

Enabling Environments for Green SMEs: Recommendations for Action

➤ **Green small and medium-size enterprises (SMEs) represent a key win-win strategy and are one of the main drivers of green transformation**

Taken together, SMEs have a greater impact on the economy and the environment than large companies; thus the dynamics of green growth very much depend on how small businesses can integrate sustainable practices into their business activities. Green SMEs that are focused on financial profit and dedicated to environmental sustainability can lead the green transformation from the ground up by creating new business models and providing examples of successful sustainable business practices that can be adopted by more and more companies.

➤ **Polymakers at all levels can play a role in enabling the creation of green SMEs, and more focused measures are needed to support the inception of new green businesses**

Polymakers, at international, national and local levels, have a key role to play in enabling the transition of SMEs to the green economy, mainly by adopting clear and coherent regulation, creating enabling market conditions for green products and services and facilitating access to funding and capacity building programmes that support investor-grade green SMEs.

Why focus on green SMEs?

SMEs represent a key win-win strategy for the economy, job creation and the environment

SMEs play a key role in economies around the world and are the most common form of enterprise. In OECD member states, SMEs account for approximately 99 % of all firms (of which over 90 % are micro-enterprises) and represent about 70 % of total employment, generating between 50 % and 60 % of value added on average. In emerging economies, SMEs account for up to 45 % of jobs and 33 % of GDP. If the contribution of informal businesses is also included, SMEs provide over 50 % of employment and GDP in most countries, regardless of income levels.¹ In the European Union, SMEs account for 58.6 % of value added.²

SMEs help to increase inclusion and reduce poverty by employing workers from various segments, including low-skilled workers, and by providing opportunities for skills development as well as access to health care and social services. Small businesses also provide solutions to the problems of poverty, social exclusion and unemployment, and fill gaps in general-interest service delivery.³ For example, in Belgium, from 2008 to 2014, jobs in social enterprises increased by 12 % and represented 17 % of total private-sector employment in 2015.⁴

What is a green SME?

There is no standard international definition of what constitutes an SME. When classifying small and medium companies the following factors are considered: number of employees, annual sales (turnover), value of assets (balance sheet) and net profit. In this brief, we use the definition employed by the European Union (EU), which states that an SME is any enterprise with fewer than 250 employees, turnover of less than EUR 50 million or total assets not exceeding EUR 43 million. A small business is defined as any business with fewer than 50 employees and total assets of less than EUR 10 million. A micro-business has fewer than 10 employees and total assets of less than EUR 2 million.

Green business models are defined as “business models which support the development of products and services (systems) with environmental benefits, reduce resource use or waste and which are economically viable. These business models have a lower environmental impact than traditional business models”,⁵ according to FORA, the Danish Enterprise and Construction Authority’s division for research and analysis.

***SMEs are
drivers of green
innovation***

New small businesses are often the first to implement innovations that have a significant impact on economic growth, as they have greater flexibility to explore new technological and commercial opportunities than more established businesses do. SMEs account for 17% of all technology patents in the European Union.⁶ Small businesses frequently adopt innovations and apply them to different contexts and locations that are not large enough in scale to attract big companies. SMEs are also receptive towards green innovations and often act as initiators in the eco-industry and clean-tech markets; in the UK, for instance, they account for over 90% of clean technology businesses, and 70% in Finland.⁷

***Greening
existing SMEs
could have a
huge impact on
pollution***

Although the individual environmental impact of small businesses may be small, their aggregate impact can exceed that of large companies; in Europe, for example, they account for 60-70% of industrial pollution.⁸ SMEs have a significant environmental impact in livestock farming, construction, metal finishing, waste handling and treatment, the food and beverage industry, and textile and leather manufacturing, making them responsible for a considerable portion of the world's resource consumption, air and water pollution, and waste generation.⁹

What drives and hinders the development of green SMEs?

Adopting sustainable practices or exploring green business opportunities can be a win-win strategy, both for the economy and for the environment. In creating businesses, entrepreneurs are dependent on a range of external conditions. Below are some of the main conclusions regarding drivers and barriers that entrepreneurs encounter when starting up a green business; these conclusions were the result of two GREEN-WIN workshops with financing experts and experts who work with green SMEs on a regular basis.

Drivers for starting up green SMEs, as identified in the Green-Win workshops:

➤ Demand for new, greener goods and the opportunity to cut costs through resource efficiency are significant drivers for green SMEs. It is important that they have good access to the market, in order to develop their product and sell it. For green SMEs that are innovating or disrupting a conventional market, a pre-existing need for the product or service may not exist. In this case, it is essential to create a need and find proxies that can ensure access to the market, whether local or regional. This is, for example, the case for the leasing of smart water metres to incentivise more efficient water use.

➤ Customers' increasing environmental awareness and responsibility is an essential aspect of green business development. More and more people prefer to spend their money on a more responsible company. Yet sustainability represents added value; the product and price are important, and the responsibility aspect comes after. Governments and civil society have a key role to play in environmental education, with a view to

raising consumer awareness of the impact of environmentally friendly products and services. This is, for example, the case in the green tourism industry, where quality and price remain key drivers, and green dimensions provide value added for consumers.

➤ Government regulation related to green standards for environmental improvement and the certification of green products and services can support businesses in assessing their environmental impact, implementing green practices and building a market for their green products and services.

➤ Collaboration, coherence in marketing and “working together” is needed. Creating a common vision among local businesses, authorities and other relevant players on how to develop a green market in a given region increases the visibility of the businesses and facilitates their access to market, knowledge and sometimes even financing. Governments and NGOs can respond to this need, facilitate the collaboration among different players and support green business development.

➤ Extreme climate events, such as extended periods of drought or frequent and more intense flooding, can act as enabling factors. In agriculture, for example, farmers may start to consider more sustainable water management solutions in response to prolonged droughts.

➤ Having access to financing is an essential enabling factor for green SME development. Impact investment, venture philanthropy and impact-focused credit lines are, for instance, essential elements, as their strategy matches the needs of small businesses.

➤ Societal and political factors also play an important role with respect to supporting the development of green SMEs in a country. Green SMEs thrive in societies where social values are supportive of sustainability and where there is social and political support for green SMEs, thus increasing demand for green products and services.

Barriers in starting up green SMEs, as identified in the Green-Win workshops:

➤ The most critical challenge for green businesses is finding their place on the market or being able to create a market niche. Difficulties in creating a market and end-user demand stem from the challenge of creating a market for an entirely new product and consumers' unwillingness or inability to pay for the green product/service. When investors assess market creation by businesses, they consider how long they are willing to wait for the market to develop and see a return on their investment, and this can affect their investment decision. This has, for example, been a challenge for waste-to-energy businesses that struggle to compete with incumbents in the energy market.

➤ If either the local or national political environment is not supportive of green enterprises, the business can fail even when the market and financial conditions are

met. Regulation and the legal framework are therefore essential as well. Bringing green businesses together so that they have a voice and can ask for the desired changes can also be difficult.

➤ Another significant challenge is access to funding. Green SMEs face challenges when trying to access commercial financing at market rates, given their high-risk profile, low liquidity and uncertain profitability. Access to financing can be difficult due to the relative immaturity of the eco-innovation market, problems in accurately pricing the risk of investments or a mismatch with the typical investment criteria used by venture capital and institutional investors.

➤ A shortage of “green” skills and lack of management skills are often a challenge for green businesses. Green entrepreneurs focus primarily on the environmental problem they want to solve and often consider business management skills as secondary. In addition, the green sector is rather new, and finding team members with “green” skills can be difficult. Having a team with strong execution potential is key to investors’ decisions to invest or not.

➤ Many company founders seeking investment lack financial literacy. Understanding terms used by financiers, understanding the financing process, knowing how to approach financing and how to prepare for fundraising are common challenges everywhere in the world.

How can policymakers support green SMEs?

*Policymakers
at all levels can
play a role in
enabling green
SME creation*

Policymakers, at international, national and local levels, have a major role to play in enabling the transition to the green economy, by making sure that green industry regulations are clear, coherent and adapted to the needs of new green SMEs.

Awareness of the importance of SMEs for the economy and environmental sustainability is increasing. The EU has undertaken a number of policy initiatives to support green entrepreneurship and improve the resource efficiency of SMEs.¹⁰ Governments are taking further steps by creating policies and applying regulations that support the greening of small businesses.

However, owing to the heterogeneity of green SMEs across regions and sectors, the specific needs of different businesses vary and access to government support remains limited for many companies. Sometimes action is taken mainly at policy level, but regulations may be missing, contradictory or not clear enough.

Although many countries are stepping up their efforts to stimulate green business development through policies and regulations, more focused measures are needed in order to increase the number of green entrepreneurial initiatives and practices.

Recommended actions for policymakers to enable green business development:

Local-level policymaking is critical for SMEs

Ensure coherence among policymakers at different levels. Some of the challenges encountered by small businesses require a global framework. For example, the adoption of the Sustainable Development Goals by the United Nations in 2015 has increased certainty about the long-term importance of such goals, thereby motivating green SMEs to thrive. However, many of the important enabling factors – e.g. taxation, environmental reporting, content, sourcing requirements etc. – can only reasonably be dealt with at the local level. More practical, day-to-day aspects of business should be addressed as locally as possible and relate directly to the environment in which the SME operates. Actions taken at the local level should be coherent with national and international policies. Conversely, policymakers at the international and national levels must be aware of local needs and conditions and take them into account.

Collaborate with business and trade associations in order to stimulate the adoption of green practices.¹¹ Governments should collaborate with business and trade associations to clarify regulations and stimulate the adoption of green practices, as well as to learn more about the needs of SMEs from the associations.

Facilitate collaboration between local authorities and green SMEs. Local authorities play a significant role in green business development and should have an environmental sustainability strategy that helps green SMEs to access the market, knowledge and resources. The green capacity of government entities that work with SMEs needs to be built. When seeking support on environmental issues, SMEs often turn to the local authority, which should be well prepared to offer guidance and advice to businesses on sustainability and regulations.

Policy and regulation need to be simple, coherent and accessible to SMEs

Ensure policies and regulations are coherent. Policymaking needs to connect different sectors to ensure clarity and coherence; climate regulations should, for instance, be consistent with and complementary to industrial regulations.

Provide advice and guidance on green practices to entrepreneurs so that they know more about how to be environmentally sustainable, measure their impact and monitor progress, as well as about the skills they need and the most cost-effective solutions. Essential measures for supporting green business development include advertising, proactive information dissemination, web-based guidance tools and direct capacity building.

Simplify regulatory requirements for SMEs and make environmental compliance processes more effective and supportive. Environmental compliance requirements should be clearer and adapted to specific business sectors and activities. The administrative burden of demonstrating compliance with environmental regulation should be proportionate to the goals and should be adapted to SMEs' ability to monitor and filter information. Compliance procedures should be

accessible to small businesses and clear, easy to follow and less time consuming, requiring a minimum amount of documentation.¹²

Support the creation of markets. Policies should make it possible to recognise green practices by creating simplified environmental management systems that are suitable for small businesses, together with sector-specific green certification procedures and eco-labelling schemes to increase consumer demand for green products. Certification of green products and services increases consumers' trust in the authenticity and green qualities of their purchase. In addition, actions to raise public awareness are needed to increase consumer demand for environmental products and services.

Provide adequate financial incentives and incubating programmes for green SMEs. Incentives provide initial motivation and confidence to invest in reducing environmental impacts, but the aim should also be to make sure entrepreneurs can operate independently, become financially sustainable and not have to depend on subsidies indefinitely. Incubating programmes, for example, need a more profit-oriented mind-set in order to become financially sustainable over the long term.

*Access to
funding
remains a big
challenge and
an area in which
governments
can make
a significant
contribution*

Support the financing of green SMEs through soft loans granted by public financing institutions at reduced interest rates during the kick-off or incubation period, and create grant programmes to boost and support green business development. Policymakers should also encourage private-sector funding of green SMEs, both by educating the financial sector about green SMEs and by creating long-term frameworks that establish "green" as an area of long-term importance.

Allow tax privileges for green investments by offering tax reductions or exemptions for environment-related investments and environmental technologies, where the environmental impact can be clearly demonstrated.

Build the capacity of green businesses. Policymakers should address the lack of green SMEs' business skills and promote training opportunities and access to education, in particular by making sure they know how to measure their environmental impacts and increasing their management skills and financial literacy. Green business networking and linkages to environmental solutions should be facilitated to raise awareness of new green technologies and sustainable solutions.¹³

Further research

Further research could look for answers to practical questions such as:

- Which factors influence the adoption of environmental aspects by entrepreneurs and consumers, and what policy measures are most efficient in raising environmental awareness of, and increasing consumer demand for, green products and services?
- What types of incentives and incubating programmes provide the most balanced enabling environment for green businesses in order to support both the implementation of green practices and their financial sustainability?
- What measures should be taken to best support the capacity building and skills development of green entrepreneurs to increase the competitiveness and investment readiness of green SMEs?
- What policies are required to “green” the activities of existing SMEs in order to reduce industrial pollution from current environmentally unfriendly production?

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Green growth and win-win strategies for sustainable climate action (GREEN-WIN)

The GREEN-WIN Project identifies, develops and critically assesses win-win strategies, green business models and green growth pathways that bring short-term economic benefits, while also supporting mitigation and adaptation goals within the broader sustainable development agenda.

Work programme

- At national levels, GREEN-WIN analyses win-win opportunities that arise through integrating policies across different sectors, and advances state-of-the-art macro-economic models in order to identify green growth pathways.
- At local levels, GREEN-WIN carries out action research case studies to develop green business models and enabling environments in the following three areas: i) coastal flood risk management in Jakarta, Kiel, Rotterdam and Shanghai; ii) transformations in urban systems in Barcelona, Istanbul, Shanghai and Venice; and iii) energy poverty and climate-resilient livelihoods with case studies in India, Indonesia and South Africa.
- Cutting across both levels, GREEN-WIN investigates financial products and policies, as well as financial system reforms that redirect financial flows towards sustainability and climate action.
- All of these activities are embedded in an open dialogue between research institutes, international organisations, business, and civil society that co-develops shared narratives around win-win strategies, business opportunities and green growth pathways

Project partners

Global Climate Forum (GCF), Germany (coordinator) | The Institute of Environmental Sciences and Technology, Autonomous University of Barcelona, Spain | E3-Modelling, Greece | Environmental Change Institute, Oxford University, UK | Ecole d'Economie de Paris, France | University College London, UK | The Ground_Up Association, Switzerland | Stichting Deltares, The Netherlands | Institute for Advanced Sustainability Studies, Germany | Global Green Growth Institute, Republic of Korea | Jill Jaeger, Austria | European Centre for Living Technology at Università Ca' Foscari Venezia, Italy | Institute of Environmental Sciences at Boğaziçi University, Turkey | Universitas Udayana, Udayana University, Indonesia | University of Cape Town, South Africa | 2° investing initiative, France | Sustainability and Resilience, Indonesia



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Contact

Jochen Hinkel (project coordinator),
Global Climate Forum (GCF), Germany
mail: greenwin@globalclimateforum.org
twitter: [@greenwinproject](https://twitter.com/greenwinproject)
web: www.green-win-project.eu