

Financing Energy Efficiency Projects for SMEs

**UNEP Workshop: Corporate Social
Responsibility & Sustainable reporting**

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SMEs In India

- Industries with investment upto Rs 10 Crores in Plant & Machinery are classified as Small & Medium Enterprises (SME).
- **SMEs contribute significantly towards country's economy and exports.**
- Indian banks have substantial exposure to the SME segment.
- **Growth and sustained profitability of SMEs strengthen the asset quality of the Banks in the long run.**
- Generally, SMEs have weaker capital base and limited resources, making them susceptible to external / internal business shocks

Business Profitability

- Underlined purpose for setting up any business unit is to earn (and also improve on) profit / surplus on a continuing basis
- Profit = Income – Expenses
 - Income = Sales Price X Quantity sold
 - Expenses = Fixed Expenses + Variable Expenses
- In a competitive economy,
 - Increase sales price – very difficult
 - Decrease fixed expenses – difficult
 - Increase quantity sold – possible but needs effort
 - Decrease variable cost – not easy but possible through increased efficiency and waste minimisation

Increase Profitability

- “Savings from improved efficiency/ cost reduction/ waste minimisation” is a superior alternative to “additional revenue” for improving profitability.
- Popular targets for improving profitability are:
 - Request lenders to reduce interest rates and bank charges
 - Initiate austerity measures
 - Cut input costs

**DO ALL THESE & SOME MORE
BUT
THERE IS NO SUBSTITUTE FOR IMPROVING EFFICIENCY**

- **Energy efficiency** improves profitability of SMEs in short, medium and long term and helps all stakeholders



Energy Efficiency

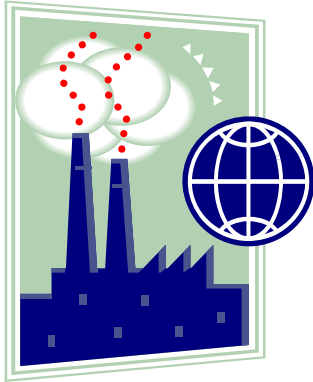
“Energy Efficiency” means use of less energy for achieving the same or better output.



Energy Efficiency Project

thus involve measures leading to savings of energy for performing same or better output, ensuring that the expected financial benefits (i.e. energy savings, expressed in monetary terms) over a reasonable period would be adequate to justify investment.

INDUSTRY



**ENERGY
EFFICIENCY
PROJECT**

BUILDING



NEW PROJECTS

Dovetail EE concepts / technologies at the design stage itself.

EXISTING ESTABLISHMENTS

Energy inefficient areas are to be identified and techno-economic feasibility of improving EE of each is to be examined.



An Investment Grade EE Project

is one where the project promoter would be enthused to make fresh investment in the hope of earning surplus out of savings from cost of energy on sustainable basis.

Investment decisions

in an industry have to be made by the promoters based on their conviction and confidence on the success of the projects, particularly in terms of expected financial benefits over a reasonable period in future.

Bankable EE Project

- *The EE Project should be investment grade.*
- *The promoter must have ownership of the project*
- *Complete techno-economic feasibility (TEF) of the project should be examined. DPR incorporates examination of TEF of the EE project.*
- *TEF of each of the sub-projects to be examined separately to facilitate decision making.*
- *Investment grade / Bankable project (basically combination of a few selected sub-projects) is judged on the basis of TEF as outlined in DPR and not on Simple pay back period which is only indicative*

Project Reports for E.E Project

- *Detailed Project Report (DPR) is required for*
 - Investment decision*
 - Financing decision*
- *DPR should be comprehensive to establish viability / bankability*

DPR Contents of EE Projects

- ❖ **Line of activity – Energy intensiveness of the establishment**
- ❖ **Total energy consumption**
- ❖ **Activity-wise breakup of different forms of energy consumption**
- ❖ **Energy Audit report – Sub-project wise – with scope / potential for savings of energy. “Simple pay back” period of each of the Sub-projects**
- ❖ **Detailed “Technical Proposals” for improvement of “Energy Efficiency” – Sub-project wise**

Components of EE Projects

■ Components

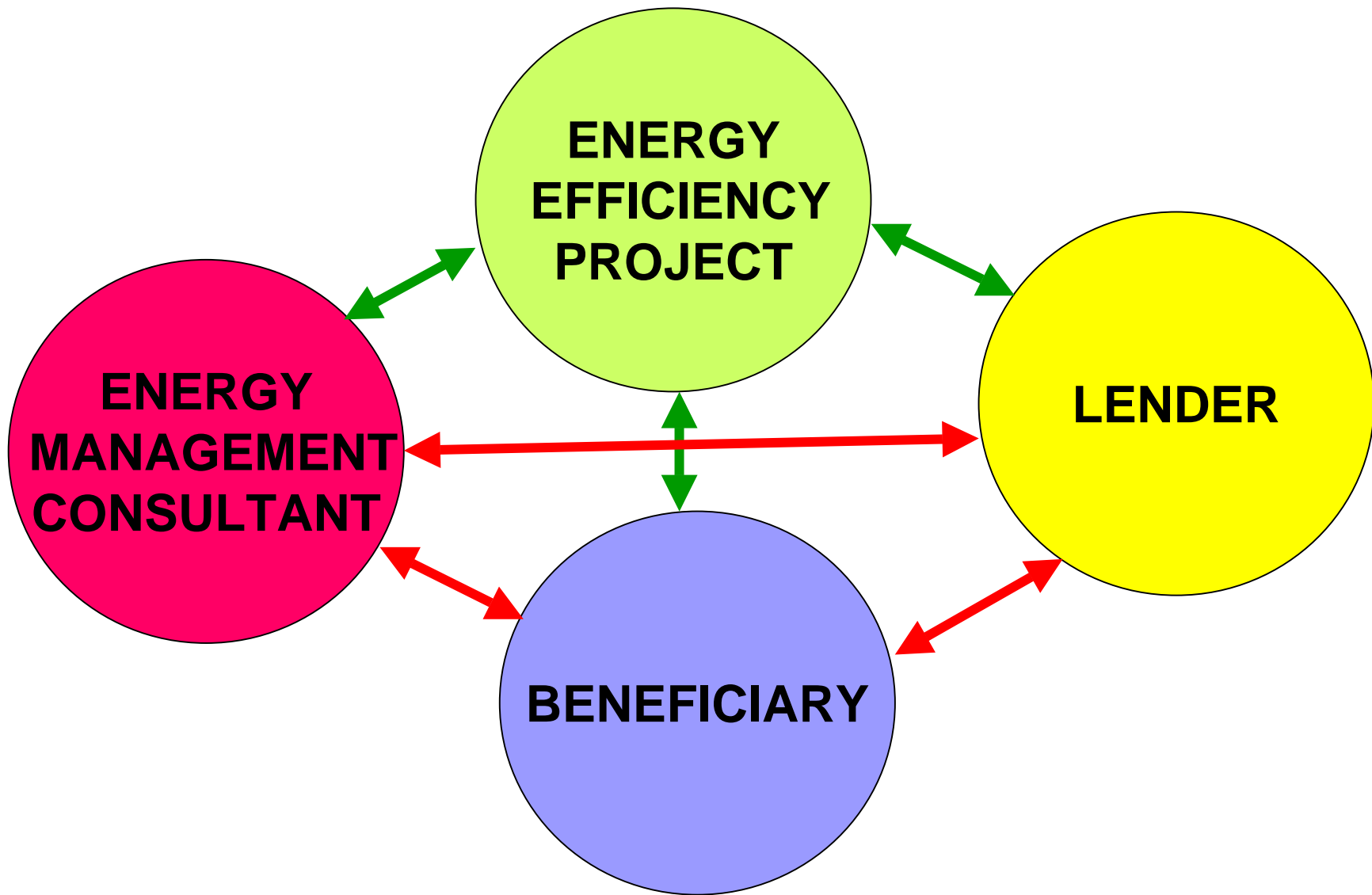
- Short term – immediate implementation, low cost, short pay back period
- Medium term – low to medium cost and pay back period
- Long term – tailor made designs, medium to high cost, comparatively longer pay back period

■ Funding options

- Usually implemented from own funds – no Bank loan required
- Often implemented from own funds – Bank loan not requested
- Bank / External funding required

Financing EE Projects

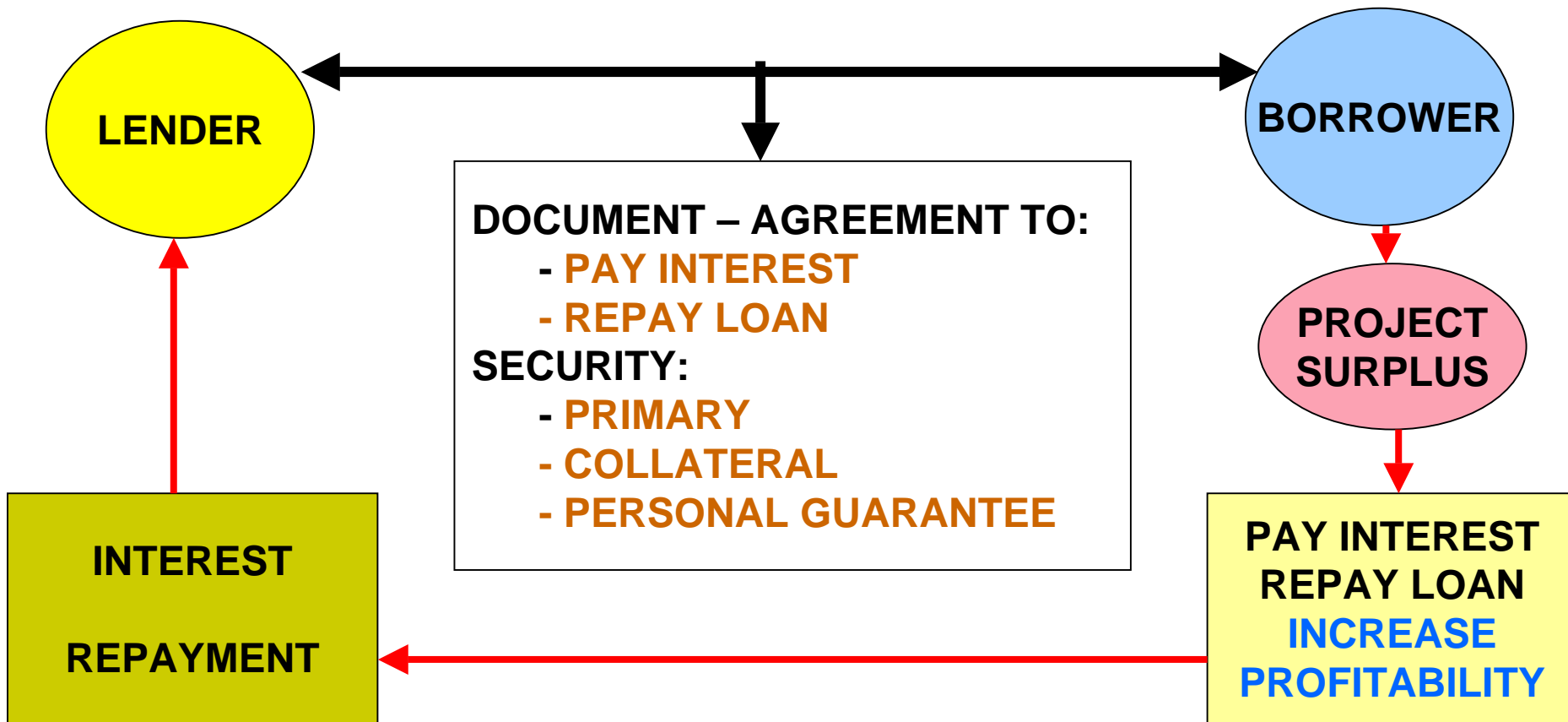
- *Financing an EE project is similar to financing any other project.*
- *From lender's point of view, EE project is easier than financing new green-field projects where techno-managerial uncertainties are more and project viability is based upon assumptions.*



Financing EE Projects

- **What a lender looks for is:**
 - a **credit-worthy** borrower
 - a **well documented** DPR
 - a **viable** project

Principles of lending



Financing EE Projects – lenders approach

- ***Background and past financials of the borrower.***
- ***Present lenders / bankers to the borrower?***
- ***Securities are held by existing lenders / bankers?***
- ***Security to be offered to the lender for the EE project?***
- ***Risk perception, evaluation and mitigation. Sensitivity to various variable factors***
- ***Credibility / track record of the EE Consultant***

Appraisal Tools for Lenders

- *Debt – Equity Ratio*
- *Tangible Asset Coverage Ratio*
- *Security Margin*
- *Repayment Period*
- *Debt Service Coverage Ratio (DSCR)*
- *Internal Rate of Return (IRR)*

SMEs & E E LENDING

- **SMEs may not require large investment for improving “Energy Efficiency”**
- **SMEs prefer to fund “LOW COST” sub-projects internally and do not approach Banks for the same**
- **Quality of Energy Audit reports need transparency and improvement. Often conceptual reports are submitted without customised solutions/ detailed specs.**
- **Loan is not a barrier for implementing EE projects. Many EE projects are being financed with expansion / modernisation / diversification projects of SMEs under Banks’ existing schemes**
- **Need to bridge the ‘Credibility Gap’ among ESCOs / EE Consultants and SME Entrepreneurs. Once convinced about EE’s contribution to bottom line, entrepreneurs would invest with / without bank loans**

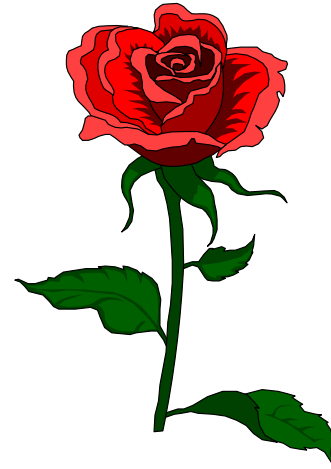
Promoting EE to SMEs

- During the past few years, following 5 leading Commercial Banks of India have evolved **“Special Schemes for EE lending to SMEs”**:
 - State Bank of India
 - Canara Bank
 - Union Bank of India
 - Bank of India
 - Bank of Baroda

SBI Project Uptech – Energy efficiency

- *Launched in 2004*
- *Objective*
 - *To motivate and support “Energy Efficiency” measures in SMEs to enhance competitiveness among SBI’s clients with sole banking arrangements.*
- *Partial (50%, maximum Rs 50,000) subsidy towards cost of Energy Audit & DPR preparation*
- *Term Loan for 90% of the cost of the project at **concessional** interest rate.*

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THANK YOU