

G7 Environment Meeting.

Mobilizing Green Finance for SMEs. April 5-6 Venice Conference

Introductory remarks by Francesco Confuorti

President, Advantage Financial



It is a great honor for me to be present here today and address this important gathering. Mobilizing green financing for SMEs and enabling them to pursue green sustainable development is a core dimension of our common future.

As it is well known, SMEs have been and remain the mainstay of the Italian economy and world famous “Made in Italy” label. Now the time has come to marshal technological innovation in the finance industry and mobilize funds wanting to invest in green ventures to foster sustainable SME development. SMEs, green financing and Fintech is the nexus from which will spring a promising future in Italy as well as in the rest of the G7 nations.

It is with this perspective that Advantage Financial cooperated with enthusiasm with the Italian Ministry of the Environment, organizer of this conference. UNEP has for years worked on the challenges of mobilizing finance for green development; recognition is due to these efforts and UNEP’s contribution at this conference.

Allow me to share with you in these introductory remarks the work we have been pursuing at Advantage Financial as it is closely linked to the issues dealt with in the conference. This work focuses on financing sustainable development in three areas:

- Relationship between financing cost and ecological footprint
- Serving SMEs by expanding data information availability, and
- Fintech at the service of sustainable development

I. Cost of Debt Financing and Ecological Footprint

Basically, our work points out to a strong link between debt cost and ecological footprint, much stronger than on the cost of equity.

At Advantage Financial, we approach financial debt sustainability by envisaging a continuous scale between Green bonds, which finance environmentally friendly projects, and Brown bonds, which finance environmentally dirty projects. We measure the ecological footprint of companies based on their “ecological, social and governance” (ESG) disclosure and map it in a continuous way to some indicators of the cost of debt.

Our approach is more general than the traditional focus on the relatively small green-subset of the bond market. The green bond market is the topic of the first panel of this Conference and I will be looking forward to the exchange of views with the speakers on these issues.

We ask whether the bond market is able to discriminate between the brown and green bonds by charging a differential spread. The idea that Advantage Financial developed some time ago is that ecological risk is a type of tail risk, which is better priced by debt rather than equity. We find strong evidence of this link. For those who are interested, all our research papers are published on our website *advantagefinancial.net*.

- Our first study we look at a sample of more than 1100 nonfinancial listed companies who reports ecological footprint data. We find a significant impact of the ecological footprint of issuers on the cost of debt financing.
(see charts 1 and 2)
- Our next studies focus on the capital and energy intensive sectors and confirm a strong link between the ecological footprint and the cost of debt.
- The 2014 study, contains very detailed estimates of **plant level data** ecological footprint, based on the EEA disclosures of CO₂ intensive sectors

(energy, utilities, industrial metals and cement), that are matched to the interest coverage ratio of the plant owner company. *(see chart 3)*

- The 2015 study focuses on Electric Utilities focus the energy mix of each utility, which is a way to define how green or brown is the bond mix of each utility. The shift in energy mix toward green (brown) brings on average to lower (higher) credit spreads. *(see chart 4)*

II. Sustainable SME sector and “Made in Italy” label development

When we think about sustainability, we need to make a difference between capital and energy intensive sectors that are the main direct contributors to CO₂ emissions and also of various forms of toxic waste in the air, in the soil and in the water, and more capital light sectors of the Made in Italy, such as food, apparel and furniture. For these sectors, we need to find additional footprint indicators and collect data on them (SME are not always willing to bear the cost to collect and disclose such data.

- One new dimension relates to the intense international trade of food that we experience in this globalized world. This creates environmental costs for moving food along the planet (some think that trade in food is in fact a proxy for trading water, especially in poor and middle-income countries).

- Further, trade in food creates a commitment to social responsibility for those food manufacturers who source basic inputs from farmers around Italy and the world. This is an area of great potential that can benefit notably Kenyan farmers very innovative initiatives and offer the potential for a more ethical trade among Europe, Italy and Africa.
- Moreover, when we speak about food we cannot forget the related dietary and health issues. Advantage Financial innovative solution **GREENMANGO** promotes sustainable consumption, thanks to its data architecture which tracks the ecological, social and nutritional impact of individual consumer product and brands.
- Looking at the future, firstly, we are fostering the creation of a B2B and a Credit guarantor (Confidi in Italian) system for local SME and entrepreneurs in Africa, starting from Kenya and the Balkans.
- Finally, I would like to mention that Advantage Financial has signed a number of R&D agreements with leading universities such as the University of Bari Aldo Moro and the Strathmore University of Nairobi from Kenya, with more agreements in the pipeline.

III. From financial innovation to sustainable Fintech

Advantage Financial, a boutique Investment Banks founded in 1992 is always scoping the future, this time bringing together sustainability with Fintech. These developments are energizing in the same way as launchers of new ventures experience. Indeed, it is an emerging and frontier markets activity.

- If finance is the recent past, Fintech and sustainability is the future, and as financial market professionals we either morph in this new paradigm, or just disappear into irrelevance. This is an easier transition for nimble, entrepreneurial entities such as ADF. Probably the only way to meet the financial need of SME in industry and services is to create an industry of small and medium Fintech intermediaries.
- I am confident that joining forces with Fintech entrepreneurs both in Italy, Africa and New Europe (think about the potential of Kenya, which is the world leader in smartphone based payment industry).
- Finally, International lending institutions, such as the African Development Bank and the BERS as well as the Ministry of Environment can have a critical supportive role.

- The second and third panels, which focus on the role of traditional financial intermediaries and Fintech entrepreneurs respectively, will be providing us with interesting insights.

IV. Looking ahead and Conclusion

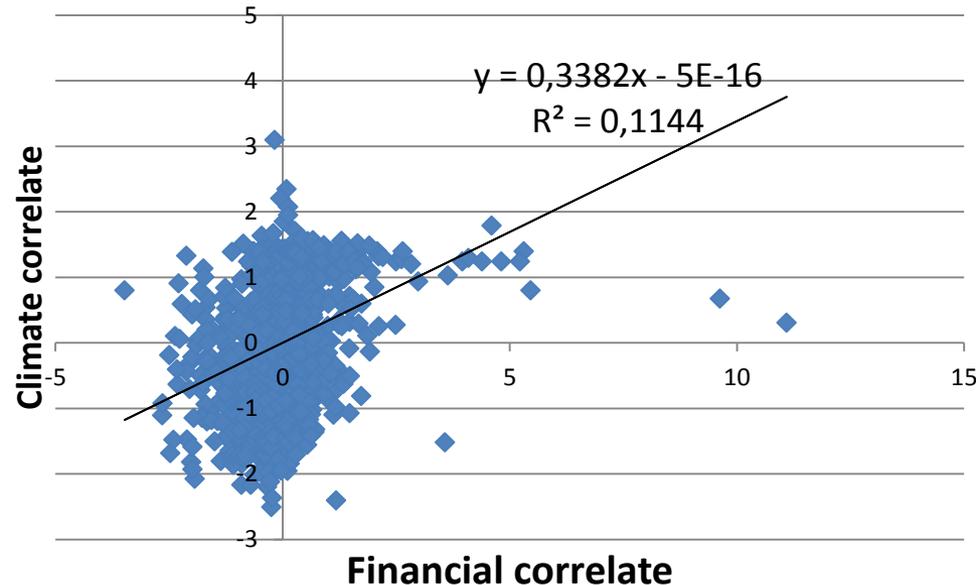
Advantage Financial projects entail the creation of one or more start-ups Our goals is not just to create new opportunities, but to create new entrepreneurs, which are creators of jobs.

- This initiative will foster growth, harmony and sustainability in some societies which share a common culture to Italy.
- It will also help forge a more constructive approach to the huge geopolitical problems such as the globalization backlash and the immigration we are experiencing in our times.

Let me conclude my introductory remarks by giving the floor to Nick Robins of Unep and Paolo Bersani of PWC, who will present the background paper for the Conference.

1. High Ecological Footprint relates to High Probability of Default

Climate vs. Financial correlate



Source: Advantage Financial, *“Ecological footprint and the probability of default in Europe”*

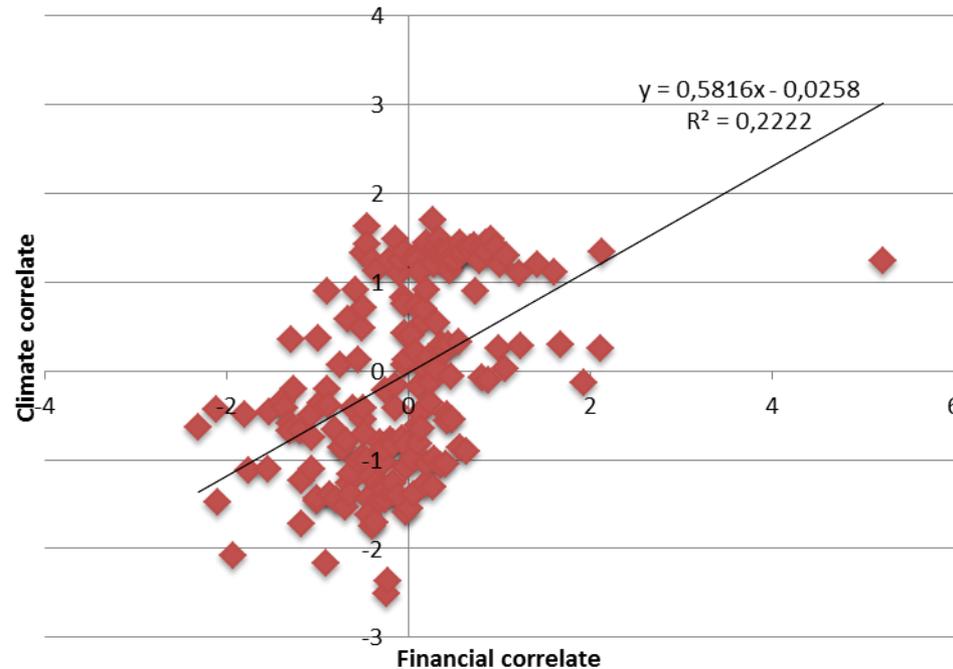
Variable definitions:

The **financial correlates** variables are defined as follows: The first line measures the issuer probability of default implicit in the Merton model computations; the profitability of the firm (the EBITDA margin), a valuation indicator (the price/earnings), an asset intensity measure (net fixed assets over total assets), and two measure of leverage, such as long (short) term debt over total assets.

The **climate correlate** variables are defined as follows: The first nine correlates are Y or N dummies measuring if the firm has or does not have a specific environmental policy in place, such as a Climate Change Process, an Energy Efficiency Policy, an Environmental Supply Management Policy, a Social Supply Chain management policy and so on. The last line measures in stead the intensity of CO2 greenhouse gas emissions scaled by total assets.

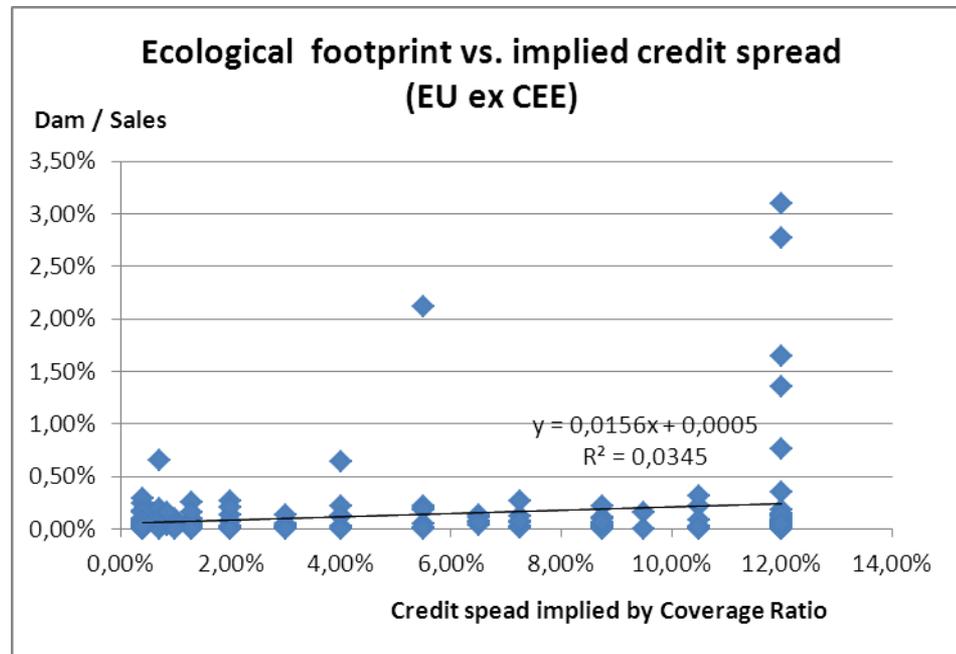
2. Ecological Footprint and the Probability of Default for Consumer Cyclical Goods

Consumer Cyclical (=181)



Source: Advantage Financial, *“Ecological footprint and the probability of default in Europe”*
Variable definitions (see previous slide)

3. The ecological footprint of energy intensive industrial plants

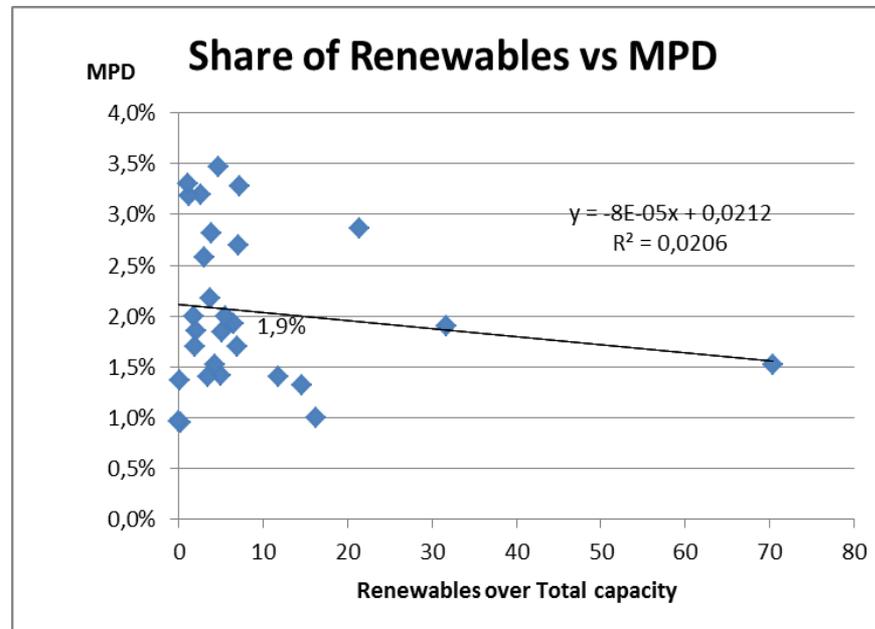


Source: Advantage Financial, *“The Ecological Impact of the European Industry and its relation to the cost of debt”*.

4. Greener Energy Mix = Lower Cost of debt

Is green just a socially responsible choice that must entail a higher bankruptcy risk than more conventional sources of generation?

In the Chart below we report evidence showing that the higher is the share of renewable electricity generation at firm level, the lower is, on average, the implied cost of debt measured by the Merton probability of Default.



Source: Advantage Financial, “*Environmental Footprint and the Cost of Capital in the Utilities sector*”