OECD

FINANCING SMEs FOR SUSTAINABILITY

Financing SMEs for sustainability – Financial institution strategies and approaches

Results of an OECD survey of public and private financial institutions

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The series provides comparative evidence and analysis on SME and entrepreneurship performance and trends and on a broad range of policy areas, including SME financing, innovation, productivity, skills, internationalisation, and others. This paper was authorised for publication by Lamia Kamal-Chaoui, Director, Centre for Entrepreneurship, SMEs, Regions and Cities, OECD. This document, as well as any statistical data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

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This publication was written by Marija Kuzmanovic (Policy Analyst, CFE) under the supervision of Lucia Cusmano (Acting Head of Division, CFE) and Miriam Koreen (Senior Counsellor and Head of Unit, CFE). The report and the survey implementation also benefitted from research and technical contributions from Bumjune Kim (Policy Analyst, CFE), Camila Jimenez (Junior Policy Analyst, CFE), and Hans Robinson Koger and Monserrat Magaña Ocaña (Interns, CFE).

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With the support of:

Introduction

Finance is a critical catalyst for the net-zero transition of small and medium-sized enterprises (SMEs), which account for about 40% of the aggregate GHG emissions of the business sector (OECD, 2023[1]). It enables SMEs to invest in adopting greener business practices. It also helps entrepreneurs and start-ups to develop and bring to market new green solutions to help societies address the climate crisis.

Yet, access to finance is one of the most important constraints that SMEs face in the transition to net-zero. In a 2023 survey, 48% of SMEs identified a lack of funding as a key obstacle to climate action. Nearly 70% stated that they need additional funds to take climate action or accelerate their progress on emissions reductions (SME Climate Hub, 2023[3]).

To achieve the net-zero transition of the business sector and its millions of SMEs, banks and other financial institutions need to systematically integrate climate considerations in key operational aspects, including, among others, strategy, financing decisions and risk management. This, in turn, requires the development of new internal capacities, employment of new internal processes and technological solutions, and deployment of new financial and non-financial solutions to the market. It also calls for access to currently scarce sustainability-related data and assessments of SME clients.

In 2023, the OECD Platform on Financing SMEs for Sustainability (see page 5) undertook a survey of public and private financial institutions to understand their current approaches and plans with regard to the integration of climate considerations in their SME operations. The survey included 39 multiple choice questions and 25 open-ended questions covering a range of issues related to sustainable finance for small businesses, including:

- Net-zero targets and transition plans at institutional level.
- Integration of climate considerations in SME operations.
- Climate-related data requirements from SMEs.
- Provision of financing for SMEs' net-zero investments (e.g. through dedicated green and sustainable financing instruments).
- Provision of non-financial support to help SMEs understand, measure and report on their climate/environmental footprint.

21 public development banks and 46 private financial institutions responded to the survey. 42 of the respondents were European, 6 were from North America, 10 from Central and South America, 7 from Asia and 2 from Africa.

Responding institutions included a mix of large and medium-sized banks, guarantee institutions and smaller and/or more specialised financing providers. 17 of the surveyed institutions had assets of over EUR 100 billion, 31 had assets of between EUR 10 billion to 100 billion, and 18 institutions had assets of less than EUR 10 billion.

This note presents key results of the survey. It provides a baseline for monitoring the future progress of financial institutions in integrating climate in SME operations.

OECD Platform on Financing SMEs for Sustainability

FINANCING SMEs FOR SUSTAINABILITY

The OECD Platform on Financing SMEs for Sustainability provides a forum for global collaboration, knowledge sharing and implementation of good practices among public and private financial institutions, policy makers and SME representatives to enhance the provision and uptake of SME sustainable finance for a successful climate transition.

The Platform is hosted by the OECD Centre for Entrepreneurship, SMEs, Regions and Cities, a global reference in the area of SME and entrepreneurship data, policy analysis and dialogue. Its current members include the British Business Bank, the Business Development Bank of Canada, Bpifrance and the Industrial Bank of Korea. The Platform's knowledge partners include the Association of European Guarantee Institutions (AECM), Bankers for Net-zero, the European Banking Federation (EBF), the SME Climate Hub and the Montreal Group.

Key findings

Strategies, targets, transition plans and climate integration in operations

- Most financial institutions have sustainability strategies . However, nearly half of public and private financial institutions have neither developed specific emissions reduction targets nor transition plans outlining concrete actions to reach them. The development of targets and transition plans is constrained by limited data, methodologies and expertise related to measuring current and future emissions.

- Most financial institutions have taken steps to integrate climate considerations in their operations. Over 60% of financial institutions consider climate implications when developing broad strategies and business plans (e.g. plans for financing, risk management, marketing, human resources, etc). Nearly half set climate-related criteria for their suppliers. 66% of institutions also assess the climate-related impacts of some or all financing/investment decisions.

- Key drivers for net-zero action in financial institutions include regulatory requirements, the implications of climate action/inaction for long-term financial and operational performance, and demand from various internal and external stakeholders, including shareholders and clients.

- Key constraints for net-zero action include the lack of data and limited internal capacities, expertise and assessment frameworks. Access to data on SME clients' sustainability performance stands out as a critical constraint, identified by over 80% of financial institutions.

- To address existing constraints, financial institutions are investing in management and employee training, seeking external advice, providing incentives and strengthening internal awareness, knowledge and skills on climate-related topics. They are also setting up internal frameworks and methodologies for measurement, analysis and reporting; devising strategies to diversify data collection sources and improve data quality, including through digital solutions; strengthening client engagement, including through non-financial support; and engaging with other financial institutions to share knowledge and solutions.

Financing instruments and non-financial support for SME clients

- The majority of financial institutions already offer green and sustainable financing instruments . On the other hand, sustainability-linked instruments and transition finance , are more nascent and offered by fewer than 50% of financial institutions.

- Most of the financing for SMEs' net-zero investments is provided through debt instruments: medium- and long-term loans (over 80% of public and 65% of private banks) and short-term loans and factoring (43% of public and 35% of private banks). 67% of public banks use guarantees to mobilise private financing for SMEs' net-zero investments.

- Most public and private financial institutions provide non-financial support to help SME clients build capacities to measure, report and take action on climate-change and net-zero. Support is provided through workshops, consulting services, training, tools and other means.

Sustainability-related data requirements from SME clients

- Financial institutions already seek sustainability-related data from SME clients. About 60% of public and private financial institutions get these data directly from clients. Approximately 40% of public and 25% of private financial institutions also use intermediaries, such as other financial institutions, or ESG data or rating providers. Furthermore, the vast majority of financial institutions that currently do not ask for any granular data from their SME clients plan to introduce such requirements in the short to medium term.

- Sustainability-related data requirements differ depending on the size and sector of the financing recipient, the type of investment and the type of financing instrument.

- Importantly, there is no common approach among financial institutions in the type of data and information they seek from SME clients, either at the stage of assessment of the financing opportunity or during the monitoring phase. Some of the surveyed financial institutions use pre-defined frameworks (e.g. ESG ratings), while others use or are still developing their own assessment/reporting frameworks. In this context, SMEs face a multitude of data requirements, which increases their reporting burden and acts as an additional barrier to finance. This is notwithstanding the fact that many SMEs, particularly micro-firms, may already be operating at net-zero, but may not be able to report on their performance.

Financing SMEs for sustainability - Financial institution strategies and approaches

Strategies, targets and transition plans

Of the 67 financial institutions surveyed, most have sustainability strategies . However, nearly half do not yet have specific emissions-reduction targets or transition plans outlining concrete actions to reach them.

Financial institutions' climate-related strategic documents

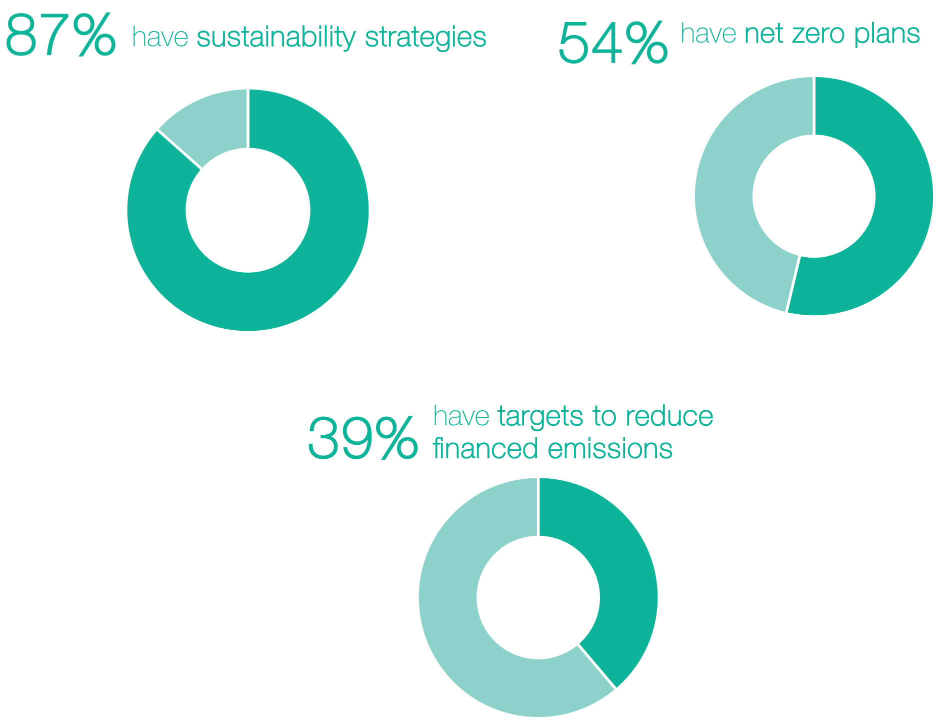
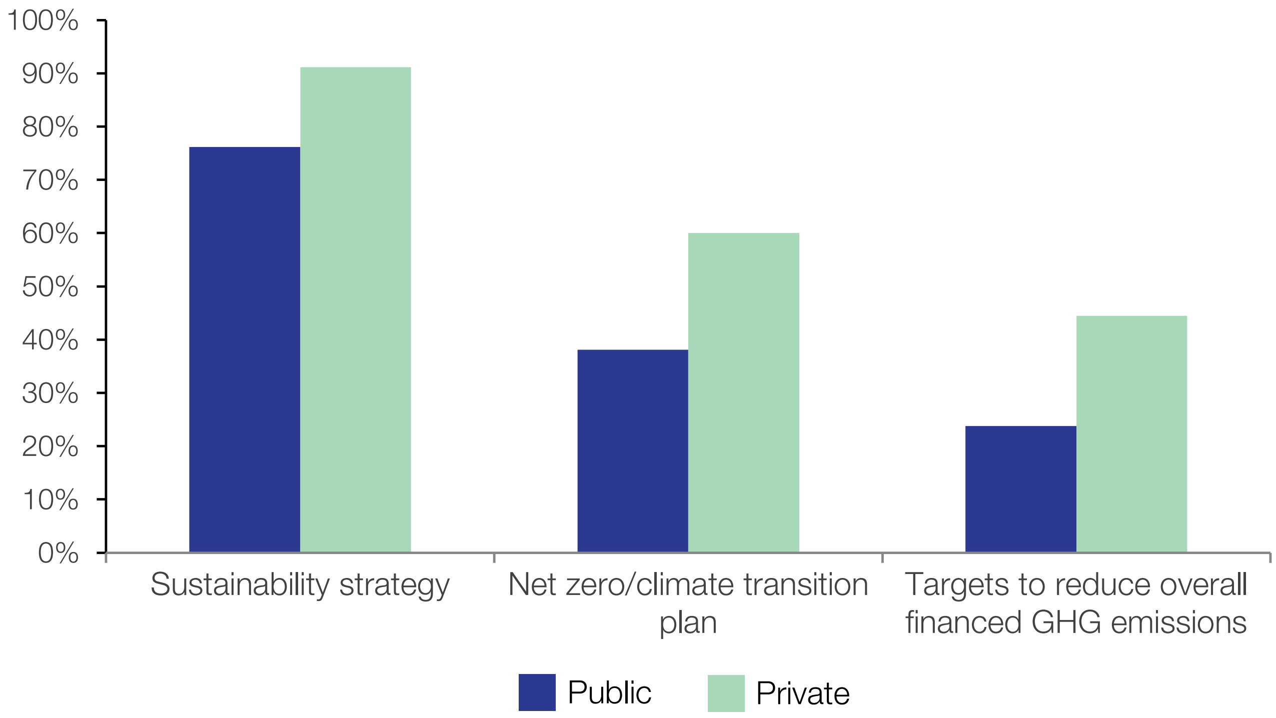
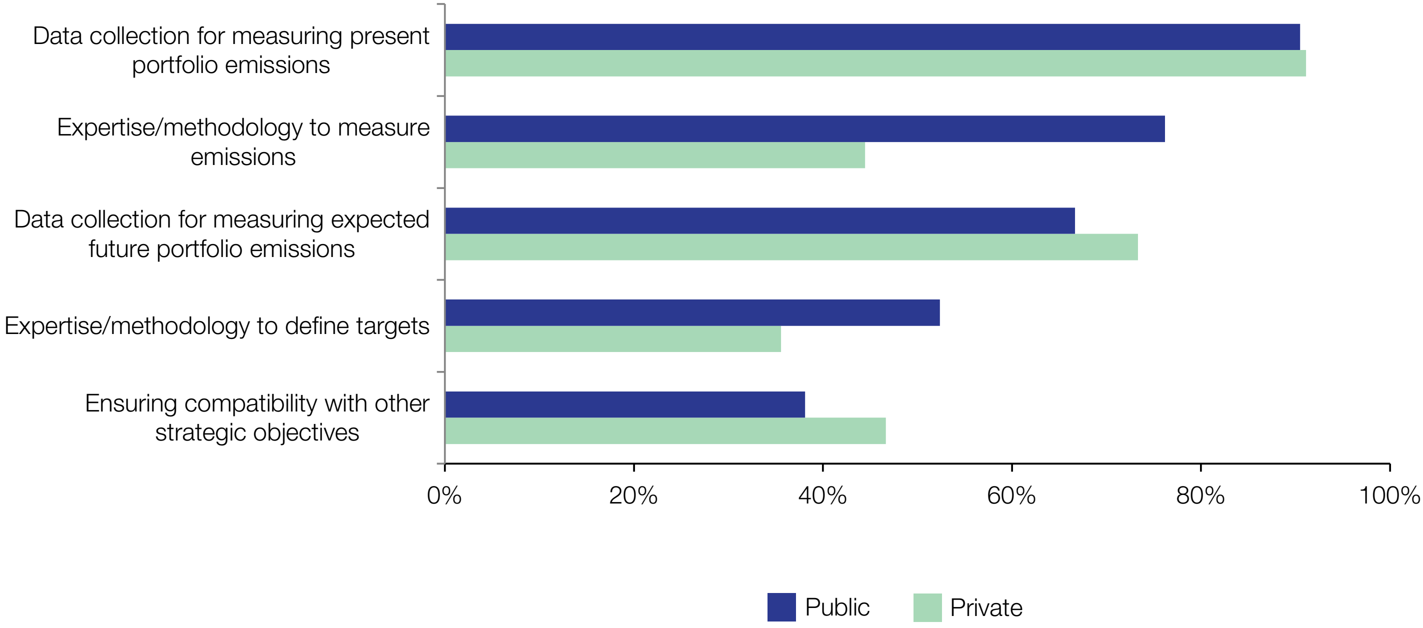


Figure 1. What types of sustainability-related strategic documents and targets does your institution have in place?
(% of respondents, multiple answers possible)



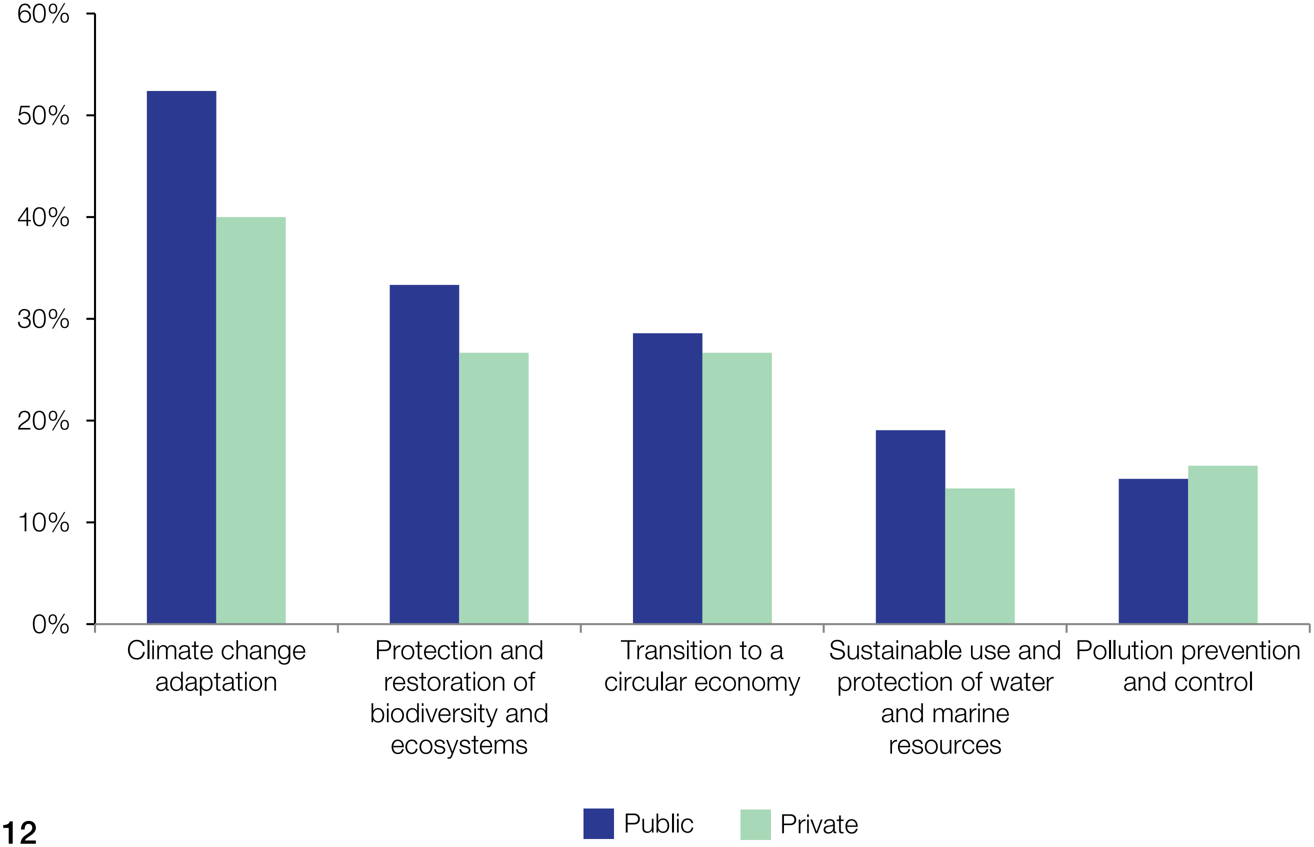
The development of targets and transition plans is constrained by limited data pertaining to current and future portfolio emissions, limited expertise and methodological challenges for defining targets and measuring emissions. Expertise and methodological barriers are a particular challenge for public institutions: 3/4 of public financial institutions cited these as barriers for measuring emissions and defining targets.

Figure 2. In your view, what are the key challenges in setting emissions targets? (% of respondents)



Climate-change mitigation and net-zero are the main focus of financial institutions' environment-related strategies. Comparatively fewer financial institutions have developed strategies and targets on climate-change adaptation, biodiversity, transition to circular economy and other environmental themes.

Figure 3. Does your institution have strategies and/or targets related to its performance on the following environmental sustainability considerations? (% of respondents, multiple answers possible)



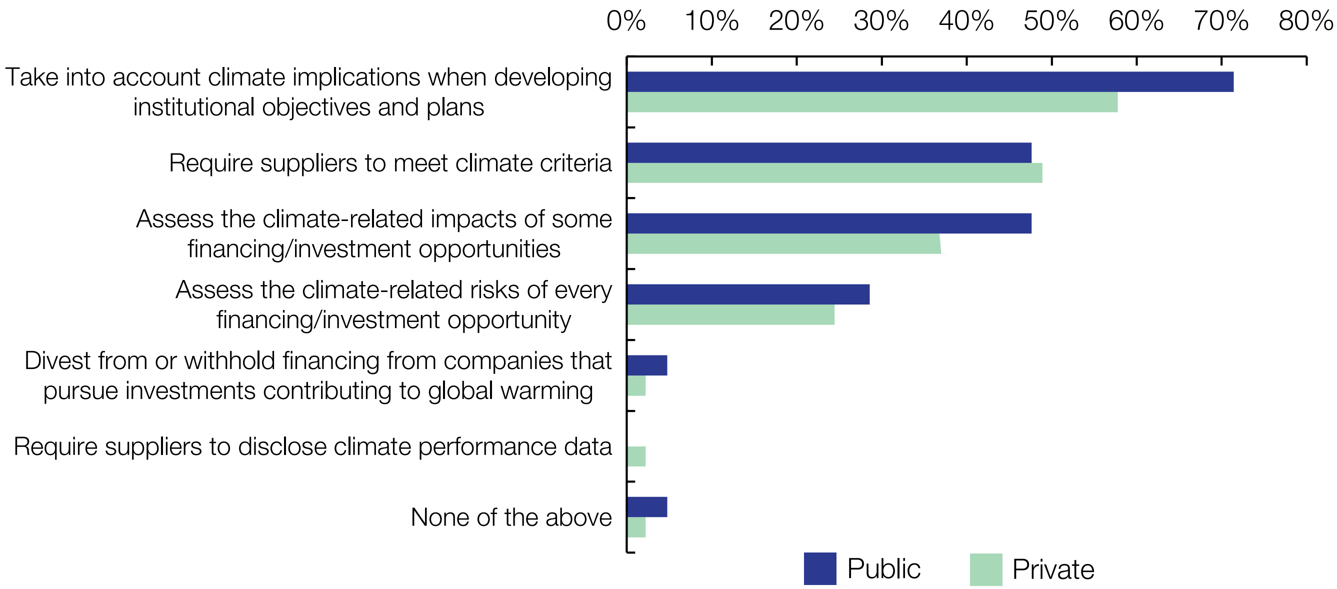
Climate considerations in operations

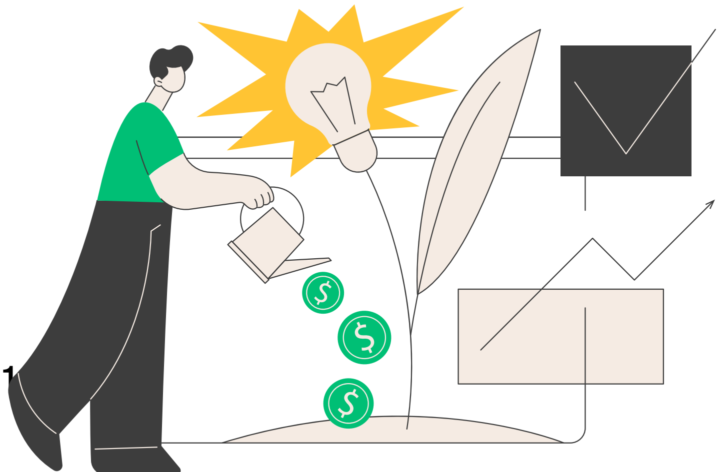
Financial institutions are taking steps toward integrating climate considerations in their SME and overall operations. Over 60% of financial institutions consider climate implications when developing strategies and business plans, and nearly half of both public and private financial institutions set climate-related criteria for their suppliers. Over 75% of public and 60% of private financial institutions also assess the climate-related impacts of some or all of their financing/investment decisions.

Financial institutions assessing the climate related impact of some or all financing decisions

66% of institutions assess the climate related impact of some or all financing decisions.

Figure 4. How (if at all) does your institution integrate climate considerations in its financing/ investment decisions? (% of respondents, multiple answers possible)





Financial institutions are also taking steps towards strengthening managerial incentives for integration of climate considerations in strategies and operations. For example, climate risks are regularly reviewed at executive board meetings in 62% of public and 77% of private financial institutions. However, more progress is needed to link executive compensation and incentives to climate-related outcomes: fewer than 30% of financial institutions link executive pay with climate-related outcomes across all executive roles. Yet studies have shown that firms that include sustainability-specific metrics in executive compensation are more likely to meet their sustainability benchmarks (Stanford Review, 2023[4]).

Figure 5. Are climate-related risks reviewed regularly at Executive Committee or Board of Director meetings? (% of respondents)

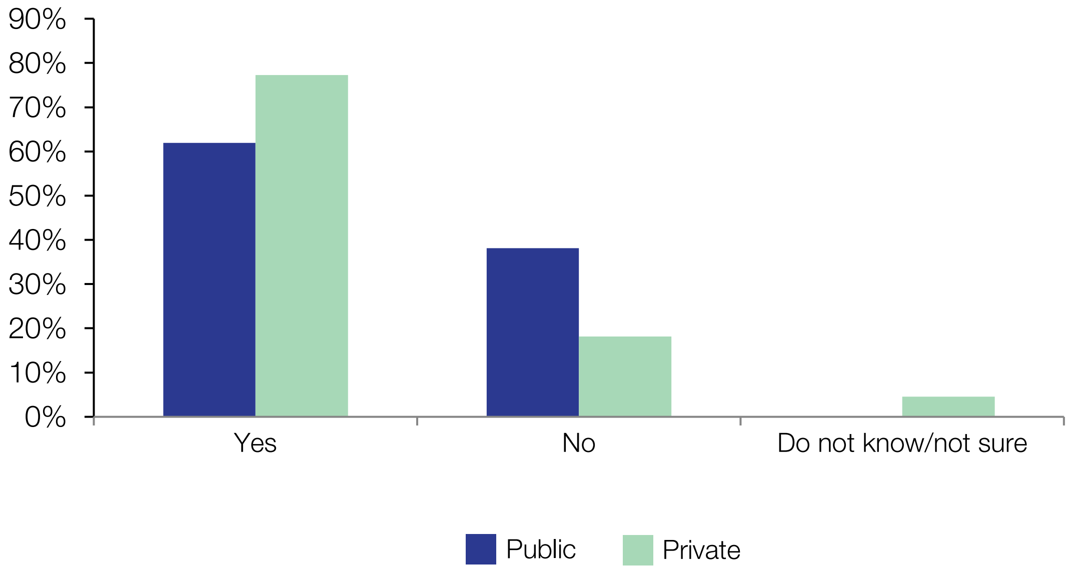
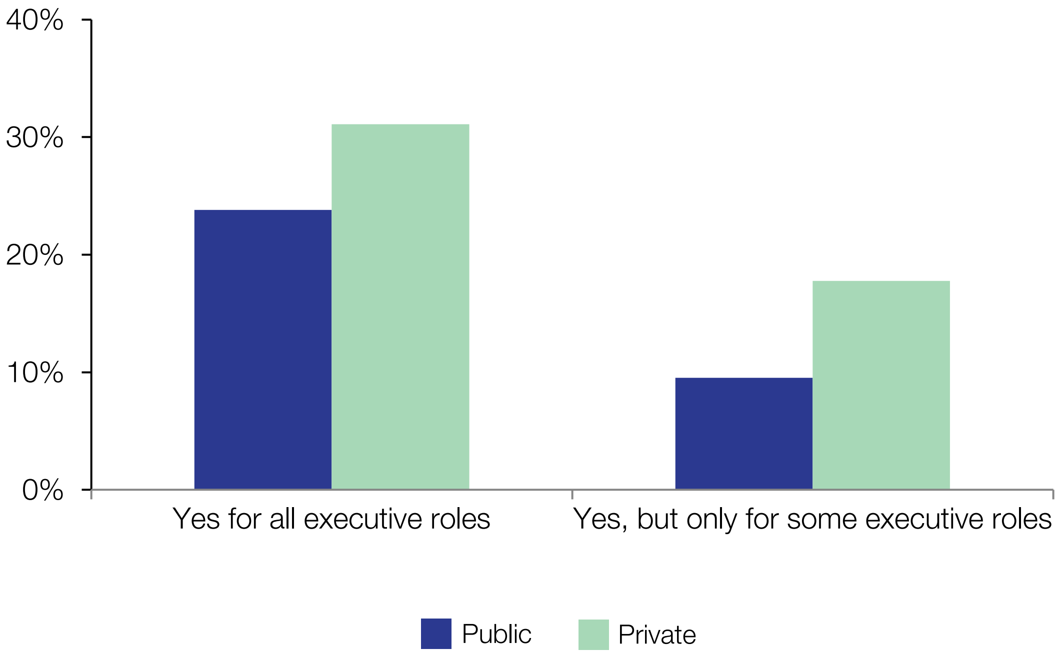
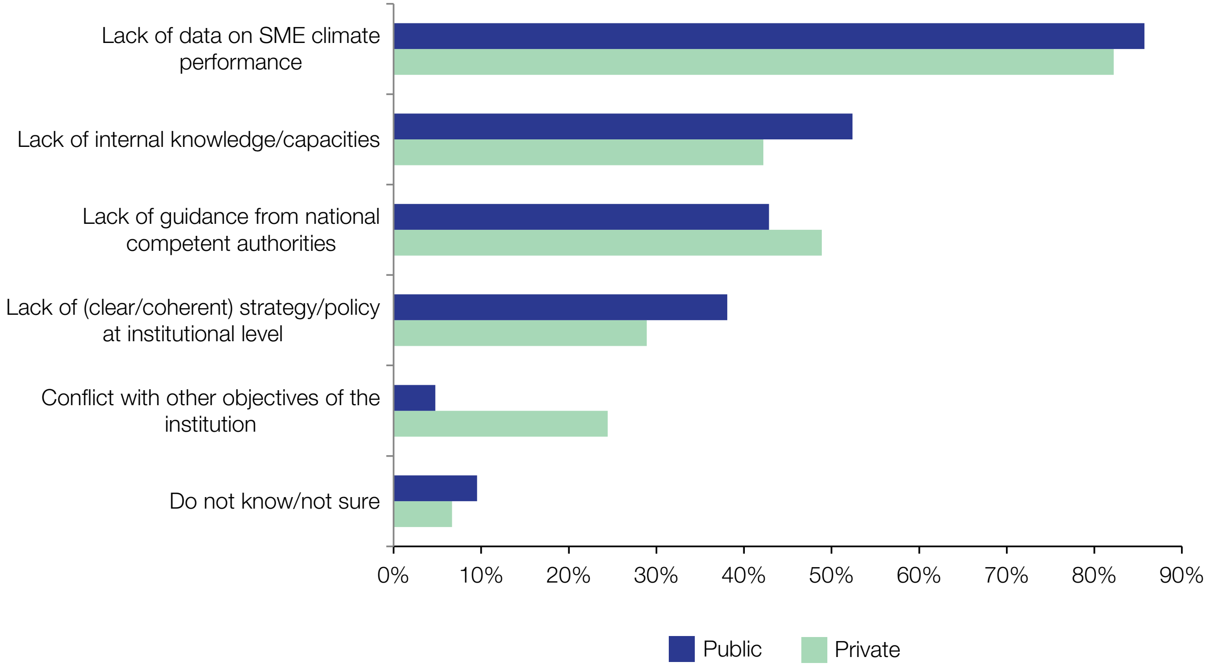


Figure 6. Are executive compensation and managerial incentives linked to climate-related outcomes? (% of respondents)



Lack of data, capacities, guidance and methodological frameworks are key obstacles to further integration of climate issues in SME operations. The lack of data on SME climate performance stands out as a major constraint: over 80% of public and private financial institutions identify this as a key challenge, compared to about 50% or less for other considerations.

Figure 7. With regard to your SME clients, what are the key challenges you face in integrating climate-change considerations in financing/investment decisions? (% of respondents, multiple answers possible)



Given the considerable knowledge and capacity gaps, most financial institutions are investing in training and other capacity building on climate-related issues for their management and employees.

Figure 8. How (if at all) is your institution developing employee awareness and expertise on climate-related issues? (% of respondents, multiple answers possible)

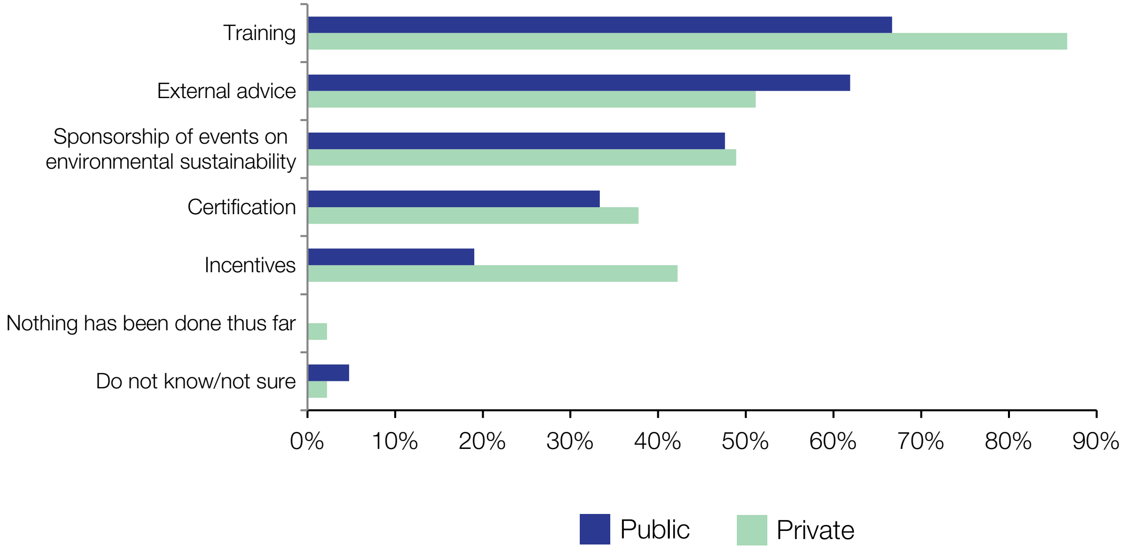
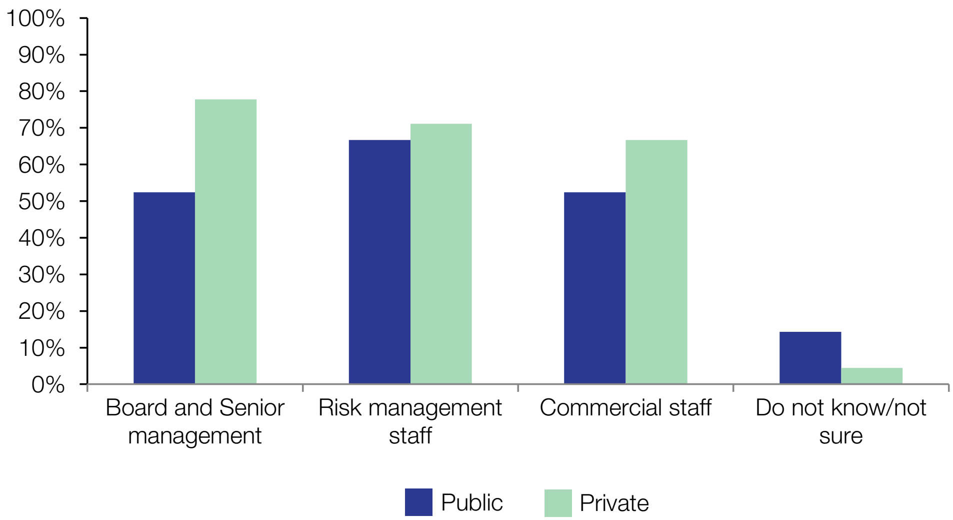


Figure 9. Who are the targets of the capacity building offers? (% of respondents, multiple answers possible)



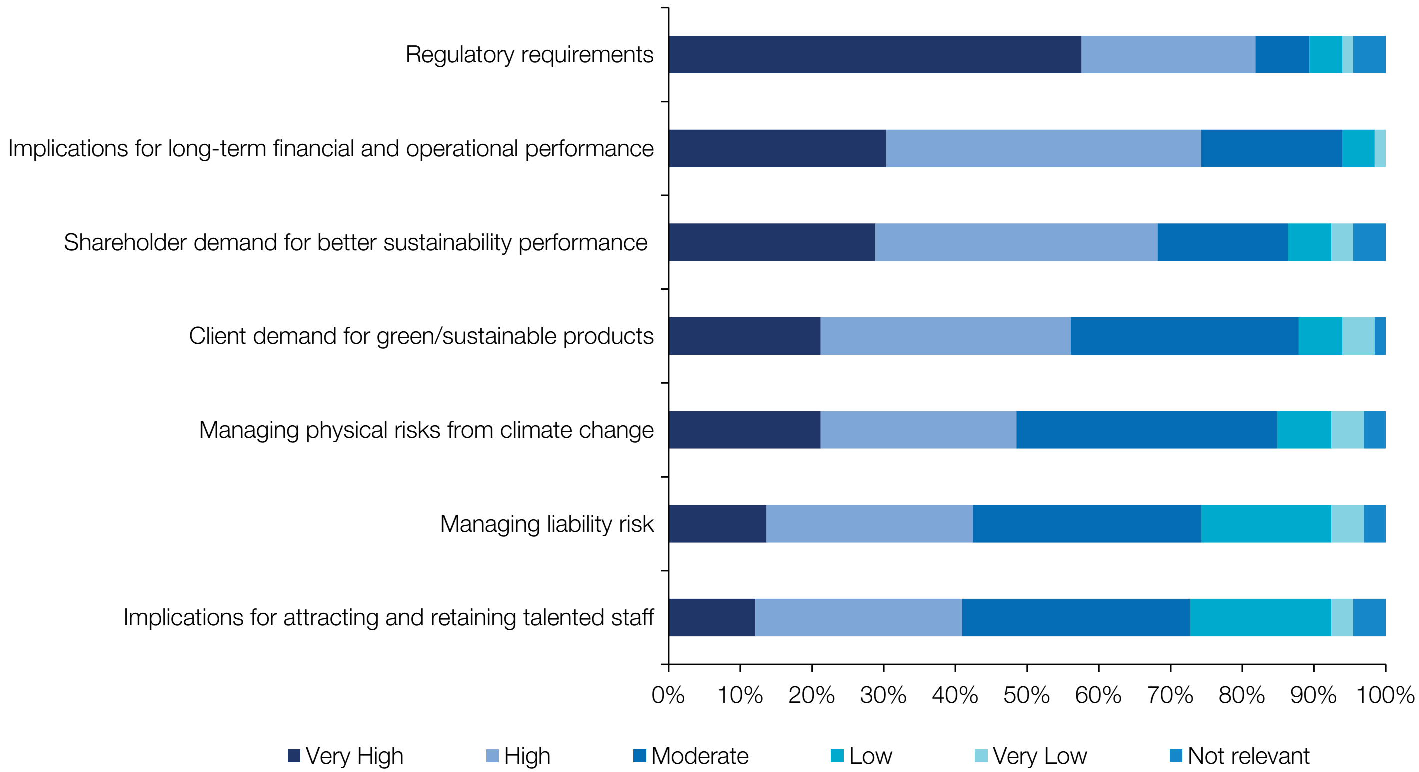
Drivers of climate action and the provision of sustainable finance to SMEs

Climate action by banks is driven by a range of push factors. In addition to regulatory requirements, implications for long-term financial and operational performance and demand from various internal and external stakeholders are the main drivers for net-zero action in financial institutions. Public and private financial institutions face similar drivers and constraints in taking net-zero action.

Most important drivers and constraints to climate action identified by financial institutions

82% identify **regulatory requirements** as a key driver of climate action

Figure 10. Rate the importance of the following factors in driving action on climate/net-zero in your institution. (% of respondents)

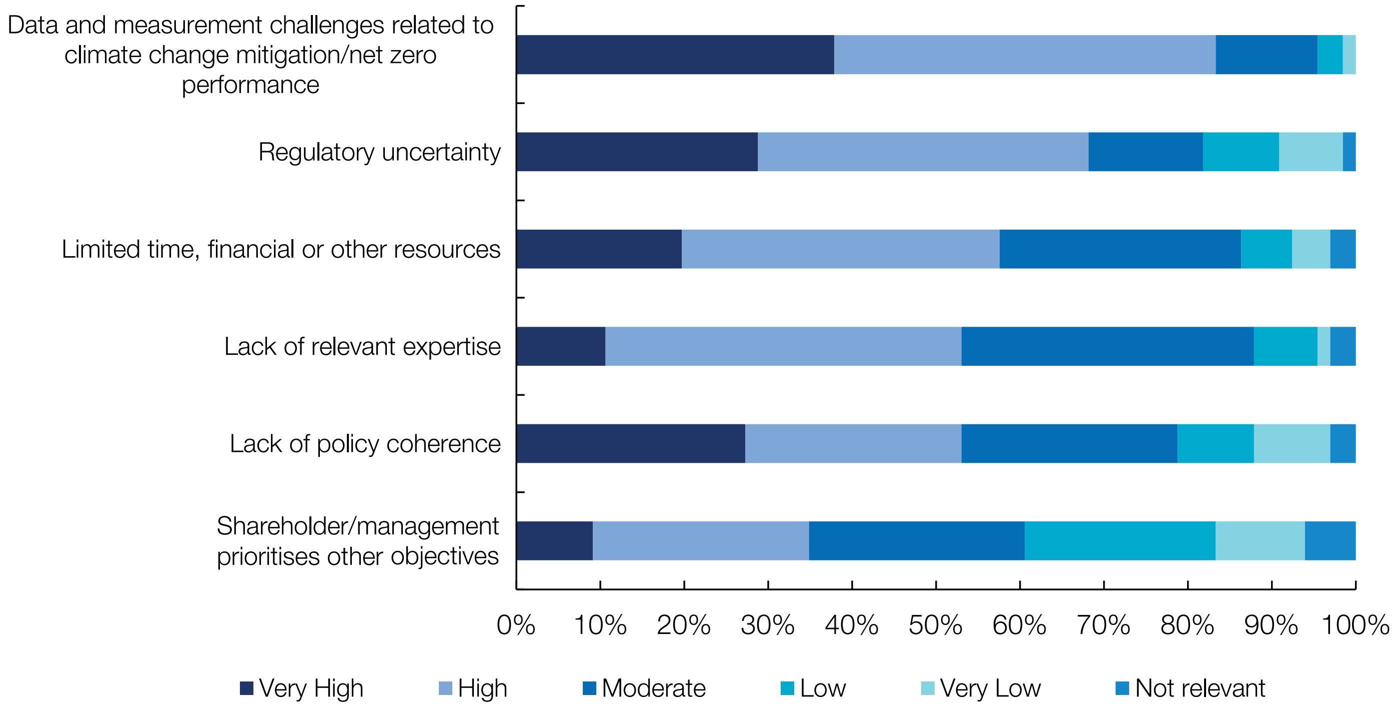


Barriers to climate action and the provision of sustainable finance for SMEs

Financial institutions indicate that net-zero action is held back by several factors. Data and measurement challenges represent an important constraint for over 80% of financial institutions. These largely reflect limited data on SMEs' climate performance and associated difficulties in assessing the climate-related risks and performance of their SME portfolios. Other constraints include regulatory uncertainty and resource and capacity constraints, including relevant skills and expertise to assess and monitor climate-related risks and performance.

84% of institutions identify **data and measurement challenges** as a key barrier to climate action

Figure 11. Rate the importance of the following constraints to climate/net-zero in your institution. (% of respondents)



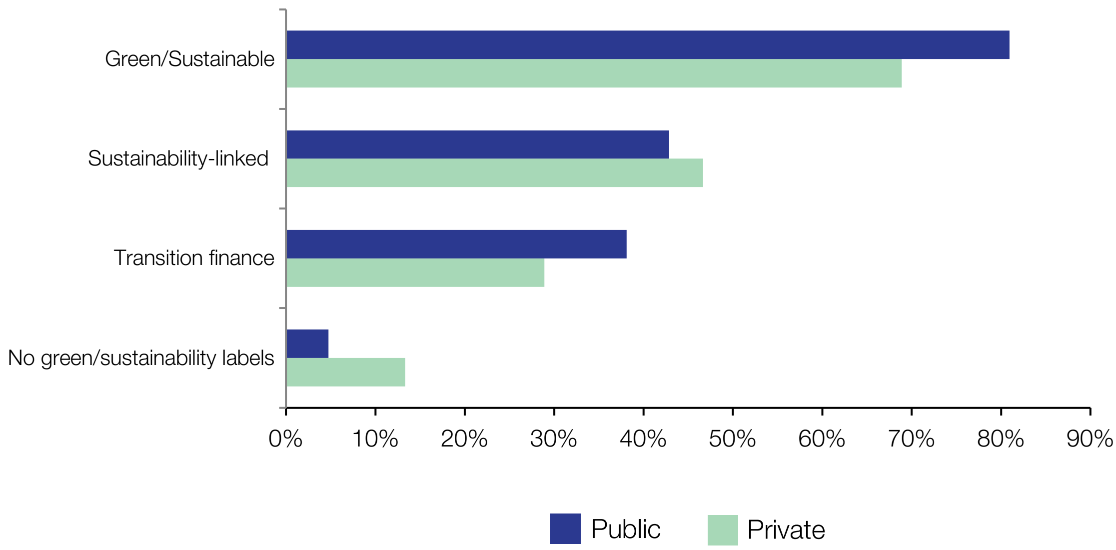
Financing instruments and non-financial support

Environmental considerations can be integrated into financing products in different ways. Products include green debt or equity that finance specific investments in greening. Sustainability-linked instruments, which links financing conditions with the sustainability performance of the investment or investee.

The majority of financial institutions already offer green - and sustainable-financing instruments. On the other hand, sustainability-linked instruments and transition finance are more nascent and offered by fewer than 50% of financial institutions. Notwithstanding some of the caveats around the sample size used in the survey, the higher share of public institutions providing green/sustainable and transition finance may reflect the specific mission and mandate of these institutions in regard to providing finance for SMEs.

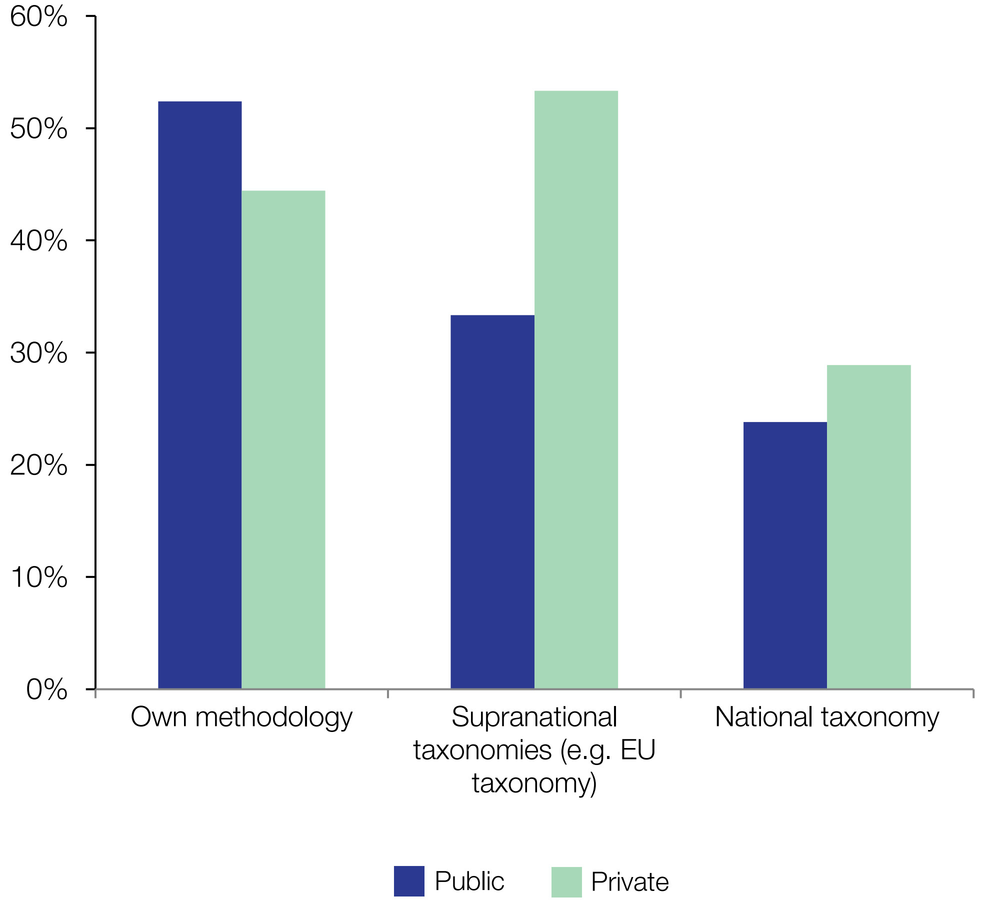
73% of institutions provide green/sustainable finance to SMEs

Figure 12. Does your institution provide any financing/investment products classified as: (% of respondents, multiple answers possible)



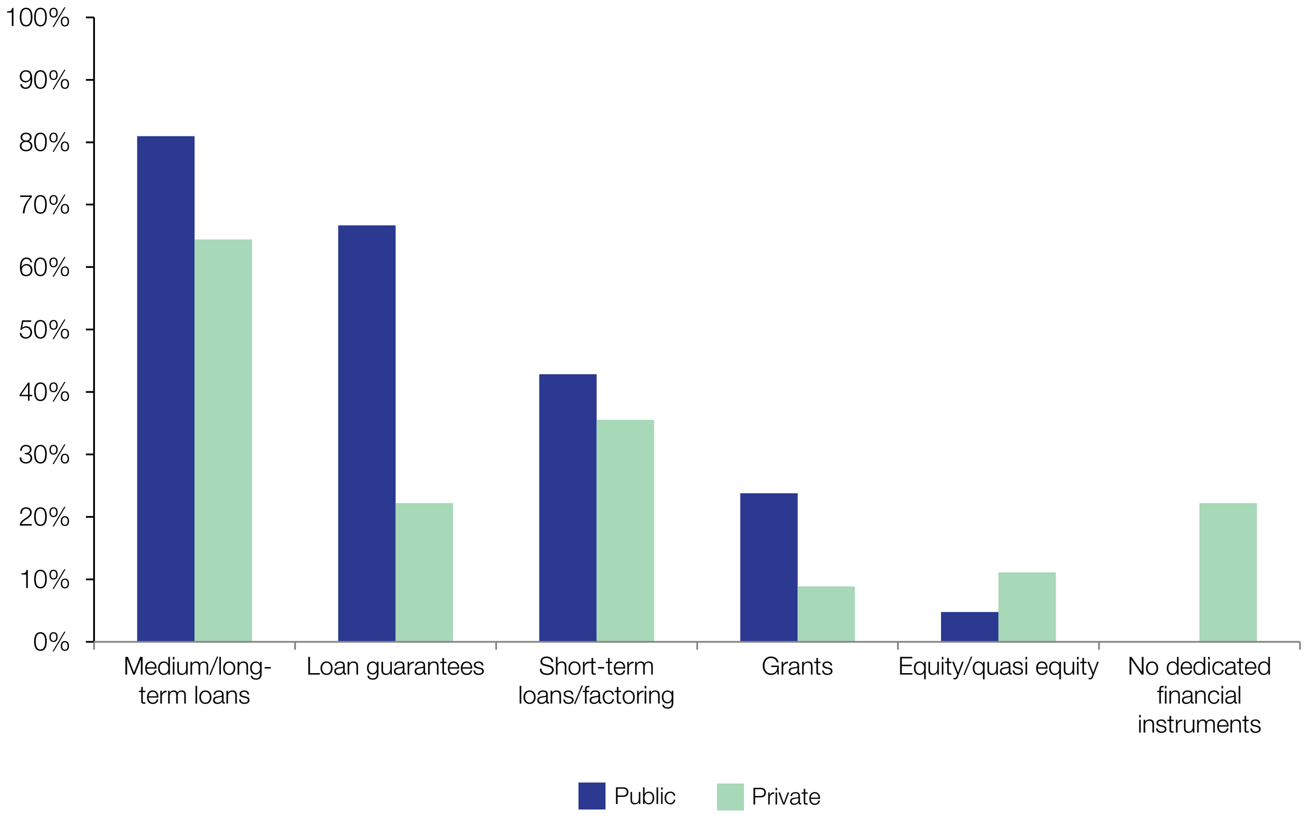
Some financial institutions use national or supranational taxonomies to define green/sustainable assets. However, about a half also rely on their own definitions, which could increase the risk of "greenwashing." This may reflect the lack of existing taxonomies in many jurisdictions, gaps in established taxonomies (e.g. in defining transition activities), or lack of mandate to transition from previously used institutional taxonomies/methodologies to newly established national or supranational taxonomies (e.g. through disclosure requirements related to these taxonomies).

Figure 13. Which taxonomy/guideline or method do you utilise to define what is green or sustainable investment? (% of respondents)



SMEs' net-zero investments are financed mainly through debt instruments: medium- and long-term loans (over 80% of public and 65% of private banks) and short-term loans and factoring (43% of public and 35% of private banks). Two-thirds of public banks use guarantees to mobilise private financing for SMEs' net-zero investments. Green or sustainable equity instruments are relatively scarce.

Figure 14. Which of the following types of tailored instruments does your institution use to finance SMEs' sustainable or green investments?
(% of respondents, multiple answers possible)



Challenges for the design and implementation of SME-related financing products centre around data and regulatory compliance issues:

- Provision of SME-related data, including translating complex sustainability requirements to SME clients.
- Compliance with supranational/national taxonomies.
- Standardising sustainability criteria.
- Identifying the best mix of products for SMEs.
- Minimising greenwashing risks.

Non-financial support is an important part of financial institutions' activities, to help SME clients build capacities to measure, report on and act on climate-change and net-zero. Support is provided through workshops, consulting services, trainings, tools and other means.

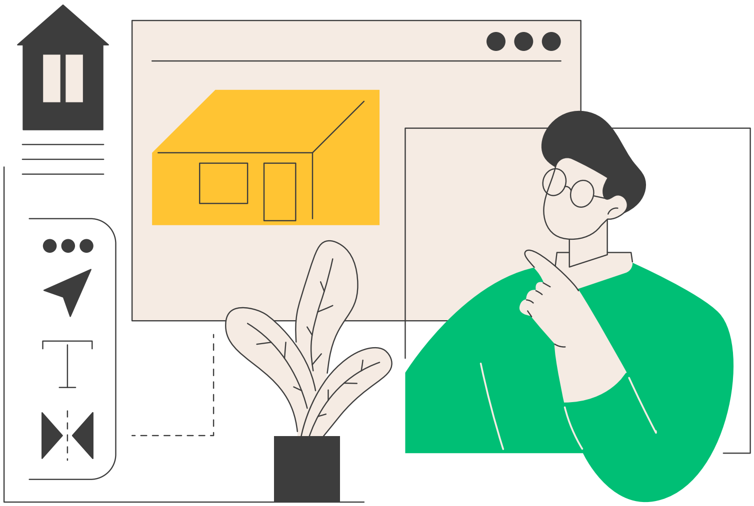
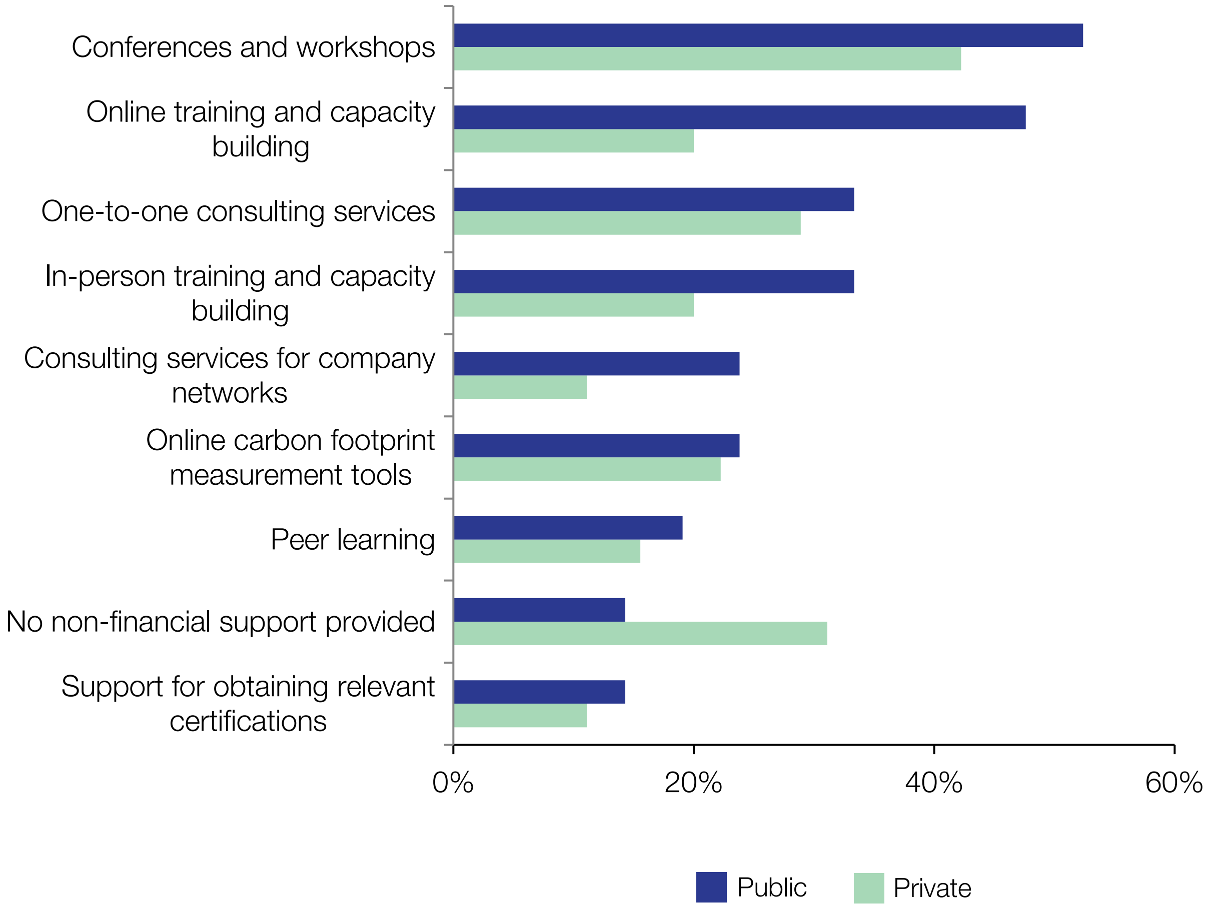


Figure 15. What type of non-financial support does your institution offer to SMEs to build their capacity to measure, report and take action on climate-change and net-zero? (% of respondents, multiple answers possible)



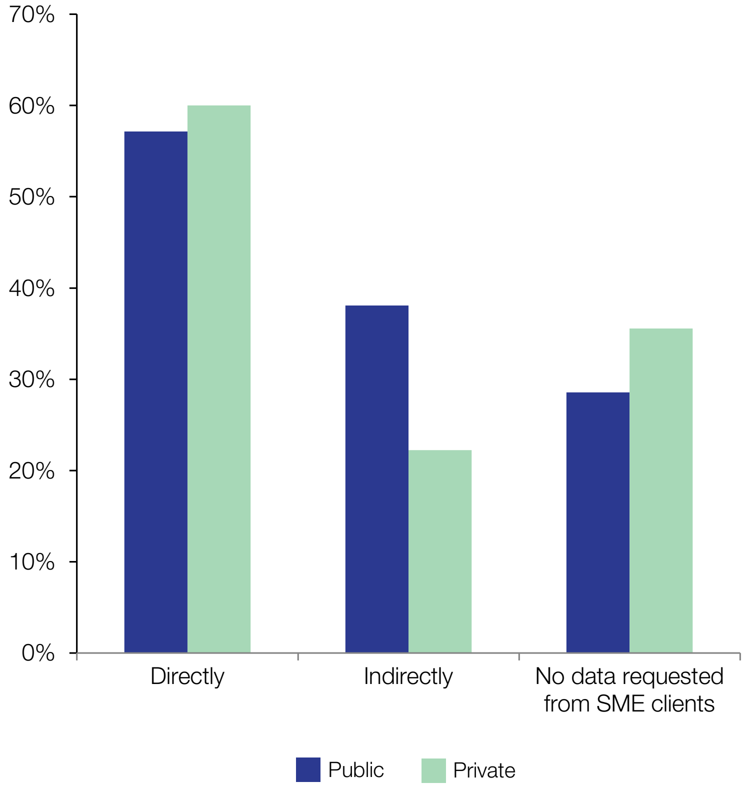
SME data and reporting on climate and sustainability

Financial institutions need granular data on their clients' sustainability performance in order to manage risks, develop relevant sustainable and transition financing instruments and meet reporting requirements. Most financial institutions already seek sustainability-related data from SMEs clients. Roughly 60% of public and private financial institutions get these data directly from clients. Likewise, 38% of public and 22% of private financial institutions may also use intermediaries, such as other financial institutions and ESG data or rating providers. Moreover, the vast majority of financial institutions that do not currently ask for any granular data from their SME clients plan to introduce such requirements in the short to medium term.

60% of institutions request data directly or indirectly from SMEs:

Sustainability-related data requirements differ depending on the size and sector of the financing recipient, the type of investment, as well as the type of financing instrument. Moreover, there is no common approach among financial institutions in the type of data and information sought from SME clients, either at the stage of assessment of the financing opportunity or during the monitoring phase. For example, some financial institutions have developed detailed questionnaires for SMEs while others ask for externally validated assessments such as certificates, ESG ratings, verified climate-related commitments and transition plans etc. Some financial institutions use existing reporting frameworks for the purposes of defining these data requirements, while others use or are still defining their own assessment/reporting frameworks. In this context, SMEs face a multitude of data requirements from different institutions, with implications for their access to sustainable/green finance.

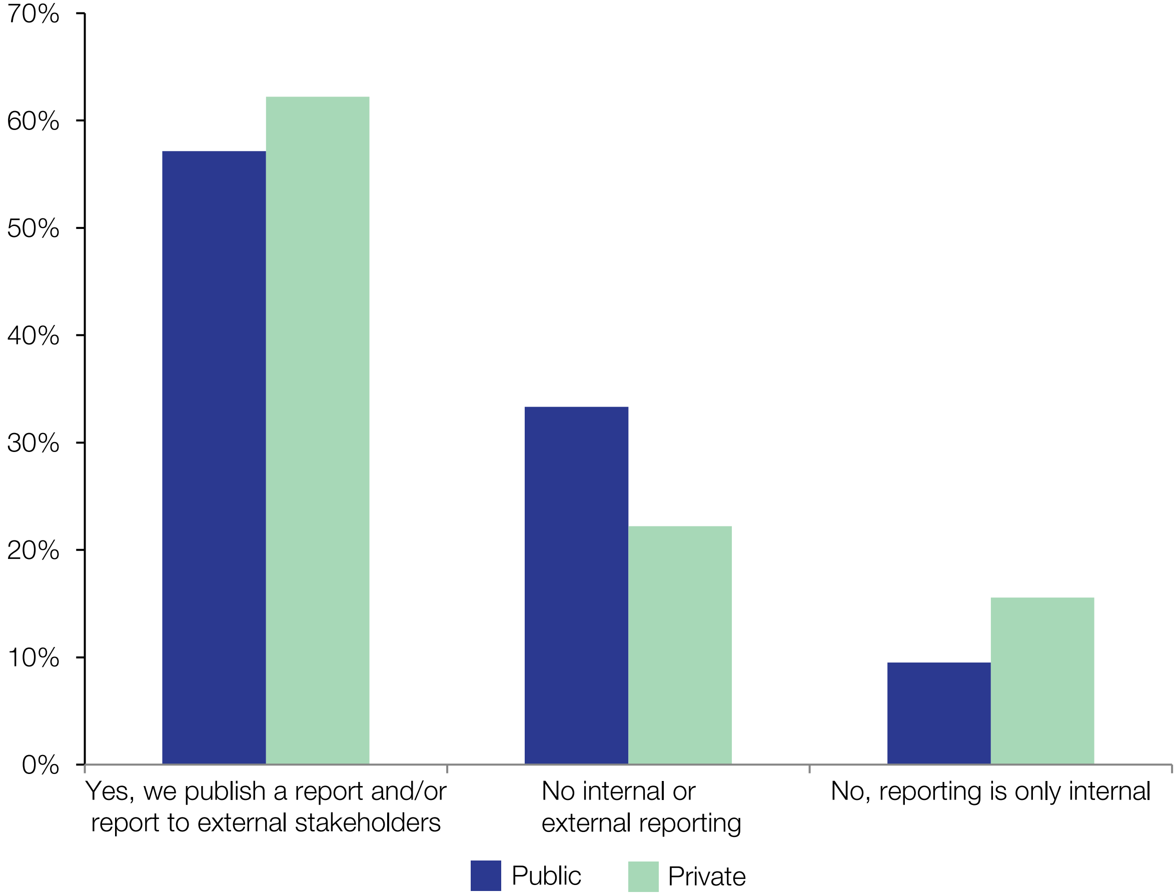
Figure 16. How is sustainability-related data obtained for small and medium-sized (SME) clients for the purposes of financing/investment decisions? (% of respondents, multiple answers possible)



Climate-related reporting

About 60% of financial institutions publish reports on their climate performance. Furthermore 56% of public and 63% of private financial institutions indicate that they report in line with international standards/frameworks.

Figure 17. Does your institution publish/release a dedicated climate report or otherwise report on its climate performance? (% of respondents)

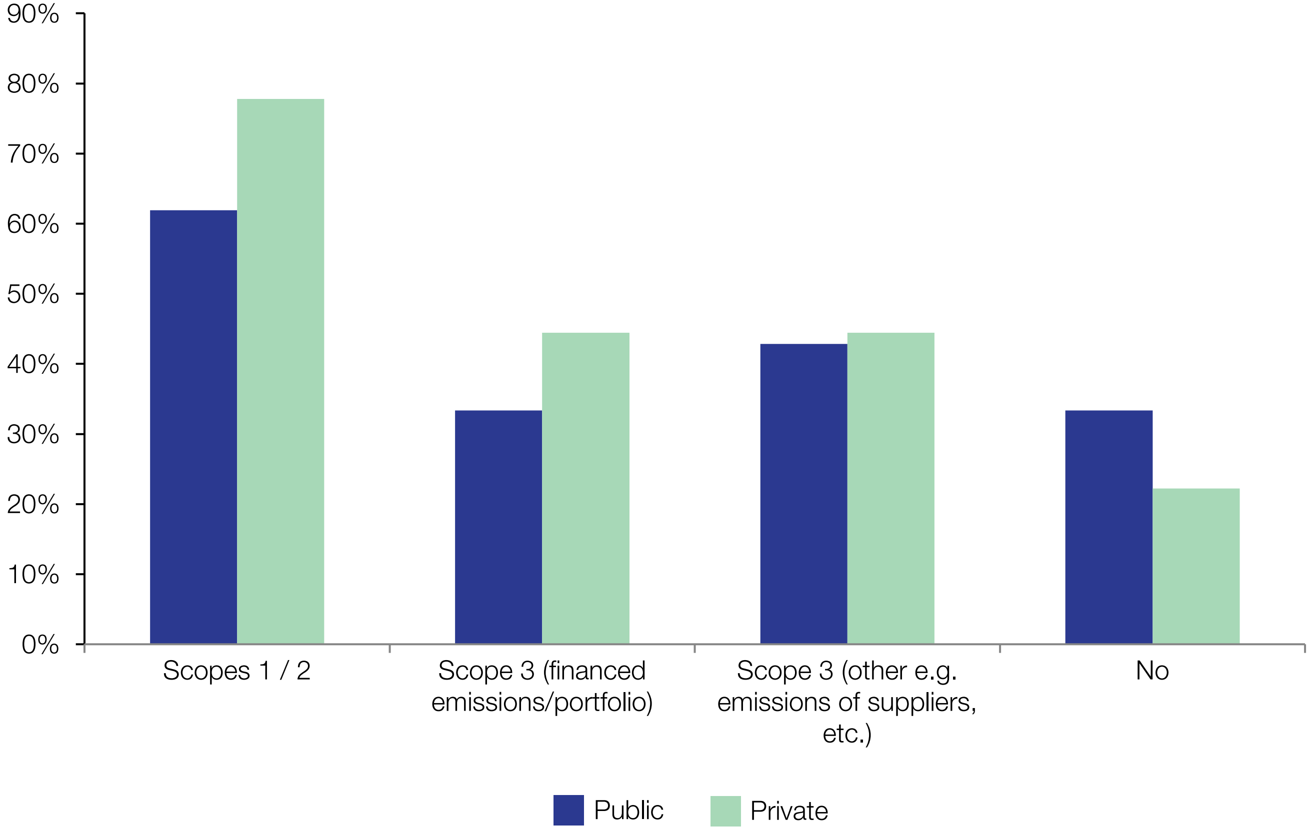


Over 60% of public and nearly 80% of private financial institutions report on the emissions stemming directly from their own operations (i.e. Scope 1 and 2 emissions). Reporting of financed emissions (i.e. Scope 3 emissions), which include the emissions of entities financed by these institutions, is still relatively limited.

73% report on their scope 1 and 2 emissions.

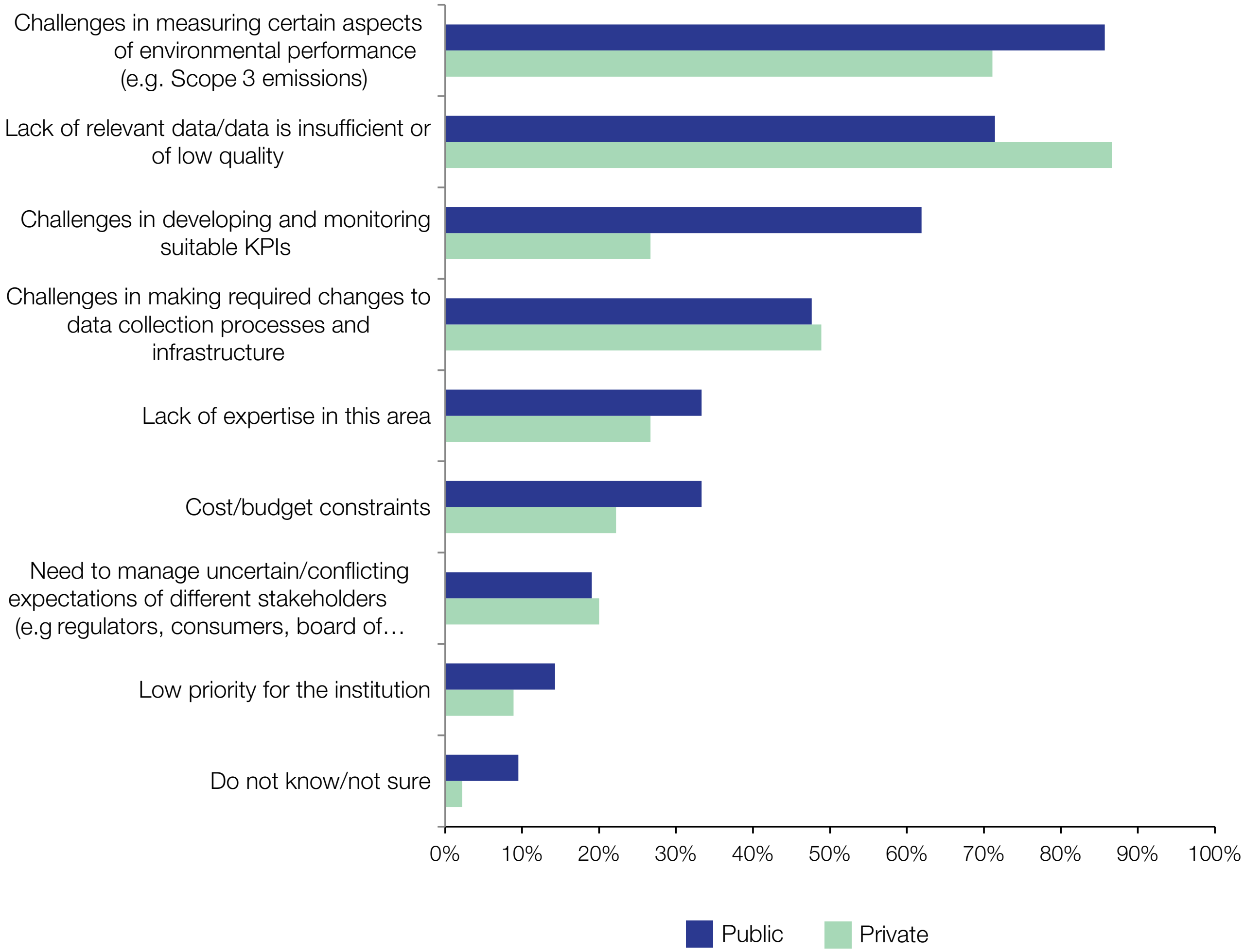
45% report on their scope 3 emissions.

Figure 18. Does your institution report on its operational GHG emissions? (% of respondents)



The main challenges that institutions face in reporting on their GHG emissions include the lack of data and/or lack of data of required quality; measuring scope 3 financed emissions; developing and monitoring suitable key performance indicators, which is a particular challenge for public financial institutions; and changing internal infrastructure for data collection.

Figure 19. What are the biggest challenges that your institution faces in measuring and reporting on your own climate performance as well as financed emissions? (% of respondents, multiple answers possible)



Financial institutions use diverse approaches to overcome the challenges to setting, monitoring and reporting on targets and performance:

- Setting up internal frameworks and methodologies for measurement, analysis and reporting.
- Devising strategies to improve data quality.
- Client engagement to gather more data at underwriting (including through surveys).
- Engaging with 3rd party data providers.
- Leveraging collectable data (e.g. national statistics) to reduce the error range.
- Digital/ICT solutions to collect/analyse data.
- Diversification of data sources.
- Engagement/networking with other financial institutions.

Conclusions and next steps

The survey provided highly pertinent and original data and insights into financial institutions' approaches and progress in the integration of climate-related risks and opportunities in their SME operations. It demonstrated that both public development banks and private financial institutions are taking steps toward accounting for climate in their strategies and business plans, financing decisions, their supplier engagement and other operational activities.

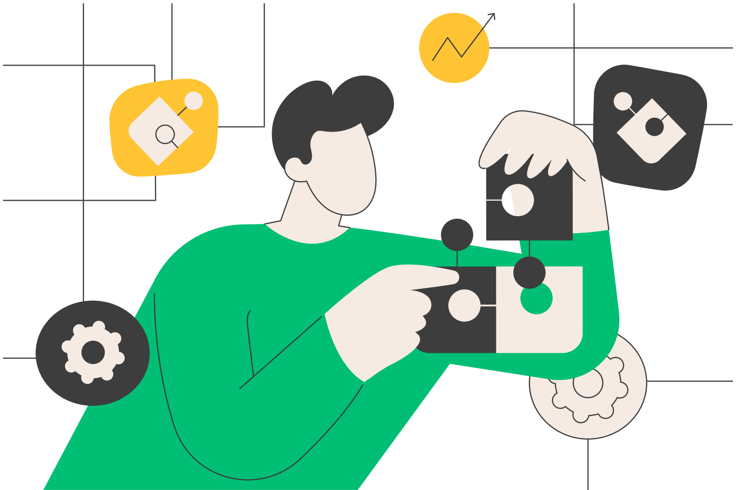
They are also providing SMEs with green and sustainable financing instruments, with about a third of financial institutions also providing financing through more innovative emerging financing instruments such as sustainability-linked loans or transition finance. These activities are driven by regulatory considerations, stakeholder demand, notably clients and shareholders, as well as considerations for long-term financial and operational performance.

However, financial institutions also face considerable constraints in some areas of climate action. Most notably, data and methodological challenges negatively affect the practical integration of climate in financing decisions, the development of relevant sustainability-linked financing instruments, risk management and increasingly mandatory non-financial disclosure. To address these constraints, financial institutions are investing in management and employee training, seeking external advice, providing incentives and otherwise seeking to strengthen internal awareness, knowledge and skills on climate-related topics. They are also setting up internal frameworks and methodologies for measurement, analysis and reporting; devising strategies to diversify data collection sources and improve data quality, including through digital solutions; strengthening client engagement, including through non-financial support; and engaging with other financial institutions to share knowledge and solutions.

As part of these efforts, financial institutions are also increasingly seeking granular sustainability-related data from SME clients. Over 80% of public and 70% of private financial institutions already ask SMEs for sustainability-related data. The vast majority of the others plan to introduce data requirements in the near to medium term.

The challenge from these developments is two-fold. In light of their more limited resources and capacities, SMEs cannot respond to the data demands in the same way as large enterprises. This warrants considerable support for SMEs - in the form of easy-to-use tools, advice, information, etc. - to develop their capacities to measure and report on their sustainability performance.

It also calls for adapted standards and streamlined data requirements for SME clients that can meet the operational and reporting needs of financial institutions, without placing an undue (and perhaps impossible) burdens on SMEs. A second important challenge, as demonstrated by the survey responses, is the lack of a common approach and framework for data collection from SME clients, which multiplies the data demands and burdens on SMEs. This calls for better alignment and convergence in the approaches undertaken by different institutions.



The OECD Platform on Financing SMEs for Sustainability will contribute to addressing many of these challenges. New work to advance the SME climate agenda includes:

- Launch of a global dialogue to foster convergence on financial institution data requirements from SMEs and stocktake of existing measurement approaches/ tools, with a view to the development of internationally comparable approaches, methodologies and potential standards.
- Sharing of knowledge and good practices in financial institutions' offers of green, sustainable and transition finance instruments, through mapping and assessment.
- Development of frameworks for transition planning for SMEs, to unlock transition finance for small businesses, particularly in high emitting and hard-to-abate sectors.
- Provision of tailored country support to enhance SME access to sustainable finance.

Glossary of terms

Emission scopes (1,2,3) describes the three different levels by which the coverage of climate-related disclosure requirements differs. While Scope 1 and 2 emissions include GHG emissions that the company is directly responsible for (1) or indirectly produces through energy consumption (2), Scope 3 emissions encompasses all other emissions that are outside of the company's control. The hard-to-measure scope 3 emissions stem from upstream activities such as commuting of employees or purchases goods as well as from downstream activities such as treatment of waste or operations of franchises.

Financed emissions are the absolute GHG emissions that banks and investors finance through their investment activities.

Green and sustainable finance comprises financing for investments in green and sustainable activities as defined by relevant taxonomies.

Greenwashing a practice whereby sustainability related statements, declarations, actions or communications, do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial service. This practice may be misleading to consumers, investors or other market participants.

Net-zero transition plans detail actions that an entity will take to achieve specific net-zero targets. An entity can achieve net-zero by reducing carbon emissions and offsetting any emissions that cannot be eliminated.

Sustainability strategy refers to the targeted approach of firms in addressing non-financial goals and meeting the environmental and social needs of all stakeholders.

Sustainability-linked finance links financing conditions with the sustainability performance of the financed entity. It does not depend on the type of investment that is financed.

Transition finance refers to finance raised or deployed by corporates to implement their net-zero transition, in line with the temperature goal of the Paris Agreement and based on a credible corporate climate transition plan.

Endnotes

[1] Public financial institutions refers to government-owned entities that offer a host of financial services/products, such as direct financing and guarantees, to support SMEs' access to finance.2
[2] Green and sustainable finance instruments provide financing for investments in activities that are green and sustainable according to relevant taxonomies.
[3] Sustainability-linked instruments relate financing conditions to the sustainability performance of the financed entity, regardless of the type of activity that is financed
[4] Transition finance is provided to entities across all types of activities conditional on the provision of a credible transition plan.
[5] Differences in responses between public and private financial institutions should be interpreted with caution as they may reflect differences in the sample size, as well as institutional differences such as size, structures, missions, funding sources, etc.
[6] Green and sustainable finance: instruments providing financing for investments in activities that are green and sustainable according to relevant taxonomies.
[7] Sustainability linked finance: instruments whose financing conditions are linked to the sustainability performance of the financed entity regardless of the type of activity that is financed).
[8] Transition finance: financing provided to entities across all types of activities but conditional on the provision of a credible transition plan.
[9] This reflects responses to qualitative questions in the survey asking respondents to elaborate on the type of data they seek from SMEs ex-ante (i.e. before the financing decision is made) and ex-post (during the financing monitoring phase).

Join us

https://oe.cd/greening-smes

Please contact the team to learn more:

Miriam Koreen: Miriam.Koreen@oecd.org

Marija Kuzmanovic: Marija.Kuzmanovic@oecd.org

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