as wind and biomass still play a minor – albeit growing – role with only 2.5% of electricity generation in 2019.¹⁵ One reason for this is the fact that coal subsidies per unit of final electricity consumption continue to exceed the incentives paid to renewable energy producers.¹⁶

¹⁴ European Commission (2020), Guidelines for the Implementation of the Green Agenda for the Western Balkans, SWD(2020) 223 final, 6 October 2020, Brussels.

¹⁵ International Energy Agency (2021), Serbia – Key Energy Statistics, available at <https://www.iea.org/countries/serbia> (accessed on 16 February 2021)

¹⁶ Energy Community (2021), WB6 Energy Transition Tracker, available at https://energy-community.org/dam/jcr:fe09c4f2-9151-4a48-b5c4-8eba920b4554/EnC_WB6_ETT2_22021.pdf (accessed on 18 February 2021)

Significant investments are also required into landfills, wastewater treatment plants, sewers and water supply networks, amongst others. Serbia is the country in Europe with the lowest resource productivity and the lowest recycling rate of municipal waste (together with Bosnia and Herzegovina).¹⁷ In fact, around three quarters of communal waste are disposed of in landfills, which do not meet sanitary standards, being subject to significant leakages and fires. Similarly, around 90% of wastewater continues to drain untreated into surface water, even in the largest cities, such as Belgrade and Novi Sad. As regards industrial wastewater, the majority of Serbian industrial installations have no treatment facilities at all. As a result, only 42% of industrial wastewater is treated, and only 10% at an adequate level (with investments underway to rectify this situation).¹⁸

The required public expenditures associated with addressing these challenges have been estimated at around EUR 8.5 billion over a ten-year period.¹⁹ This translates into an increase of the public budget of some EUR 500 million annually. Apart from improving the state of the environment and public health, these investments would help to raise public investments in Serbia to a level comparable to other countries of Central and Eastern Europe (CEE) and are projected to provide significant short-term economic benefits. By raising demand for domestic labor, equipment and materials, such investments could increase Serbian GDP growth by at least 0.5%.²⁰

Despite the need to expand investments in environmental protection, the COVID-19 pandemic had the opposite effect on the public budget. As a result of budget cuts, numerous planned activities in the environmental sector need to be scaled down or postponed. This affects all areas, including waste and wastewater management, pollutant emissions reductions, climate change mitigation and the adaptation of measures for natural protection.²¹ This is also reflected in the 2021 budget, which does not plan for any major increases in government expenditures for these purposes.²² Delays of projects in the area of energy and environment are not only due to budget cuts but also due to the inability of Parliament to meet and ratify loans during lockdown, as well as due to reduced speed of project approvals from global donors.²³ In addition, it has been criticized that the Serbian rescue package did not contain any green conditionalities placed on recipients of government support, thus lacking incentives for investments in improving the environment and mitigating climate change.²⁴ This can be considered as a missed opportunity for accelerating the green transition in the context of “building back better”.

National Legislation Accelerating the Green Transition in Serbia

Notwithstanding the slow start to the green transition, there are numerous developments on the national policy level with the potential to accelerate progress over the coming years and thus also to increase demand for green finance in the country. For example, the Government of Serbia, in March 2021, adopted a law on climate change, which sets the legal framework for future action on

17 European Environment Agency (2019), The European environment – state and outlook 2020, available at <https://www.eea.europa.eu/publications/soer-2020> (accessed on 11 February 2021)

18 Republic of Serbia - Fiscal Council (2018), Investments in environmental protection: a social and fiscal priority, available at <http://www.fiskalniasvet.rs/doc/eng/FC%20-%20Investments%20in%20environmental%20protection.pdf> (accessed on 16 February 2021)

19 Ibid.

20 Ibid.

21 United Nations Serbia/UNDP (2020), COVID-19 Socio-Economic Impact Assessment, available at <https://serbia.un.org/en/download/50709/92907> (accessed on 18 February 2021). The document is also available in Serbian.

22 Republic of Serbia - Fiscal Council (2020), Assessment for the Draft Budget for 2021, available at http://fiskalniasvet.rs/doc/analize-stavovi-predlozi/2020/FC_Summary_Assessment_of_the_draft_budget_2021.pdf (accessed on 16 February 2021)

23 United Nations Serbia/UNDP (2020), COVID-19 Socio-Economic Impact Assessment, available at <https://serbia.un.org/en/download/50709/92907> (accessed on 18 February 2021).

24 Ibid.

greenhouse gas mitigation and adaptation. Based on this law, the Government plans to adopt a 10-year national low-carbon development strategy with an action plan within the next two years.²⁵ In addition, the Government is currently working on a set of regulations on renewable energy sources, energy efficiency, and mining and geological research. The draft law on renewable energy sources stipulates that a mandatory target for the share of renewable energy sources will be set out in Serbia's upcoming National Energy and Climate Plan (NECP), to be part of an amended Law on Energy.²⁶ It proposes the continuation of feed-in-tariffs for the production of electricity from renewable energy sources but also introduces an auction scheme to select renewable energy projects and the level of support received by them. In line with the EU's Clean energy for all Europeans package adopted in 2019, the draft aims to empower Serbian energy consumers by introducing the concept of prosumers²⁷ and renewable energy communities.²⁸

Further impetus to the green transition can also be expected from the adoption of the Serbian Circular Economy Roadmap in September 2020, which focuses on four priority sectors, including manufacturing industry, agriculture and food, plastics and packaging, and construction.²⁹ Against this background, the Government plans to adopt in 2021 a Program for Circular Economy together with an Action Plan for a three-year period. A particular focus will be on waste management, where the Government plans to adopt a number of policies, including a Waste Management Strategy and associated Action Plan, a new Law on Waste, and amendments to the Law on Packaging and Packaging Waste. Circular economy principles will also increasingly be integrated in green public procurement, inter alia through a new Law on Public Procurement and the Strategy for Development of Public Procurement with its associated Action Plan.

In addition, a major investment cycle in the field of wastewater treatment and water supply was started, mainly driven by the Multiannual Investment and Financing Plan (MIFP), an annex to the Chapter 27 negotiation position document³⁰ and incorporated within the broader "Serbia 2025" infrastructure framework.³¹ This investment cycle covers a financing gap of some EUR 8 billion mainly through the blending of donor funds, budgetary resources and loans from International Financial Institutions (IFIs). In addition to financial arrangements with the German KfW in the field of energy and environment, the Council of Europe Development Bank (CEB) in the field of climate action and water management, and the European Bank for Reconstruction and Development (EBRD) in the area of waste management and circular economy, the Government of Serbia also works with Chinese state-owned enterprises and banks in the field of waste and wastewater management with potential participation of Serbian MSMEs.³²

25 See also Balkan Green Energy News (2021), Serbia adopts bill on climate change, available at <https://balkangreenenergynews.com/serbia-adopts-bill-on-climate-change/> (accessed on 23 March 2021)

26 See also Balkan Green Energy News (2021), Serbia opens public consultation on draft law on renewable energy, available at <https://balkangreenenergynews.com/serbia-opens-public-consultation-on-draft-law-on-renewable-energy/> (accessed on 10 February 2021)

27 Energy users who also produce renewable energy.

28 A collective of final customers (natural persons, MSMEs, local authorities etc.) located in the proximity of the renewable energy project owned and developed by the community with the aim to provide local environmental, economic or social community benefits for its members.

29 Republic of Serbia – Ministry of Environmental Protection, circular economy, UNDP (2020), Roadmap for circular economy in Serbia, available at <https://circulareconomy.europa.eu/platform/sites/default/files/roadmap-for-circular-economy-in-serbia.pdf> (accessed on 16 February 2021)

30 See <https://www.srbija.gov.rs/vest/439116/joksimovic-pregovaracka-pozicija-za-poglavlje-27-podneta-ek.php> (accessed on 17 March 2021)

31 See <https://www.predsednik.rs/lat/pres-centar/vesti/predstavljen-program-srbija-2025> (accessed on 17 March 2021)

32 See <https://www.mgsi.gov.rs/lat/aktuelnosti/momirovic-najznacajniji-projekat-izgradnje-komunalne-infrastrukture-u-srbiji> (accessed on 17 March 2021)

Greening MSMEs in Serbia

SMEs are the backbone of the Serbian economy, constituting 99% of all enterprises, employing more than 65% of the labor force and accounting for over 57% of gross value added in 2018.³³ These figures are very similar to EU-wide averages.

Despite the fact that there are some positive developments in terms of greening (M)SMEs, greening policies targeted at enterprises are still in their infancy in Serbia. Serbian performance in the area of SME greening is quite low and Serbia is among the three lowest-performing economies in the region.³⁴

However, due to its gradual convergence with the EU, Serbian businesses show readiness to be part of the green transition driven by the EU. While companies are generally aware of the economic and social benefits of the transition to greener business models, a range of policy and financial barriers to the transition remain.

A current drawback in Serbia is the unpredictability of the business and administrative environment. For example, there is a discontinuity in passing directives and decrees, which creates uncertainty on behalf of clients and financing institutions. The expiration and long-overdue reintroduction of feed-in-tariffs for renewable energy sources is an example. Similarly, where regulations exist, bylaws and directives are either missing or overdue, which equally affects investors and projects, which get delayed, put on standby or are abandoned completely. Any uncertainty translates into business risks: technological – whether the idea or product will work technically, market – whether there will be sufficient demand, and financial – whether borrowed funds will be repaid. All together these risks may result in higher operating costs of green businesses.

In addition, there is a lack of cooperation between responsible ministries due to overlapping competencies and incompatible strategies. It has thus been proposed to develop a coordination body for MSME greening in order to improve coordination between different government institutions, to avoid duplication of efforts, and to increase the uptake of measures aimed at greening MSMEs.³⁵

However, probably the most significant obstacle for the greening of MSMEs is the absence of sufficient capital and financial instruments responding to the specific needs of MSMEs. The next chapters will address this issue by giving an evidence-based overview about the demand and supply of green finance in support of MSME greening.

The European Green Deal as a Key Driver of Serbia's Green Transition

Serbia's dedication to the green transition is emphasized by its EU perspective and the related requirement to align national legislation with the EU acquis. The EU's major new growth strategy, the EU Green Deal, and the Green Agenda for the Western Balkans launched in Sofia on 10 November 2020, will support the Serbian economy in leaping from a traditional economic model to a green economy, and should increase related demand for green finance in the future.

33 OECD (2020), Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard, available at <https://www.oecd-ilibrary.org/sites/54da3754-en/index.html?itemId=/content/component/54da3754-en> (accessed on 16 February 2021)

34 OECD (2019), SME Policy Index – Western Balkans and Turkey 2019, Chapter 18. Serbia: Small Business Act profile, available at <https://www.oecd-ilibrary.org/sites/354bd091-en/index.html?itemId=/content/component/354bd091-en> (accessed on 16 February 2021)

35 OECD (2019), SME Policy Index – Western Balkans and Turkey 2019, Chapter 18. Serbia: Small Business Act profile, available at <https://www.oecd-ilibrary.org/sites/354bd091-en/index.html?itemId=/content/component/354bd091-en> (accessed on 16 February 2021)

With the European Green Deal,³⁶ the EU aims to become carbon neutral by 2050. The forthcoming European Climate Law³⁷ will make this political commitment legally binding on the EU-level. Other objectives of the Green Deal include the efficient use of natural resources by switching to a circular economy, reducing pollution and protecting nature and biodiversity. To support industry towards climate neutrality, the Commission has also adopted a new Industrial Strategy³⁸ focusing on the green and digital transitions as well as competitiveness on the global stage. A new SME strategy³⁹ will help to address the particular challenges of SMEs in the green and digital transitions by building the required capacity and securing access to the right skills. In support of the transition to a circular economy, the Industrial Strategy establishes a strong link with the new Circular Economy Action Plan,⁴⁰ adopted in parallel to the Industrial Strategy. This action plan establishes a sustainable product policy framework addressing the entire life cycle of (initially) seven priority product value chains with both high resource use and high potential for circularity.⁴¹

Reaching the objectives of the European Green Deal will require significant investment from the EU, national public sector and private sector. To finance the green transition, the Sustainable Europe Investment Plan (SEIP)⁴² has been created as the investment pillar of the European Green Deal. It plans to mobilize at least EUR 1 trillion of public and private sustainable investments over the upcoming decade. About half of this amount will be financed from the new long-term EU budget for 2021-2027, 30% of which must support climate objectives. More than a quarter will be raised through the InvestEU Fund, which will provide an EU budget guarantee for the European Investment Bank (EIB) and others to invest in higher-risk projects, thus crowding in private investment. Other sources include national co-financing and the Just Transition Mechanism (JTM), which will mobilize at least EUR 150 billion for re-skilling workers and citizens and for helping businesses create new economic opportunities in those regions particularly affected by the green transition.⁴³ It should be noted that InvestEU and the JTM are not open to non-EU27 countries. Nevertheless, they could be seen as testcases of how the just transition could be tailored.

Both InvestEU and the JTM are under the EU's post COVID-19 economic recovery effort called NextGenerationEU (NGEU)⁴⁴. This temporary instrument designed to boost the EU's recovery will also support local economic growth and jobs in the context of the green transition, for example, through a renovation wave of buildings and infrastructure and a more circular economy. It also aims to accelerate the roll-out of renewable energy projects – especially wind, solar – and kick-start a clean hydrogen economy in Europe.

Due to the close political and economic interlinkages with between the EU and Serbia, the EU Green Deal is directly relevant for Serbian business, including MSMEs. Within the EU integration progress, Serbia will be required to align national legislation to the EU acquis, including environmental

36 European Commission (2019), The European Green Deal, COM(2019) 640 final, 11 December 2019, Brussels.

37 European Commission (2020), Proposal for a Regulation of the European Parliament and of the Council establishing the framework for achieving climate neutrality and amending Regulation (EU) 2018/1999 (European Climate Law), COM(2020) 80 final, 2020/0036(COD), 4 March 2020, Brussels.

38 European Commission (2020), A New Industrial Strategy for Europe, COM(2020) 102 final, 10 March 2020, Brussels.

39 European Commission (2020), An SME Strategy for a sustainable and digital Europe, COM(2020) 103 final, 10 March 2020, Brussels.

40 European Commission (2020), A New Circular Economy Action Plan for a Cleaner and more Competitive Europe, COM(2020) 98 final, 11 March 2020, Brussels.

41 Electronics and ICT, batteries and vehicles, packaging, plastics, textiles, construction and buildings, as well as food, water and nutrients.

42 European Commission (2020), Sustainable Europe Investment Plan – European Green Deal Investment Plan, COM(2020) 21 final, 14 January 2020, Brussels.

43 See also European Commission (2021), The Just Transition Mechanism: making sure no one is left behind, available at https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/actions-being-taken-eu/just-transition-mechanism_en (accessed on 19 February 2021)

44 See also European Commission (2021), Recovery plan for Europe, available at https://ec.europa.eu/info/strategy/recovery-plan-europe_en (accessed on 19 February 2021)

legislation. However, Serbia is already economically highly integrated with the EU market, with almost two thirds of Serbian exports destined for the EU in 2019⁴⁵ and thus required to comply with internal market legislation.

A Green Agenda for the Western Balkans

The European Green Deal is also a central element of the future engagement of the EU in the Western Balkans region, which is outlined in two strategic documents adopted by the European Commission in October 2020: the Economic and Investment Plan (EIP) for the Western Balkans and the associated Green Agenda for the Western Balkans.⁴⁶

The EIP constitutes a long-term investment package, which seeks to mobilize up to EUR 9 billion of IPAIII⁴⁷ funding for the period 2021-2027 to support sustainable connectivity, human capital, competitiveness and inclusive growth, as well as the green and digital transitions. As part of this investment package, the EU will set up a new Western Balkans Guarantee Facility, which will aim at crowding-in private investors with the ambition to potentially raise investments of up to EUR 20 billion along the lines of the six investment priorities set by the EIP. The diversified finance envisaged by the EIP will strengthen competitiveness in the region and will also help Serbian MSMEs to grow and green their businesses. Emphasis will be put on green growth and the circular economy, and in particular on scaling up investments in green technologies and reducing the costs of deployment of green technologies in the region.

Aimed at implementing the European Green Deal in the region, a Green Agenda for the Western Balkans⁴⁸ has been embedded in the EIP. At the Western Balkans Summit held in Sofia on 10 November 2020, Western Balkans leaders launched the Green Agenda and committed to a transition to a sustainable economy in the areas of climate change, circular economy, pollution, sustainable agriculture and biodiversity. The Sofia Declaration⁴⁹ aligns the countries of the Western Balkans with the EU's target to become carbon neutral by 2050 and requires them to develop and implement integrated Energy and Climate Plans showing how climate action will be mainstreamed in all relevant sectoral policies. Some of the concrete measures included in the declaration include boosting energy efficiency and renewable energy sources, aligning with the EU Emissions Trading Scheme, implementing sustainable mobility solutions, phasing-out of coal subsidies, improving waste management infrastructure, establishing adequate air quality monitoring systems, and many more.

The implementation of the Green Agenda will be supported by the EU through IPAIII. A key implementing mechanism in this regard will be the Western Balkans Investment Framework (WBIF), and in particular two existing WBIF blending facilities, namely the Green for Growth Fund (GGF) and the Regional Energy Efficiency Programme (REEP). In addition, guarantees provided through the Western Balkans Guarantee Facility (EFSD+) will be used to attract private funding in key areas.

45 Delegation of the EU to the Republic of Serbia (2021), Serbia-EU Trade Liberalization, available at <http://europa.rs/serbia-and-the-eu/trade/?lang=en> (accessed on 18 February 2021)

46 European Commission (2020), An Economic and Investment Plan for the Western Balkans, COM(2020) 641 final, 6 October 2020, Brussels.

47 Instrument for Pre-accession Assistance (IPA) III for the period 2021-2027

48 European Commission (2020), Guidelines for the Implementation of the Green Agenda for the Western Balkans, SWD(2020) 223 final, 6 October 2020, Brussels.

49 Regional Cooperation Council (2020), Sofia Declaration on the Green Agenda for the Western Balkans, 10 November 2020, available at <https://www.rcc.int/download/docs/Leaders%20Declaration%20on%20the%20Green%20Agenda%20for%20the%20WB.pdf/196c92cf0534f629d43c460079809b20.pdf> (accessed on 18 February 2021)

The Green Agenda, endorsed by the Government of Serbia, will have a substantial impact on the policy agenda in Serbia – if implemented properly. It has the potential to set the sails for a green transition of the entire Serbian economy with transformational potential in all sectors. It is essential to create awareness among Serbian MSMEs, allowing them to adapt their business models in due course to ensure their long-term competitiveness in the future.

Defining Sustainable Finance – The EU Taxonomy

In the face of vast and increasing amounts of public and private finance available to make the green transition happen in the EU, the Western Balkans and elsewhere, it is of paramount importance to specify what qualifies as a sustainable investment. With the aim of aligning the financial system with EU policies supporting the green transition, the EU in June 2020 adopted a framework for classifying environmentally sustainable economic activities, including investments, known as the “EU Taxonomy”⁵⁰. It aims to provide a clear and standardized guidance on which economic activities can be deemed environmentally sustainable, thus facilitating the mobilization of (cross-border) sustainable finance for delivering on the European Green Deal.

Under the current regulation, an economic activity is only considered as environmentally sustainable if it contributes to one or more of the following six environmental objectives:

- Climate change mitigation,
- Climate change adaptation,
- Sustainable use of water and marine resources,
- Circular economy,
- Pollution prevention, and
- Healthy ecosystem.

In reverse, it follows that financial market participants that do not comply with one or more of the aforementioned environmental objectives will not be able to use national labels or issue related green financial products or corporate bonds. This will address concerns about greenwashing, increase investor confidence, and potentially channel more private investments into sustainable activities. The EU Taxonomy will thus help policy-makers, industry and investors to support and invest in economic activities that contribute to the transition towards a low-carbon and circular economy.

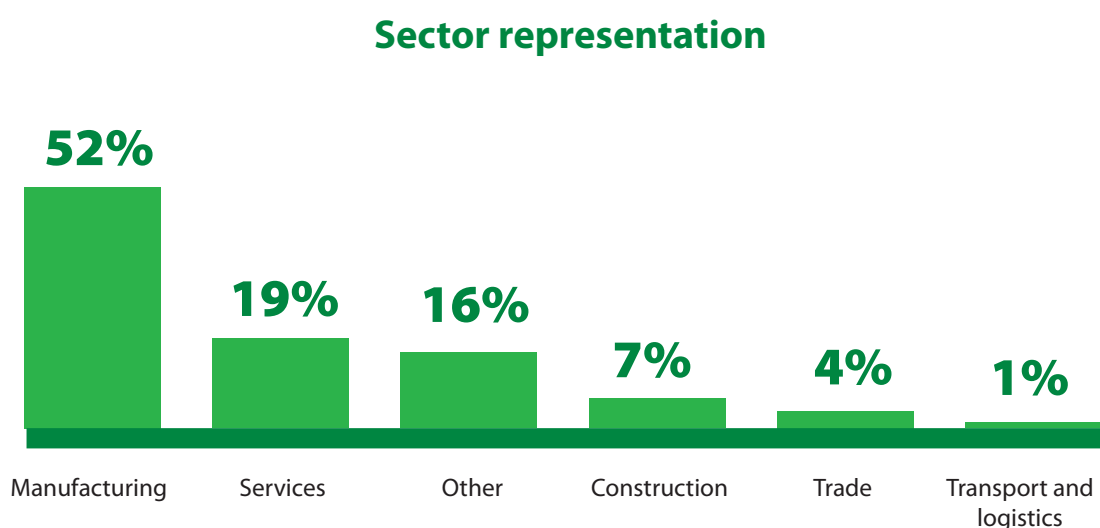
⁵⁰ European Union (2020), Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852> (accessed on 18 February 2021)

3. The Perspective of MSMEs on Green Finance in Serbia

This chapter addresses the current practices for financing green investments among MSMEs in Serbia, as well as the needs and suggestions provided by businesses and business representatives for scaling-up green finance in the future. It is mainly based on a survey amongst Serbian MSMEs as well as individual interviews. The survey was implemented with the Chamber of Commerce and Industry of Serbia with a questionnaire (comprised of 64 questions) sent to targeted companies, which was completed and returned by 146 companies.⁵¹ The interviews were conducted with a total of 12 companies, one business association, one consulting company, the Fiscal Council, and the Chamber of Commerce and Industry of Serbia. Box 1 provides examples of business entities interviewed for this report.

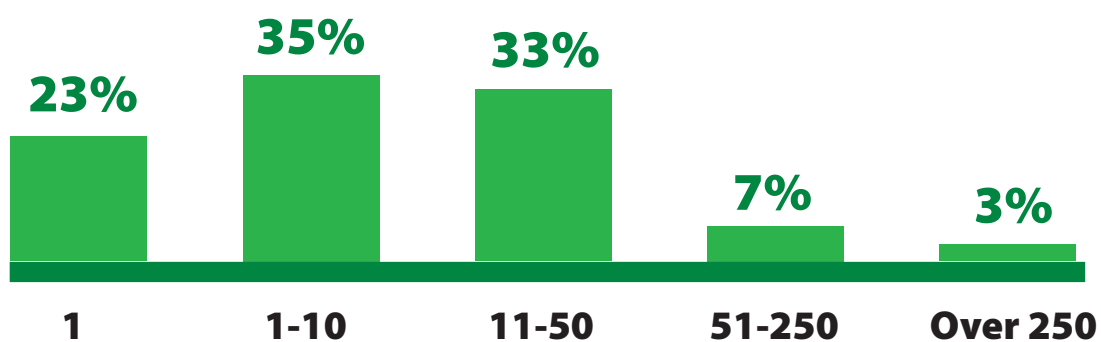
The sample of survey responses is largely composed of companies from the manufacturing sector (52%) and the service sector (19%). Respondents are largely micro and small enterprises, 58% of which have 10 or less employees. Figure 1 gives an overview about the sample structure.

Figure 1: Sample structure of questionnaires received from MSME survey (n=146)

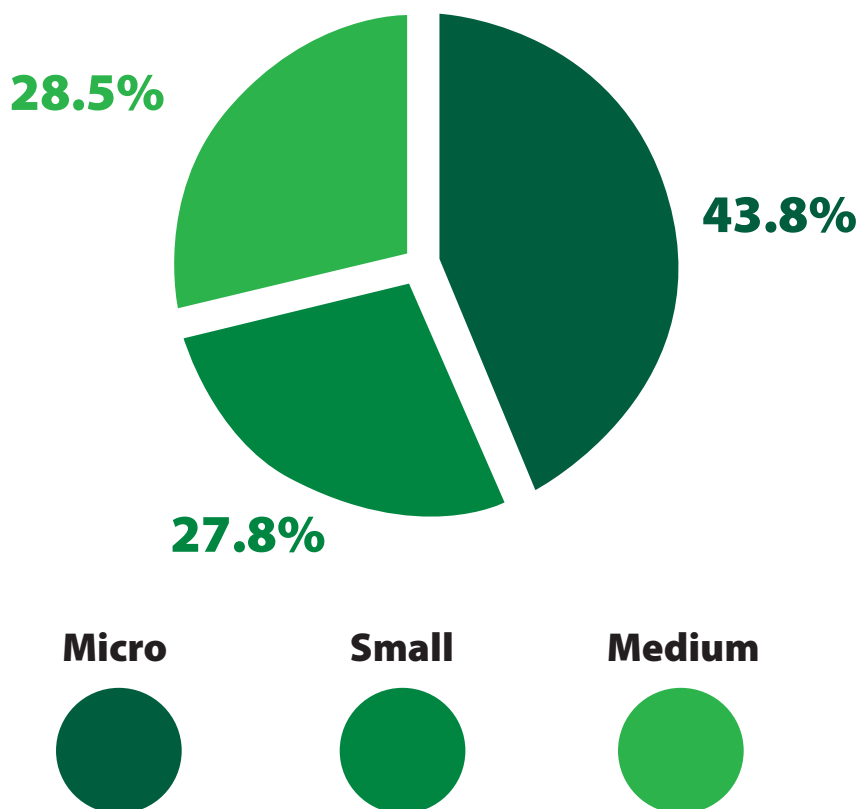


⁵¹ Interviews were conducted on 7-18 September 2020 and 15-19 February 2021. The questionnaire was completed and returned by companies on 21-29 September 2020.

Number of employees



Classification of the enterprise



Source: Own elaboration based on survey conducted among 146 MSMEs in Serbia

While micro and small enterprises constitute the majority of respondents, they are somewhat underrepresented compared to the realities of Serbian business sector, where over 96% of all companies have less than 10 employees. These companies also face the largest difficulties in accessing banking products, as banks require a good credit history, relatively large turnover, low levels of debt, and sufficient equity. In addition, they may also experience problems with defining their financing needs and developing a clear business plan.

Box 1: Examples of business entities interviewed for this report

Serbian Biogas Association (SBA)

The SBA was founded in March 2012 to support companies planning to build the first biogas facilities in Serbia. Today, it has over 30 members that own 14 biogas plants with a total installed capacity of over 14.4 MW.

Enviros

Enviros is an international consulting company in the field of energy, environment and management. Based in Prague, it has offices in the Czech Republic, Slovakia and in Belgrade. Officially registered in Serbia in 2016, Enviros has been operating in the Western Balkans market since 2006. It currently employs 44 professionals.

Eso Tron

Eso Tron doo was founded in 2011 in Novi Sad. Eso Tron is the largest company collecting waste edible oils in Serbia, and the only company in the wider area that is registered for the organized collection of organic waste and its processing. Eso Tron is the first company in Serbia to obtain a permit for grinding and sanitizing organic waste.

Eko Sistem

Eko Sistem, based in Jagodina, was founded in 2006. The company specializes in the collection, sorting and recycling of secondary raw materials, especially heat-shrinkable foils, PET packages and all types of soft plastics.

Dairy Petrov

Dairy factory Petrov was established in 2012 in Veliko Srediste, near Vrsac. The company is known for biodynamic production with a dairy production capacity of up to 1,300 tons per year.

Sanicula

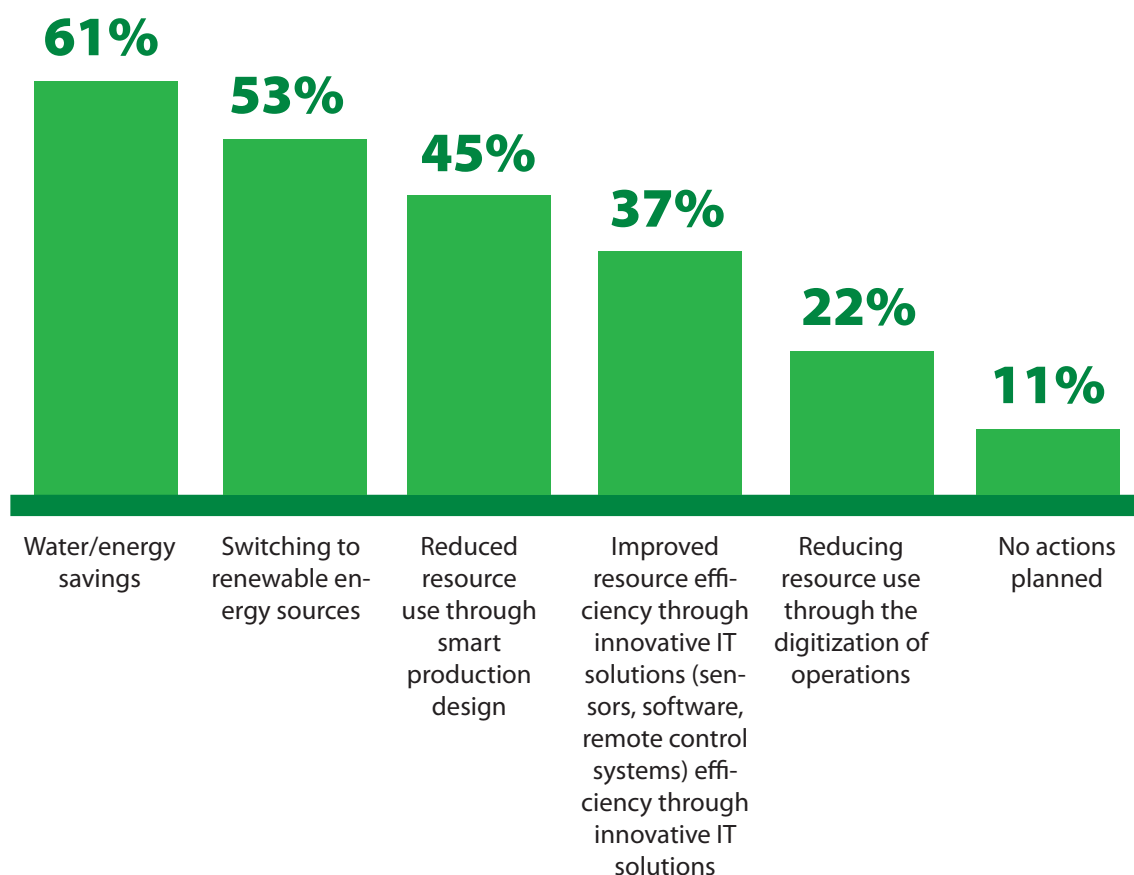
Sanicula is a Serbian-Belgian company, which produces medical herbs and essential oils of high quality for the international market.

Incentives and Barriers for Green Investments

Many Serbian MSMEs have already engaged in greening their businesses and even more plan to do so in the future. These investments are often small in scale and are also often not part of the core business focus. For example, almost a quarter of the companies had already invested in energy efficiency improvements over the past five years. An additional 16% of respondents had ongoing projects, and over 40% of respondents planned to increase the energy efficiency of their undertakings in the future. Investments in energy efficiency are mostly focused on the replacement of inventory/machines and on reducing energy consumption, to a lesser extent also on solar panels (for internal use and/or for selling electricity to the market) and waste management. This shows that ageing and often inefficient equipment offers the largest potential for greening MSMEs when replaced with cleaner and more resource efficient alternatives.

Future investment plans are summarized in figure 2. It shows that companies mainly planned to invest in energy and water efficiency, renewable energy sources, and resource efficiency through the digitalization of business operations. Only 11% of respondents did not have any plans to invest in green technologies in the future.

Figure 2: Planned Green Investments by MSMEs in Serbia (multiple responses possible)



Source: Own elaboration based on survey conducted among 146 MSMEs in Serbia

More targeted interviews with some of the concerned MSMEs revealed that the key motivation for these investments is reduced operational costs associated with energy and resource savings. This is particularly relevant as almost half of all companies participating in the survey mentioned high operating costs as the key challenge to their business. Although electricity is still relatively cheap in Serbia, cost savings are also expected in view of rising electricity prices in the future. In the packaging industry, green investments are also often driven by the need to minimize waste and to reduce transport costs. Corporate social responsibility has been mentioned as another key driver of green investments, which also includes the desire of MSMEs to decrease pollution and to mitigate GHG emissions. For example, some companies aim to reduce their carbon footprint by replacing old equipment with more eco-friendly equipment, particularly in the context of expanding business operations. A few companies also see a benefit of green investments in the improvement of their credit rating.

Those companies that have invested in greening their business in the past have largely resorted to internal funds (65-84% of companies, depending on investment activity), much fewer to a mix of internal and external sources (11-31%), while only 4-5% of companies relied exclusively on external finance. Companies investing in waste reduction (e.g., equipment, waste reduction, sorting waste etc.) most commonly resort to own sources of finance (84%). Investments in pollution abatement (e.g., wastewater treatment, equipment, solar energy etc.) are also highly dependent on the availability of own sources of finance (77%). As regards companies investing in the reduction of energy consumption (e.g., equipment, solar panels, heating systems, biogas facilities etc.), about one third has resorted to mixed sources of finance – the highest share of all activities.

Table 1: Overview about past and planned Green Investments by MSMEs

Activity	Percentage of companies already invested	Percentage of companies plan to invest	Percentage of companies which don't plan investments
Reduced energy consumption	69	7	24
Reduced waste generation	44	19	37
Reduced water/air pollution	45	26	29

Source: Own elaboration based on survey conducted among 146 MSMEs in Serbia

The above figures and high levels of own sources are also the result of MSME's limited knowledge about all available financial instruments. Without adequate financial departments, MSMEs are unaware of their options and – for example – often do not know how to use instruments such as leasing or factoring. As a result, when in need of external finance, they resort to more expensive instruments, such as short-term loans or even overdrafts (the most expensive form of finance). The survey conducted in the context of this report revealed that the most commonly used financial product was indeed short-term loans, used by 41% of companies resorting to external finance. Long-term loans and guarantees are equally preferred by around 30% of companies each. Leasing and overdraft have been used, but only to a very limited extent by 5% and 3% of all companies, respectively.

There remain substantial barriers for MSMEs to invest in green technologies, some of which have been exacerbated by the COVID-19 pandemic. High interest rates and the poor development of capital markets in Serbia have been mentioned most often by MSMEs as causes for them to turn their back on green investments. High interest rates are seen in the wider context of high borrowing costs. These also include other additional transaction costs such as banking fees, legal expenses, technical due diligence etc. which increase the price of the initial investment. The poor development of the capital market does not offer a chance for MSMEs to create a more favorable mix of financing instruments and thus obstructs developers/investors to reduce overall borrowing costs.

Other but less prominent barriers include the inability to collect existing receivables and the lack of sufficient collateral. Collateral issues develop in particular with banks which regard green investments more from the asset-based lending standpoint than as a project finance. In the survey, only few companies lamented poor legislation and corruption as a barrier to MSME greening. During the interviews, however, many companies complained about the lack of support from both the regulatory environment and from commercial banks.

As regards policy, the MSMEs interviewed particularly highlighted uncertainties associated with the regulatory framework, high administrative requirements for green investments, and the general lack of a fiscal/financial framework to incentivize MSME greening. For example, in the absence of a polluter-pays system, current eco-taxes are collected based on company size and classification of business activity, thus independent from actual pollution levels. In addition, the current inspection system based on a “find-and-fine” approach, does not incentivize green investments as long as fines are much lower than the negative impacts associated with environmental pollution. Another concern that has been mentioned is the limited role played by green public procurement of governmental institutions on all levels.

Similar to the perceived lack of government support, MSMEs criticize that commercial banks do not follow a particularly green approach and are not supportive of companies that plan green projects. In fact, the opposite may be the case where banks ask for significant collateral on very unfavorable terms (ratio 1:2) for projects that are not common from the bank’s perspective – often including green projects. The role of guarantees was emphasized in this regard, both national and EU guarantees, as well as the need to involve banks and financial institutions very early on, helping them to better understand green projects and the risks associated with them.

It is interesting to note that the availability of skilled staff is not considered a major barrier to green investments by the majority of companies. About a third of the companies surveyed had problems hiring adequately skilled staff. The top three qualifications demanded are machine engineers, electro engineers and general engineers. Shortages of skilled labor are often addressed by employing retirees and by organizing internal trainings and qualification programs. Only 27% of respondents think that greening MSMEs will create additional employment opportunities.

Green Investments to be Postponed or Downsized due to COVID-19

The financial challenges faced by MSMEs in financing green investments have increased in the face of the COVID-19 pandemic. While the private sector showed overall good resilience during the pandemic, it suffered from an increase in operative costs resulting from workforce absences (especially during pandemic peaks) and health safety measures. According to the Serbian Chamber of Commerce and Industry, micro and small enterprises were less impacted by value chain disruptions because they largely operate on the national market. The biggest problems were faced by foreign companies with up to 500 employees, which had difficulties maintaining value chains (e.g., importing raw materials from abroad) and are facing rising logistics costs (e.g., due to additional costs of PCR tests required for drivers).

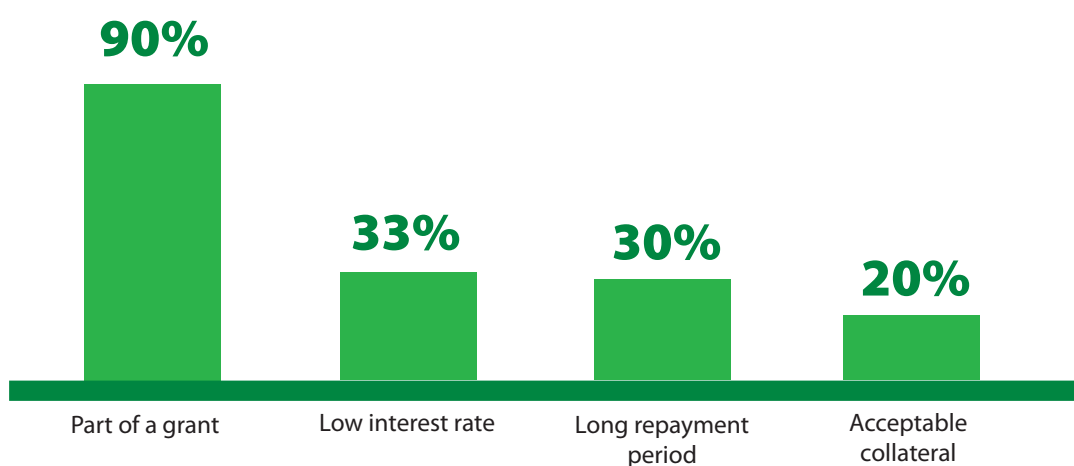
While the sectors most impacted by the pandemic in Serbia were tourism, transport, car industry and the hospitality industry (hotels, restaurants, bars), many companies in other sectors also experienced liquidity issues. In comparatively few cases did companies resort to loans or other financial products to improve liquidity. The vast majority of MSMEs relied on their own resources and reserves while responding to the COVID-19 crisis.⁵² However, despite the fact that companies had green project ideas and concepts developed before the pandemic, hardly any investments came through in 2020. On a positive note, interviews with MSMEs suggest that most investments have been postponed rather than cancelled, while some investments were downsized. Similarly, the pandemic had another positive effect by accelerating the digital transition even among small enterprises. In addition, some companies managed to decrease production costs because of additional efforts to maximize resource utilization, energy savings and other costs to compensate for the workforce absences.

Financial Instruments Preferred by MSMEs

As noted above, access to finance is a key constraint of MSMEs to grow and green their business. It is particularly difficult for MSMEs to obtain loans and they rely more on internal funds to run their businesses. As a result, there is a significant finance gap for MSMEs, which in Serbia amounts to about USD 10.1 billion, equivalent to 27.6% of Serbian GDP.⁵³ Similarly, some 45% of all MSMEs operating in Serbia are considered financially constrained.⁵⁴ In order to improve access to finance, MSMEs do not only require tailored financial products but also technical support, education and training.

Subsidies and grants are perceived as the two most important financing instruments which support and encourage MSME greening. To finance green projects, almost three quarters of survey respondents also indicated their interest in taking a loan, the vast majority of which (90%) prefer a combination between a loan and a grant (see figure 3). The grant element is thus of key importance when considering green finance for MSMEs. However, loans are an appropriate instrument to finance, e.g., energy efficiency investments, since the energy savings can be used to repay the loan, thus eventually representing a gain for the MSME. Figure 3 also shows that MSMEs prefer low interest rates, long repayment periods and an acceptable collateral.

Figure 3: MSME preferences for loans (multiple responses possible)



Source: Own elaboration based on survey conducted among 146 MSMEs in Serbia

52 United Nations Serbia/UNDP (2020), COVID-19 Socio-Economic Impact Assessment, available at <https://serbia.un.org/en/download/50709/92907> (accessed on 23 February 2021).

53 SME Finance Forum (2021), MSME Finance Gap, available at <https://www.smefinanceforum.org/data-sites/msme-finance-gap> (accessed on 24 February 2021).

54 Ibid.

Personalized interviews with MSMEs revealed that guarantees play an important role in facilitating loans where banks ask for significant collateral on particularly unfavorable terms for green projects. Another often mentioned preference of MSMEs was also for longer grace periods, i.e., a longer transitional period during which an MSME can refrain from paying towards a loan without penalties. These are often required for MSMEs to generate revenue with new equipment (e.g., after the construction phase) before starting to repay a loan. Other external sources are not met with particular interest by the MSMEs surveyed, including issuing (green) bonds and equity co-finance.

When asked about the preferred mix of finance for green investments, a general picture emerged from the survey and interviews which reflected a mix of about 20% subsidies and grants, 15-25% internal funding and 50-60% bank loan or other external sources of funding.

The most common instrument for externally financing green businesses are loans. As regards borrowing conditions, MSMEs prefer interest rates of below 3%, a tenor of up to 10 years, a grace period of at least one year and a reasonable collateral and/or guarantee covering collateral requirements.

Table 2: Preferred borrowing conditions for MSMEs in Serbia

Condition	MSME preferences
Interest rate	2-3% p.a.
Tenor	5-10 years
Optional grace period	1-2 years
Collateral	Reasonable collateral and/or guarantee (partly) covering collateral requirements

Source: Own elaboration based on survey conducted among 146 MSMEs and interviews conducted with various MSMEs and related stakeholders in Serbia

As regards the loan tenor, MSME long-term preferences may be in contrast to banks' limited long-term deposits in adequate amounts. Long repayment periods extending for a decade contribute to the risk perception and a high degree of prudence on the part of creditors. Hence, money for long-term loans mainly comes from credit lines and donor development programs.

To reduce risks often associated with MSME borrowing, risk sharing may be an option depending on individual situations. In the case of classic loan products, financial and commercial risks are borne by the borrower. However, there are also models where risks are shared among project stakeholders, including – in addition to the borrower – also contractors, equipment and energy suppliers. The suitability of different risk sharing instruments depends on a MSME's financial strength and credit worthiness, predictability of revenues, regulatory frameworks, commercial financing environment, and nature of a project including implementation capacity.

Education, Training and Technical Assistance

Despite the importance of financial support, this is only one – albeit important – aspect of the assistance required by MSMEs to implement green investments. In addition, companies are much in need of education, training and technical support. In fact, 49% of the MSME survey's respondents would accept technical support for the implementation of green projects, in particular regarding financial forecasts, legal requirements, feasibility studies, environmental and social compliance, as well as training in emerging technologies or technological processes relevant to the green economy. Moreover, businesses need to be enabled to report on environmental performance indicators regarding GHG emissions, air/soil/water pollution, resource use and waste generation. Some companies acquire external expertise, e.g., for project preparation, administration and additional know-how. Others would prefer to receive education, training and/or technical assistance from banks, business associations or IFIs in the context of their financing arrangements.

Education, training and technical assistance does not only concern immediate green business opportunities but also longer-term adjustment requirements to new EU legislation. For example, only about 10% of respondents are aware of the EU Green Deal (see above). Similarly, only about 13% are familiar with the EU Emissions Trading Scheme (EU ETS) and less than 4% have started with preparations for entering the EU ETS. Serbian MSMEs are thus in dire need of training and education and about two thirds of respondents show interest for support and assistance to align their business with the obligations and opportunities arising from EU requirements, including the environmental and climate change acquis, the EU Green Deal and the Circular Economy Action Plan. This will be helpful not only for companies operating on the Serbian market and adapting to new legislation, but also for companies cooperating with foreign partners or operating on international markets with additional environmental requirements. However, interest in harmonization with new policies also goes hand in hand with an interest in more financial opportunities for MSMEs, which is quite in the spirit of the EU Green Deal as the EU's growth strategy.

4. The Banks' Perspective on Green Finance in Serbia

The transition to an inclusive, low-carbon and circular economy requires increasing investments in cleaner and efficient production. The previous chapter has shown that there is a willingness of Serbian MSMEs to invest in greening their business models. This chapter looks into how the increasing demand for green finance can be met by an effective banking system which can provide sustainable finance and know-how to assess and implement green projects. The first section presents challenges and requirements for commercial banks operating in the Serbian market to support the green transition of MSMEs in Serbia. The second sections deals with the role international financial institutions (IFIs) can play to accelerate this transition.

The Role of Commercial Banks

Socially responsible banking requires an understanding that investments have impacts that go beyond financial key performance indicators, thus raising the need to include social and environmental considerations. Green banking aims to increase the environmental benefits of the banking sector by promoting environmentally friendly business practices and models. In order to reduce negative environmental impacts, green banking requires the disengagement from investments that harm the environment, e.g., through large amounts of environmentally harmful emissions and waste streams, and a shift towards activities that nurture sustainable, low-carbon and circular business models. Up until now, green finance in Serbia concentrated mostly on renewable energy sources, energy efficiency and sustainable transport. However, green investments increasingly support other areas as well, including resource efficiency, waste and waste water management, as well as climate resilience (adaptation).

Commercial banks embarking on the green transition need to review their business model in order to green their internal activities and products, as well as those of their clients and borrowers. On the one hand, their daily operations eventually need to become carbon-neutral (e.g., in terms of heating and cooling), while their products will need to prioritize energy and resource efficient alternatives (e.g., mobile and online banking, green accounts, paperless billing etc.). On the other hand, banks need to promote and support the green transition among borrowers through their lending activities.

Regarding green lending in Serbia, a large part of sustainable finance to date has been invested in large-scale energy and transport infrastructure. Project developers in these sectors often have sufficient size and capacity to access and acquire the necessary debt and equity. However, sustainable investments also need to encompass small-scale investments of households and MSMEs aimed at facilitating a broad green transition across the whole economy and along entire value chains.

In order to assess the challenges, opportunities and capacities of Serbian commercial banks to invest in the greening of MSMEs, interviews have been conducted with seven commercial banks operating in the Serbian market, including (in alphabetical order) Banca Intesa, Erste Bank, Komercijalna banka, Procredit Bank, Sberbank, Unicredit Bank and Vojvodjanska banka.⁵⁵

There is a high level of experience among these banks in renewable energy projects (wind, solar, hydro, biogas, combined heat and power). Energy efficiency projects (mostly building retrofitting) have also benefited significantly in the past. Recycling and solid waste disposal projects have been implemented to a lesser extent. Only few banks already have internal regulations prohibiting “brown” investments, e.g., in fossil fuel industries, but there is a high level of awareness that the importance of green finance will increase in the coming years.

Despite this optimistic outlook for green finance in general, there are numerous concerns related specifically to the nature of MSMEs that continue to obstruct the accelerated implementation of small-scale green projects in Serbia. These concerns are summarized in table 3.

55 These interviews were conducted from 5-7 October 2020 based on a questionnaire with 15 questions on sustainable banking Serbia.

Table 3: Barriers mentioned by commercial banks for the implementation of Green Projects among Serbian MSMEs

Barrier	MSME relevance	Potential solution
Equity participation	Equity investment is generally lower in MSMEs than in large firms.	Improved legal framework and investment climate to attract investors including private equity funds, grants.
Collateral requirements	Collateral of MSMEs is often deemed insufficient by banks.	Credit guarantees for project portfolio or individual projects.
Loan maturity	Loan maturities of five to seven years are often insufficient for MSMEs, which prefer longer repayment periods of 12 to 15 years.	Long-term loans, support of IFIs for loans with maturities of more than 15 years.
Funding limits	Past focus of green finance in Serbia has been on large infrastructure projects. Business income of MSMEs is often inadequate to justify financing at all.	Integrative solutions such as platforms for merging small-scale energy projects.
Project preparation	Business plans or feasibility studies of MSMEs are often inadequate, e.g., lacking environmental or risk assessments, thus not conveying sufficient assurance to outside parties.	Standardization of business plans and feasibility studies, technical assistance by IFIs, local banks, Serbian Chamber of Commerce, SME associations etc.
Investor experience	Investors often lack knowledge and previous experience in low-carbon and circular business models.	Awareness raising campaigns, grant-funded technical assistance, capacity building, consulting, training
Internal capacity	MSMEs have limited financial literacy and ability to prepare (and implement) bankable projects.	Grant-funded technical assistance
Regulation	MSMEs are very sensitive to regulatory uncertainties and discontinuities.	Long-term policy framework for the transition to a low-carbon and circular economy in the EU and Serbia.

Source: Own elaboration based on interviews conducted with seven commercial banks operating on the Serbian market

The above table gives an indication of how commercial banks need to adapt their services to the specific requirements of MSMEs. The three most commonly cited issues with MSMEs include insufficient equity, lack of collateral and a general inadequacy of project preparation, presentation and implementation.

MSMEs are likely to lack sufficient capital to contribute significant amounts of equity in a green investment. This situation has further been exacerbated by the COVID-19 pandemic, which caused liquidity shortages due to containment measures-related revenue reductions. Where equity participation cannot be replaced by bank loans (e.g., due to high risk profile), it could be incentivized by changes in tax laws, regulation and accounting rules. Similarly, in Serbia there is significant potential to increase the role of private equity funds, not just in providing sufficient equity but also in acting as potentially unbiased intermediaries between all involved stakeholders. Local banks, on the other hand, are not willing to provide equity finance to MSMEs themselves, both due to the Serbian Banking Law and internal procedures.

Given the size of MSMEs, they often do not have enough assets that can be used as collateral by banks. The resulting lack of lending can be addressed by credit guarantees. These are mostly provided by IFIs (see below) – either for an entire project portfolio or for individual projects. Currently two out of the nine available guarantee schemes in Serbia are national schemes, but IFI schemes generally enable local banks to define the general conditions of the guarantees provided through them – in line with internal policies.⁵⁶ Credit guarantees allow local banks to outsource the risk associated with defaulting MSMEs to a third party such as an IFI. Given the in-depth due diligence required by IFIs for the approval of credit guarantees, these schemes also help commercial banks to better develop and assess green projects. Guarantee schemes by IFIs should therefore be coupled with technical assistance to domestic commercial banks, allowing them to build internal capacity for properly assessing green projects. This is the case, e.g., under the current EFSD and future Western Balkans Guarantee Facility (EFSD+ guarantees).

A third class of investment barriers mentioned by several interviewed Serbian commercial banks is associated with the widespread inability of MSMEs to prepare project proposals and feasibility studies in a proper way. Time and capacity are limited resources in MSMEs. In addition, there is limited knowledge and experience regarding green investments. As a result, project proposals often lack crucial information about investments, such as a proper risk assessment or – in the case of green investments particularly important – proper environmental assessments. The resulting lack of information and transparency not only increases the risk of project failure, but also fails to convey sufficient assurance to commercial banks.

This problem needs to be addressed through a better focus on project preparation and dedicated support to MSMEs. For example, a more standardized approach to project proposals and feasibility studies can help to increase transparency and comparability of projects. At the same time, standardized proposals and feasibility studies may result in a more conservative approach to technology application with negative impacts on the innovative nature of projects, which is the focus of the green transition.

MSMEs can be supported in numerous ways, including through technical assistance by IFIs and local banks, as well as consulting and training provided by institutions such as the Serbian Chamber of Commerce or SME associations. The costs incurred during the project preparation phase are ideally financed by grants.

Similarly, MSMEs can benefit from partnerships with academia and local governments.⁵⁷ This can help MSMEs to adopt innovative technology, but also assist them in the implementation phase through mobilizing available experts and project managers at the local level.

⁵⁶ Chamber of Commerce and Industry in Serbia (2020), *Guarantee Schemes Available in Serbia*, Belgrade.

⁵⁷ See also *Strategija industrijske politike Republike Srbije za period 2021 do 2030 („Službeni glasnik RS” br. 35/2020)*

Once a green project is considered bankable, banks commonly quote a breakdown of funding to be roughly 30% equity and 70% external financing. The latter can consist of a mix of instruments, including credit lines, guarantees, grants, and/or technical assistance. In addition, loans by commercial banks may be supplemented by IFI loans (see also next subsection). The benefits and drawbacks of these instruments are summarized in the table below.

Table 4: Benefits and drawbacks of common financial instruments for financing Green Projects of Serbian MSMEs

Instrument	Benefits	Drawbacks
Grant/subsidy	Promotes certain policy objectives, e.g., green growth	Time limited offer, limited funds
Guarantee	Risk mitigation tool, improves bankability of projects	In-depth due diligence required
Standard loan	Allows for large investments and business growth	Creditworthiness of borrower, collateral often insufficient
IFI loan	Provides additional funds and finance, often comes with transfer of know-how	Specific priorities and focus on certain business areas
Green bonds	Source of fixed income for banks	Significant capital requirements, dinar denomination, cumbersome regulation

Source: Own elaboration based on interviews with seven commercial banks operating in the Serbian market.

MSMEs commonly choose grants and state subsidies as their preferred source of finance. Local banks suggested to use grants at the beginning of a project as part of the initial investment rather than at its end. Grants are also the preferred instrument to finance technical assistance. The EU's instrument for pre-accession assistance for rural development (IPARD) has been mentioned as a good example of direct support to beneficiaries. It was recommended to be extended and modified to support also broader green projects in EU candidate countries. Guarantees, on the other hand, are particularly important to address insufficient collateral of MSMEs. As such guarantees are often an essential precondition for lending, but – particularly when issued by IFIs – tied to a potentially cumbersome but rewarding in-depth due diligence. Standard loans require long term financing, often in combination with a grace period at the beginning of the investment (e.g., during construction until the business becomes operational). One commercial bank noted that the maximum acceptable maturity was 15 years, above which IFI involvement becomes increasingly useful. However, as noted above, these financing instruments do not exclude one another but are seen as mutually reinforcing. A combination of lending, technical assistance, grants and guarantees has repeatedly been suggested to ensure a (green) project's success.

In addition, commercial banks in Serbia are generally interested in both corporate and sovereign green bonds as a means to accelerate green project development. However, while financing for MSMEs is generally dominated by bank loans, the Serbian bond market remains substantially underdeveloped, limited to a small number of municipal bonds. No green bonds have yet been certified in Serbia due to considerable drawbacks for issuing such bonds. In addition to the costs associated with registering

bonds with the Central Register of Securities, the certification of bonds as “green” is expensive – in the range of EUR 15,000, which is particularly cumbersome for the green bonds smaller in size. Existing bonds in Serbia remain uncertified, meaning that they could be in line or not in line with the standard setters in the industry (e.g., Climate Bonds Initiative). Similarly, bonds generally require significant capital and are acceptable only for large projects of more than EUR 100 million. A particular concern of commercial banks is the fact that bonds are generally denominated in Serbian dinars only, while the prices in projects are usually denominated in Euros (only the state can issue securities denominated in dinars and foreign currencies).

Box 2: Municipal bonds in Serbia

Although municipal bonds remain seldom in Serbia due to limited capacity on the local level, a number of Serbian cities/municipalities have issued bonds over the past five years, including Novi Sad, Pancevo, Sabac and Stara Pazova. So far, these bonds have been largely unrelated to environmental projects and were issued to finance communal infrastructure such as water networks, streets, schools and kindergartens, refurbishment of sport halls etc.

Municipal bonds are denominated in Serbian dinars and were issued at an average interest rate of 6.54% and an average term to maturity of seven years. The longest term to maturity was 12 years (Novi Sad), while the shortest was five years (Stara Pazova). Experiences collected with these bonds can be useful for expanding the use of municipal bonds to environmental projects in the future. Similarly, corporate bonds could be the next step in raising additional finance for the green transition as the bond market in Serbia matures.

Commercial banks will need to better align their activities with the ongoing transition to an inclusive, low-carbon and circular economy. The following steps, based on interviews conducted with commercial banks operating in Serbia, will help as guidance in this alignment process.

- **Commitment to financing green projects.** There is widespread agreement among commercial banks that demand for green finance will increase substantially over the coming years. Demand will not only increase in overall scale but also in project diversity, extending beyond energy and transport infrastructure projects towards other areas such as resource efficiency, recycling, waste management, water treatment etc. This creates enormous opportunities for commercial banks which can only be reaped if banks commit to financing green projects in the long-term (beyond the length of IFI credit lines) and install the relevant green finance offices, departments or technical advisors for green financing.

- **Building internal capacity in the bank.** To fully benefit from the potentials of the green transition, commercial banks need to train and invest in dedicated staff able to develop, assess and implement green projects of MSMEs on a continuous basis. Technical assistance and trainings provided by IFIs are essential in internal capacity building. This can be reinforced through partnership with the Chamber of Commerce as well as through using existing UNDP best practice examples.

- **Using experience from green segments of existing portfolio.** Most banks have existing green retail and corporate portfolios. An analysis of ongoing and completed green projects may offer tailored insights, including best practices and lessons-learnt, which can provide a basis for future green investments in new clients and markets.

- **Partnering with MSMEs in project identification, preparation and implementation.** On the one hand, banks are usually reluctant to expand their MSME client pool. They prefer to work with existing, well-known clients due to high acquisition costs (due diligence) and are little motivated to expand their client pool with new MSMEs. On the other hand, a lot of MSMEs are bank averse and prefer to fund their business with own funds. Given the limited capacity of MSMEs to prepare bankable projects, commercial banks should consider guiding MSMEs in preparation and implementation of green projects. Economies of scale can be achieved through standardized business plans or feasibility studies, as well as through integrative solutions such as platforms for merging small-scale projects.

- **External funding for green investment.** Commercial banks rarely finance start-ups and new green projects from their own sources – primarily due to maturity gaps. To speed up the green transition, commercial banks in Serbia thus need to cooperate closely with bilateral and multilateral development banks who can provide dedicated credit lines.

The Role of International Financial Institutions (IFIs)

In addition to commercial banks, bilateral and multilateral IFIs play an important role in the green transition of their partner countries. For example, they can help raise awareness for the green transition among market participants, including local banks, businesses, and individuals. In addition, IFIs provide know-how transfer to commercial banks and businesses allowing them to better assess projects for financing. Most importantly, however, IFIs provide additional sources of finance with potentially transformative effects on the economy.

For this report, interviews were conducted with representatives of four multilateral and bilateral IFIs, including the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), International Finance Corporation (IFC, member of the World Bank Group), and the German KfW promotional bank, as well as with the country office of the International Monetary Fund (IMF) in Serbia.⁵⁸

All IFIs support the green transition and the greening of the financial system. In the past, their support concentrated on renewable energy projects (hydro, solar, wind, biogas) and energy efficiency (in buildings). In the future, IFIs project rising importance of projects in the areas of solid waste, waste water treatment, irrigation and de-carbonization of industrial production.

IFIs consider MSMEs as trail blazers in the transition to an inclusive, low-carbon and circular economy. For the past decade IFIs have financed them either directly or through a variety of credit lines. The key instruments used by IFIs to support MSMEs include grants (for project development, combined with capacity building), guarantees (for risk-sharing or risk reduction), debt (including concessional loans, soft loans, credit lines to commercial banks, traditional loans and bonds), as well as equity (private equity and venture capital) and mezzanine financing. However, their engagement in greening MSMEs in Serbia is generally considered as neither cheap nor easy, and characterized by long payback periods and high risk.

An observation made by IFIs is that the general investment climate in Serbia has suffered under the COVID-19 pandemic and that despite the availability of credit lines and incentives for green projects demand for (green) finance has decreased considerably in 2020. This is also linked to a general lack of commitment to financing green projects by commercial banks, who – with few exceptions – do not have the capacity to assess and implement these kinds of projects and often perceive related investments as unprofitable. A strong emphasis of IFIs in their cooperation with Serbian clients is thus on providing technical assistance and trainings to local banks as well as incentives aimed at increasing the appetite for green investments.

⁵⁸ Interviews were conducted from 12-16 October 2020.

Technical assistance and training are generally well received by all involved stakeholders, including end users, commercial banks, intermediaries and public sector (e.g., for procurement). A combination of loans and TA is considered essential, providing training for both lenders and borrowers while also raising awareness for green projects among the general public. In the general absence of established green finance departments in commercial banks, TA plays a crucial role in enabling banks to deal with the demand of their clients for IFI grants and other services, to identify investment opportunities and most importantly to undertake the necessary project assessments. The project assessments can be undertaken by the banks themselves or, given the broad technical expertise required to deal with multidimensional and multisector projects, through a pool of advisers under strict non-disclosure agreements, possibly under the auspices of the Serbian Chamber of Commerce. MSMEs can also benefit directly from TA provided by IFIs, for example in the preparation of investment plans.

However, a major shortcoming is the prevailing short-term perspective of commercial banks on sustainable finance, often aligned with the duration of specific projects or credit lines. This leads to a situation where the know-how provided by TA programs subsides once TA is not extended or no other similar credit line established. It is thus essential that local banks invest in their own internal capacity to ensure that their employees and their clients benefit from such TA programs and additional trainings also in the long run.

A longer-term perspective to internal capacity building is also warranted in view of increasing green finance expected in the context of the EU Green Deal and the Green Agenda for the Western Balkans.

In addition, IFIs link the provision of credit lines to certain development indicators, including GHG emissions targets. These indicators are monitored throughout the repayment period and need to be taken into consideration by local banks in addition to their own lending conditions.

Incentives are generally regarded as a useful tool to motivate business owners to venture into green investments – which are usually not associated with the core areas of their businesses and often regarded as unprofitable. Incentives come in many different forms, as shown in table 5.

Table 5: Incentives provided by IFIs to MSMEs and commercial banks to increase the uptake of green investments in Serbia

Type of incentive	Motivation
Credit guarantees	Risk sharing mechanism enabling commercial banks to reduce credit risks and increase lending.
Grants	Disbursed at the end of a project when agreed environmental indicators are met.
Concessional loans	Reductions of the interest rate can be linked to the achievement of environmental indicators such as reduced GHG emissions.
Flat incentives	Capital relief in the form of a fixed percentage for all investments aligned with certain investment eligibility criteria.
Broad perception of green finance	Helps to raise awareness, get clients attention and interest in green investments.
Tax incentives	Provided in cooperation with the government, tax incentives can reduce costs of green investments.
Other legislation	Support to government in introduction or continuation of targeted legislation in support green investments, e.g., feed-in-tariffs for renewable energy sources.
Elimination of disincentives	Barriers to green investments needs to be phased-out.

Source: Own elaboration based on interviews with IFIs operating in Serbia.

As noted above, credit guarantees provided by IFIs are essential to promote financial access to MSMEs characterized by insufficient collateral. Risk sharing between IFIs and commercial banks increases the pool of eligible companies and incentivizes local banks to increase lending in areas targeted by credit guarantee schemes, such as green investments.

Currently there are nine available guarantee schemes in Serbia implemented through commercial banks. Six of them are financed through EU programs, two are national schemes, and one is financed by the United States Agency for International Development (USAID). These guarantees are generally in the range of 30-70% of the contract value, cover loans for investment and working capital, and are mainly targeted at industry – although some schemes also specialize in startups, innovative companies, liquidity, social entrepreneurship and agriculture. The majority of programs enables commercial banks to define the general conditions in accordance with internal policies (e.g., guarantee, loan amount, interest rates, repayment period etc.).⁵⁹ More guarantee schemes are expected to be established in the future.

Grant contributions by IFIs continue to be an important incentive for green investments in Serbia, particularly in – but not limited to – the project preparation and development phase. They are

⁵⁹ Chamber of Commerce and Industry in Serbia (2020), Guarantee Schemes Available in Serbia, Belgrade.

often not provided directly to MSMEs but through intermediaries such as, for example, the Serbian Entrepreneurship Foundation. Grants usually need to be well justified on the basis of, for example, institutional or market failures, environmental externalities, first mover costs etc.

A problem related to grants is that they are often linked to the achievement of key (environmental) indicators at the end of a project. Differentiating the level of incentives based on the implementation success, such as the level of CO₂ emissions reductions, raises the uncertainty for MSMEs as they often cannot rely on the exact amount of the incentive. A more reliable and secure alternative for such conditional grants is the introduction of flat incentives (e.g., 15% of the overall investment), which are granted to all MSMEs that are aligned with predefined investment eligibility criteria.

Incentives play an important role in investment decisions, but so do disincentives. The latter need to be better addressed to avoid situations where green investments become unprofitable because, for example, heating costs are calculated per square meter rather than on the basis of actual energy consumption. This also applies to subsidies to polluting industries or industrial activities, for example, based strongly on the use of fossil fuels.

As regards the existing challenges related to green bonds in Serbia (see above), IFIs can play an important role in providing advisory programs necessary for the improvement of the local capital market. However, the legal framework needs to be improved for more green investments to materialize in the future.

IFIs can also engage with MSMEs indirectly through partnerships with selected and prequalified municipalities, which have a track record in public-private cooperation, municipal bonds and/or cooperation with academia. This can create a space for MSMEs to propose locally implementable solutions. IFI support can also be blended with existing local funds for entrepreneur support. The recently implemented Climate Smart Urban Development project by UNDP may serve as the role model for creating local partnerships with MSMEs and academia.

Example of a de-risking mechanism for Green Financing: The UNDP Innovation Challenge

UNDP is dedicated to promoting innovation in resolving complex developmental issues. Innovation Challenges are prized challenges organized with a view to soliciting innovative ideas and solutions to address development challenges, which cannot be achieved through traditional solicitation processes. The selected projects on Innovation Challenge calls could be offered awards, technical assistance and equity co-financing for developing of the bankable idea and its offer to commercial or development banks. The program thus helps to replace business-as-usual solutions for energy/heat generation, waste management, transportation, farming etc., which are considered inefficient and costly, by climate-smart solutions that provide social, economic and environmental added-value to citizens and local communities.

Since 2017, UNDP has organized complex and successful challenge calls mitigating climate change in urban areas, promoting open data, tackling COVID-19, accelerating the re-use of biowaste and improving air quality in Serbia.

The mechanism consists of several phases: identification of challenges (usually at the community level), formulation of the challenge calls, evaluation of the most innovative business ideas and projects, incubation/acceleration support and deployment of the most advanced innovative businesses and projects. UNDP's Innovation Challenge methodology created an enabling environment for public and private companies to make their investments not only bankable, but also less carbon intensive and environment friendly, and thus competitive on the local market.

An important aspect for de-risking green investments under the Innovation Challenge is incubation/acceleration support. This is a form of technical assistance provided to innovative ideas aimed at transforming them into viable projects and businesses, ready for implementation. It includes guided mentorship, trainings, peer-to-peer learning, market research and business planning, as well as support in the elaboration of technical documentation. This type of support also includes mapping of funding opportunities. For many projects or businesses, blending of funds is considered the best option, combining private sector financing, budgetary funds, grants and loans. Many projects and businesses that complete the acceleration process became attractive for commercial or IFI loans. For projects with proven social or environmental impacts, alternative financing instruments, such as crowdfunding, can also be an option.

The innovative ideas and solutions selected in the Innovation Challenge usually require additional co-financing support in order to attract other sources of funding. Co-financing for such initiatives is conditional and can be secured in the form of Performance-Based Payment Agreements (PBPAs), which are part of the Innovation Challenge program. They constitute a partnership agreement between UNDP and the responsible party (e.g., a public or private enterprise), accompanied by the project document with clearly specified results, activities and indicators/milestones. Payments according to the PBPAs are made in tranches triggered by the successful achievement of agreed indicators/milestones.

Through the Innovation Challenge, UNDP has supported 11 climate-smart investment projects and businesses since 2019. The program mobilized private sector investments and commercial borrowing worth USD 12 million, with only USD 700,000 of seed grant funding. In addition, the initiative has created multiple environmental and economic benefits, including significant GHG emissions reductions.

The Green for Growth Fund: Providing Technical Assistance to MSMEs in Serbia

The Green for Growth Fund (GGF) is an impact investment fund established in 2009 by EIB and KfW with the task to reduce energy consumption, resource use and CO2 emissions in South Eastern Europe, the Middle East and North Africa. In the past, GGF's clients in Serbia were dominantly MSMEs (54%) in partnership with financial institutions (FIs), benefiting from targeted technical assistance. To date 35 technical assistance projects have been implemented (or are under implementation) with a budget of EUR 1.5 million. Key areas of intervention in relation to MSMEs in Serbia include:

- Impact analysis & holistic energy audits – Impact assessments of FI clients' investments to verify eligibility for GGF financing and measure the impact achieved. Holistic energy audits to provide FI clients with suggestions for potential green investments to achieve energy efficiency and/or reduce CO2 emissions in their operations.
- Environmental & social risk assessments – Contribution to adequate E&S risk management practices for FI's end-borrowers. Support to FIs to conduct E&S assessments and due diligence of end-borrowers and their projects.
- Awareness raising campaigns – Increasing end-borrowers awareness for green products and practices, focusing among others on MSME clients.
- Energy efficiency/renewable energy workshops – Promotion of green investment opportunities among FI's existing and potential clients and introduction to local green product/solutions providers. For example, GGF held a workshop on EE finance in the agricultural sector with the Association of Serbian Banks.
- Market studies – Sector or topic-specific relevant studies, to get a better understanding of market status, trends and potentials for green investments. For example, a study on water, waste and resource management technologies was conducted for an FI, to promote resource efficient technologies and practices among its clients, with a focus on MSMEs.

Annex: Methodology

The results presented in this report are based on both quantitative and qualitative methods. In an effort to collect representative quantitative data, an online survey has been conducted among Serbian MSMEs. This data has been used to draw general conclusions regarding the demand side of green finance. This quantitative approach has been complemented with online interviews aimed at collecting qualitative information from the supply side of green finance (commercial banks and IFIs) and gaining more in-depth insights about MSME views that could not be obtained by the surveys.

Survey and interviews were conducted between September 2020 and February 2021 in cooperation between the EU Delegation to Serbia and the UNDP Office in Serbia.

Quantitative approach – A survey among Serbian MSMEs

The majority of research data on the demand side was collected by means of a survey, which was implemented by the Chamber of Commerce and Industry of Serbia.

The aim of the survey was to collect a wide range of data from green SMEs in pursuit for answers to the following questions:

- Appetite among MSMEs for green investments,
- Barriers for green investments,
- Preferences of MSMEs for green incentives and loan conditions, and
- Awareness of relevant EU legislation.

The first part of the questionnaire covered basic generic questions. The second section consisted of 5-point Likert scale questions regarding the respondent's attitude towards green investments (energy efficiency, renewable energy, waste management and circular economy). The third part of the survey focused on preferences regarding incentives and access to finance, while the fourth section focused on questions about the respondent's familiarity with relevant EU strategies and regulations. In total, the questionnaire comprised of 64 questions.

The questionnaire, originally developed in English, was translated into Serbian and then translated back into English by a second party in order to prove the accuracy of the translation.

The final version of the questionnaire was distributed by the Chamber of Commerce based on the classification of SME business activity. Data collection was done online. A total of 146 companies completed and returned the questionnaire between 21-29 September 2020.

Qualitative approach – Online interviews

The second part of the research consisted of a series of online interviews, conducted by UNDP, with the aim to get more qualitative information about the challenges and opportunities related to Serbian MSMEs' green investments.

Interviews were conducted with:

- Twelve MSMEs with green business models and long experience with green investments, selected from UNDP's database of green MSMEs. These interviews were conducted between 7-18 September 2020 and 15-19 February 2021.
- Seven commercial banks operating on the Serbian market, including (in alphabetical order) Banca Intesa, Erste Bank, Komercijalna banka, Procredit Bank, Sberbank, Unicredit Bank and Vojvodjanska banka. These interviews were conducted from 5-7 October 2020 based on a questionnaire with 15 questions on sustainable banking in Serbia.
- Four multilateral and bilateral IFIs, including the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), International Finance Corporation (IFC, member of the World Bank Group), and the German KfW promotional bank, as well as with the country office of the International Monetary Fund (IMF) in Serbia. These interviews were conducted from 12-16 October 2020.
- Fiscal Council of the Republic of Serbia, conducted on 01 October 2020.
- Chamber of Commerce and Industry of Serbia (Department for Circular economy and Department for Economic Support Programmes and SMEs), conducted on 18 February 2021.

All interviews were conducted online (via Zoom) in Serbian, recorded, transcribed and translated into English afterwards.

Ethics

All research participants received all relevant information regarding the research objectives, data collection, processing and presentation prior to their participation. Participants were made aware of the reasons why they were selected and confidentiality was agreed to avoid allocating individual statements to individual business entities. Participants were invited to contact the research team directly in case they had any additional questions regarding the research and their participation in it. In this way, all participants were provided with a maximum of transparency and information in order to freely decide whether to participate in the research or not.

Lead Author

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Dr Arno Behrens is an independent International Sustainability Adviser consulting international organizations on environmental policies with particular focus on circular economy, climate change, energy transition and green recovery. Currently working as international consultant at the World Bank's Global Practice on Environment, Natural Resources and Blue Economy, Arno is also the lead author of the UNDP Study on "Scaling-Up Green Finance for the Private Sector in Serbia in the Post-Pandemic World". Previously, Arno worked for the OSCE, UNIDO, the European Commission and the German Federal Foreign Office. For over 10 years, he worked as Head of Energy and Sustainable Resources at the Centre for European Policy Studies (CEPS) in Brussels, Belgium. He is also visiting professor on EU environment and energy policy at LUISS University in Rome, Italy. Arno holds a PhD in environmental economics.

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Mr Vladimir Krušković

Mr. Vladimir Kruskovic has seventeen years of development advisory practice out of which twelve were spent in sustainable finance development facilities. As of 2009, he has been working in projects developing energy efficiency and renewable energies in both private and public sectors (techno-economic modelling and selection of the most appropriate financing instruments). He has extensive knowledge of bank procedures for energy efficiency and renewable energy project assessment, and of the design, implementation, management and monitoring of financial sector projects. He has been involved in IFI advisory programs in the Southeast Europe, the Middle East and the Caucasus. In 2014, he took part in the preparation of the Third National Energy Efficiency Action Plan (NEEAP) for the Republic of Serbia, an in-depth policy research and a complete overview of the domestic developments in the field, including harmonization of practices with EU best standards. As of 2018, Mr.Kruskovic is a consultant with EBRD's Western Balkan Green Economy Financing Facility (GEFF – Residential), program designed to promote improvements in the area of energy efficiency in the national residential sector. Mr.Kruskovic holds a Bachelor's degree in Management received at the Faculty of Organizational Sciences, University of Belgrade. Speaks English and German.

Mr Zoran Pavlović

Mr Zoran Pavlović is an experienced Senior Corporate Banker with demonstrated history of working in the banking industry. Engaged as independent consultant and owner of consultancy company Prudent Capital since 2018, with main focus on Financial Consulting of corporate clients in the area of Banking, Investments, Project Financing-Renewable and Real estate projects, Sales Management, Company Development and Improvement. Prior to this Zoran Pavlović had been working in the banking industry for a period of 14 years. Starting from 2012 until 2018 Zoran Pavlovic had been engaged as a Head of SME and Project Finance Department in Sberbank Srbija, responsible for the organization, planning and performance of all activities within the Department (cooperating with all legal entities with turnover between 1 and 50 EUR million, including domestic and international clients as well as project finance (real estate and renewable energy projects) and clients within public sector). Within a period 2005-2012 Zoran had been working in Volksbank Serbia as a Corporate Relationship Manager (2005-2009) and Deputy Head of Corporate Department (2009-2012). Zoran has a Bachelor of Education focused in Finance, Banking and Insurance from the Faculty of Economics, Belgrade University, Serbia. Speaks fluent English and has basic knowledge of Russian.

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Žarko Petrović is the team Leader of the Resilient Development Cluster in UNDP Serbia since 2016. This Cluster combines Nature, Climate, Energy and Resilience issues, as well as support to the Government of Serbia in implementing complex and granular development projects and support to Government's cooperation with international finance institutions (IFIs). Prior to this post Žarko managed UNDP recovery and disaster risk reduction projects in UNDP Serbia, focusing on recovery post 2014 floods and the managing the consequences of the migration wave 2016-2015 period, and, before that, he worked on governance issues in 2014-2012 period. Before UNDP, Žarko worked on international scene on conflict and security issues (for EU in Kyrgyzstan and Central Asia 2011-2010 and for OSCE in Georgia/South Ossetia 2009-2008 and for UN Peacekeeping in Georgia/Abkhazia 2008-2007). Žarko started his career in his native Serbia, as a practicing attorney-at-law, working primarily on human rights cases in early 2000s. Žarko is a lawyer by education and holds MSt in International Human Rights Law from Oxford University, UK and is a graduate of the Diplomatic Academy of the Serbian Ministry of Foreign Affairs. Speaks fluently English and Russian and has basic knowledge of German.

Mr Antoine Avignon

Antoine Avignon was born in Paris, France, in 1975, and spent part of his childhood in the Alps, where he learnt about the Alpine fauna and flora, before moving to Toulouse, where his passion for cooperation and development continued to grow. In 2003, he moved to work with the European Union in Africa on large portfolio of infrastructures, water supply/sanitation and wildlife conservation. He co-founded in 2013 the first Environmental Film Festival in Albania (EFFA) to support environmental awareness and young filmmakers. Since 2017 based in Belgrade, Antoine works at the European Union Delegation to Serbia in charge of the environment and climate action portfolio.

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Stevan Pechitch is a French economist and lawyer (with degrees from the ESCP Europe business school and the Pantheon-Assas University in Paris). Stevan has more than fifteen years of professional experience in project management, in particular of EU pre accession projects. His track record includes managerial positions in large projects including as project manager of the IPA funded project “EU for better environment” supporting alignment of the Serbian strategic, institutional and implementation framework with the part of the EU Environmental acquis related to the Air, Chemicals and Horizontal sectors.

Mr Slobodan Perović

Slobodan Perović is consultant in the area of environment and engineering with experience in international development projects. Prior to this Slobodan managed Sector for Strategic Planning and Projects, of the Ministry of Environmental Protection from 2017 to 2020 in the capacity of Assistant Minister, working on accession driven investment planning in the field of environment, circular economy and management of IPA funds. Before MEP, Slobodan worked as development expert with the Continental Wind Partners for six years, developing Serbia largest wind farm, assuming roles in managing technical and environmental side of project development, financing and procurement. Slobodan experience also includes work on USAID disaster risk reduction projects in Serbia from 2006 to 2011, focusing on institutional reform in the field of emergency management at local and national level and managing the consequences of the natural and man-made disasters. Slobodan started his career in Serbia, as a teaching assistant at University of Belgrade in 1998, local councilor and spokesperson to City Council in early 2000s and National Democratic Institute (US) regional trainer from 2003 on. Slobodan is a engineer by education, holds MSc in Petrology and Geochemistry from Belgrade University, Serbia and is an alumni and Steering Committee member of the Petnica Science Center. Speaks fluently English and has basic knowledge of German and French.

