

## Chapter 1

### Greening SMEs: Opportunities and challenges in EaP countries

*This chapter discusses the importance of greening SMEs and the opportunities and challenges that it entails. While the environmental impact of individual enterprises may be low, in aggregate their impact is significant. SMEs are also important for green growth as key drivers of eco-innovation and key players in emerging green industries. Reducing the environmental impact of SMEs through achieving and going beyond environmental compliance in both manufacturing and services is a key success factor in greening the economy.*

*Obstacles are also explored, including the difficulty of SME environmental regulation due to their number and diversity of activities, and the challenges that SMEs face in greening, such as limited capacity to respond to regulation, risk aversion, and access to finance. SMEs are often unaware of business opportunities of green practices, are concerned about short-term financial profitability and reluctant to invest in green technologies, especially given the difficulty in accessing affordable finance.*

## Definition of SMEs

The legal definition of SMEs varies by country and by industry. In addition to the number of employees, methods used to classify small companies include annual sales (turnover), value of assets and net profit (balance sheet), alone or in a mixed definition. The definition in the European Union (EU) is that an SME is an enterprise of less than 250 employees, with a turnover below EUR 50 million or balance sheet total not exceeding EUR 43 million. A small business is defined as having less than 50 employees with a less than EUR 10 million balance sheet, and a micro-business would have less than 10 employees and less than EUR 2 million balance sheet.

Among EaP countries, the definition of an SME in terms of the number of employees is identical to that of the EU in Armenia, Moldova and Ukraine (in the former two countries the turnover thresholds have been adjusted to the average income levels, which are much lower than in the EU). Belarus defines micro-enterprises as having up to 15 employees, small companies have up to 100 employees, and medium-sized firms up to 250 (there is no turnover criterion). Georgia has set lower thresholds: 20 employees for small enterprises and 100 for medium-sized ones. In Azerbaijan, the thresholds for “small enterprises” (a single category) vary depending on the economic sector: 50 employees in industry, 25 in agriculture, and 10 in services, for example.

At the same time, environmental regulatory regimes are designed around environmental risk and not to address any particular company size. No environmental regulation specifically targets SMEs, instead distinguishing low-risk activities and installations, although regulatory guidance usually keeps in mind particular features of small businesses. Environmental enforcement authorities are not systematically aware of the number of SMEs they regulate and do not collect this information.

It is not easy to define low risk to human health and the environment. Environmental regulators in different countries have very different risk tolerances, driven in part by their mandate and the institutional context. In practice, low-risk installations are usually defined “by exclusion”, i.e. as those that are not considered high-risk. Risk assessment criteria typically relate to the environmental hazard of a regulated facility (its complexity in terms of impacts on different environmental media, location with respect to urban and environmentally sensitive areas, volume of pollution releases and potential for accidents) and to its operator’s performance (compliance record and environmental management practices). Low-risk installations are generally eligible for a simplified regulatory regime.

The environmental legislation of EaP countries defines an enterprise as having low, medium or high environmental risk depending on their economic activity and potential environmental impact. For example, in Georgia and Belarus economic activities with high environmental impact are defined in relation to the requirement to undergo an environmental impact assessment (EIA). Low environmental impact may also be defined with respect to certain environmental media: in Belarus, no air emission limits are set for low-impact facilities.

This Guide uses the term “SMEs” as a more widely accepted term, particularly in the context of greening the economy and in recognition of the specific regulation and compliance challenges related to small businesses. However, it focuses on those SMEs that are considered by relevant environmental regulators to be low-risk installations.

## Role of SMEs in greening the economy

SMEs account for approximately 99% of all enterprises (of which over 90% of enterprises are micro-enterprises) and two-thirds of employment across the OECD area. Although small businesses' individual environmental footprint may be low, their aggregate impact can, in some respects, exceed that of large businesses. For example, SMEs account for 60-70% of industrial pollution in Europe (Miller, 2011). The key sectors where SMEs have a significant environment impact include livestock farming, construction, metal finishing, waste treatment, food and drink industry, and textile and leather manufacturing.

SMEs are important for green growth as key drivers of eco-innovation and key players in emerging green industries. Growing opportunities exist in the services associated with greener manufacturing. Highly creative and innovative SMEs in the service industry, such as design and architecture firms or bio-energy solution providers, contribute increasingly to eco-innovation across a broad range of industries. New and young firms are particularly important for radical green innovations, as they often exploit technological or commercial opportunities which have been neglected by more established companies or even challenge the business models of existing firms.

The “green transformation” is also a significant business opportunity for SMEs themselves as important suppliers of goods and services. Indeed, the principal drivers for SMEs to adopt green practices are non-regulatory and include:

- the rising price of commodities and key raw materials
- potential cost savings and competitive advantage
- market pressure from customers.

However, the willingness and capability of SMEs to adopt sustainable practices and seize green business opportunities generally face size-related resource constraints, skill deficit and knowledge limitations. SMEs are often unaware of many financially attractive opportunities for environmental improvement. There is a widespread misperception that protecting the environment is associated with technical complexity, burdens and costs. Even when they are aware of the potential of better environmental performance to improve a firm's competitiveness, a lack of appropriate skills and expertise commonly prevents firms from acting upon win-win opportunities. At the same time, the lack of resources often leads to SMEs being risk-averse and less willing to invest in new technologies, partly because of the uncertainty about the payback period.

The UK Carbon Trust poll found that 65% of consumers want to purchase products from environmentally responsible companies. Yet more than half of SMEs see a greener economy as a threat, about half of small businesses believe that benefitting from the green economy requires a lot of investment capital, and only 22% think that investing in green products and services will lead to higher profits (Carbon Trust, 2011).

For SMEs, going green is largely a voluntary action dependent upon the vision and conviction of one or a few individuals. Many SMEs are willing to invest in more energy-efficient and environmentally friendly processes, but they require reliable partners in financing their investments and the right regulatory framework. However, they often face obstacles in getting access to finance, with banks being reluctant to fund such investments and lacking the specialised staff needed to evaluate SME projects.

An increasing number of business associations in OECD countries are asking their governments to provide support to SMEs in the transition to the green economy. In response to this, the EU has undertaken a number of policy initiatives to support the green transformation

of SMEs (Box 1.1), aimed at making sure that regulations are easy to understand and take account of the needs of small businesses; providing clearer information on the range of green choices available and their practical and financial aspects; and using financial incentives to give small businesses confidence to invest in green technologies and management systems.

### Box 1.1. Policy initiatives for SME greening in the EU

The concerns of small businesses have become a priority as governments across the EU introduce better regulation initiatives. The Small Business Act for Europe (2008) was developed to establish the “Think Small First” approach to policy making and regulation and to promote SMEs’ growth. One of its ten high-profile principles is “enable SMEs to turn environmental challenges into opportunities” – a paradigm which lies at the heart of the transition to green growth. The European Commission has committed itself to “rigorously assessing the impact of forthcoming legislation and administrative initiatives on SMEs (“SME test”) and taking relevant results into account when designing proposals”.

The European Commission has recently prepared a Green Action Plan for SMEs, which aims to:

- Improve resource efficiency of European SMEs;
- Support green entrepreneurship;
- Exploit the opportunities of greener value (supply) chains; and
- Facilitate market access for green SMEs.

Sources : EC (2014), *Green Action Plan for SMEs: Enabling SMEs to turn environmental challenges into business opportunities*, <http://ec.europa.eu/growth/smes/business-friendly-environment/green-action-plan/>; EC (2008), *Think Small First – A “Small Business Act” for Europe*, [https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act\\_en](https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act_en).

## Obstacles to improving environmental performance of SMEs

Recent research has shown that while SMEs account for approximately 64% of the industrial pollution in the EU, only very few of them proactively engage in actions to reduce their environmental impact: 3-4% of micro-businesses, 7-8% of small companies and 6-7% of medium-sized companies (Calogirou et al., 2010).

For the government, the environmental regulation of SMEs represents a major challenge due to the diversity of SMEs’ activities and respective environmental issues, the substantial number of operators, and the lack of information available to the regulator about their levels of compliance. The majority of SMEs are “vulnerably compliant” (EC, 2002), in the sense that they do not know enough about environmental requirements to ensure that they always comply with all of them.

What motivates SMEs and their owners is likely to be very different from what motivates large corporations. Despite their heterogeneity, SMEs have many common characteristics that influence their approach to environmental issues and the implementation of green practices; both in achieving and going beyond compliance (see also Table 1.1):

- Ownership and management are concentrated on the same hands. The entrepreneur plays a key role in the enterprise and his personal preference is usually the most influential factor when deciding about investments and business strategies.

- This entrepreneur is very likely to suffer from important time and task pressure, which leaves him with little time to reflect strategically on future activities beyond the core business of the company. This could imply that investments that are not related to core business are regarded as secondary and suffer from insufficient attention.
- SMEs have a limited capacity (lack of resources, time and expertise) to absorb environmental requirements and to comply with them, as well as a low awareness of the need to address their environmental impacts.
- The entrepreneur himself usually is not well informed about opportunities of the relevant green practices, their costs and benefits. Given this time and task pressure, SMEs usually rely heavily on the opinion of their professional surrounding (trade associations, suppliers, clients, accountants, etc.), which often have the same lack of information.
- The entrepreneur is often risk-averse given the relatively small economic size of the enterprise. Uncertainty may be associated with operational issues within companies, such as the capacity to absorb and implement the change required to improve environmental performance. These include uncertainty about the most appropriate technology to be used and the lack of knowledge on how to incorporate green practices into the core business planning.
- The required pay-back for new investments is often as short as two-three years (it is also a function of the cost of capital). Generally, environmental technologies encompass higher costs in the short term whereas the extra benefits are realised in the longer term, which hinders their adoption by SMEs. Limited access to finance is also a key limitation. The most common environmental issues for SMEs, such as resource and energy savings, which usually are not related to the core business of the company, are only addressed if actions are likely to result in a substantial cost reduction in the short term.

Table 1.1. **Internal barriers in SMEs that prevent the adoption of environmental improvements**

Resources	Attitudes and company culture	Awareness
<ul style="list-style-type: none"> <li>• Lack of time to investigate issues or locate support or tools</li> </ul>	<ul style="list-style-type: none"> <li>• Belief that SMEs have a low environmental impact and have no environmental issues to consider</li> </ul>	<ul style="list-style-type: none"> <li>• Low awareness of environmental legislation</li> </ul>
<ul style="list-style-type: none"> <li>• Severe time pressure in small enterprises</li> </ul>	<ul style="list-style-type: none"> <li>• Mismatch between beliefs and actions: positive attitude toward the environment is not translated into actions</li> </ul>	<ul style="list-style-type: none"> <li>• Low awareness of support organisations and information sources</li> </ul>
<ul style="list-style-type: none"> <li>• Lack of resource allocation to address environmental issues</li> </ul>	<ul style="list-style-type: none"> <li>• Perception that environment has no relevance to the business: environment given no status as a business issue</li> </ul>	
<ul style="list-style-type: none"> <li>• Lack of investment in training</li> </ul>	<ul style="list-style-type: none"> <li>• Scepticism about the potential cost savings and market benefits</li> </ul>	
<ul style="list-style-type: none"> <li>• Cost constraints on investment</li> </ul>	<ul style="list-style-type: none"> <li>• Prevalence of short-term business planning; belief that costs of environmental measures arise quickly while benefits accrue slowly</li> </ul>	
<ul style="list-style-type: none"> <li>• No employee allocated responsibility for environmental issues</li> </ul>		

Source: EC (2002), *European SMEs and social and environmental responsibility*, <https://publications.europa.eu/en/publication-detail/-/publication/60177f21-1835-4c5e-bf29-6a47b5b0808f/language-en>.

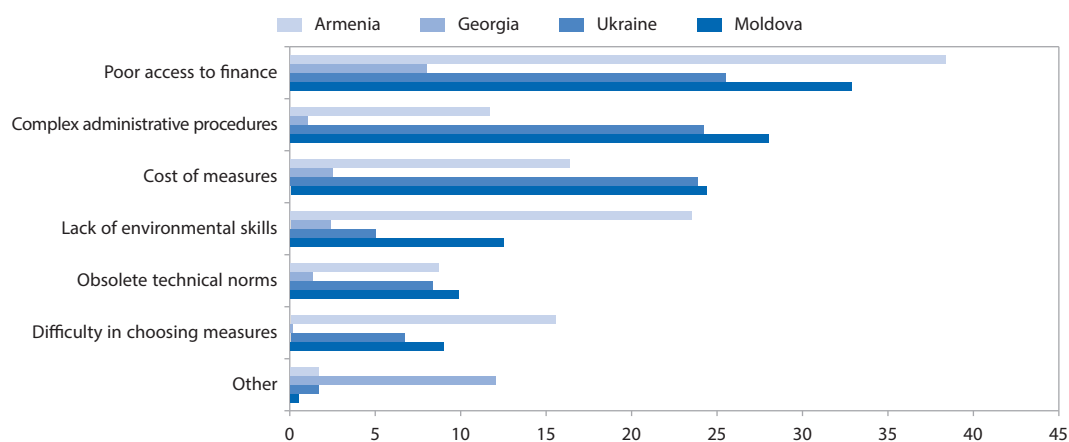
- SMEs experience little external pressure to behave in a more environmentally friendly manner. It is difficult for NGOs or customers to assign specific negative environmental consequences to one or more SMEs, while it is much easier to target large well known enterprises. Furthermore, governments in general avoid increasing external pressure on SMEs by environmental legislation.

A Eurobarometer survey of EU SMEs (EC, 2013) looked at reasons for inaction on resource efficiency. Approximately 26% of European SMEs said that administrative or legal procedures were complex, and 24% said that the cost of environmental actions was a barrier. In addition, 20% indicated that they were hampered by a lack of specific environmental expertise, and 17% experienced problems in choosing the right actions for the company.

Half of SMEs in the EU (51%) do not wish to go beyond compliance with applicable regulatory requirements, while 22% are contemplating doing more than required by the legislation, and 19% are doing so already (for 11% of respondents, environmental concerns are part of the company's priority objectives). The larger the SMEs, the more likely it is to define environmental concerns as a priority.

In similar surveys in EaP countries,<sup>1</sup> among the key obstacles to engaging in green practices SMEs quote costs and poor access to finance (for all sizes of SMEs), and various bureaucratic barriers such as complex administrative procedures and obsolete technical requirements (Figure 1.1). The lack of environmental skills is generally not considered to be an important gap: as other survey responses illustrate, SMEs in the region see themselves as technically competent to introduce green practices. A large percentage of respondents indicate that they do not encounter any difficulties in trying to undertake environmentally friendly actions. However, they still do not want to go beyond compliance with environmental requirements: for about 35-40% of SMEs in Armenia, Georgia and Ukraine this is not a priority for the company.

Figure 1.1. **Barriers to green practices among SMEs in EaP countries, percentage of respondents**



Sources: OECD (2016a), *Promoting better environmental performance of small and medium-sized enterprises in Ukraine*, [www.oecd.org/env/outreach/Ukraine%20pilot%20project%20report%20EN.pdf](http://www.oecd.org/env/outreach/Ukraine%20pilot%20project%20report%20EN.pdf); OECD (2016b), *Promoting better environmental performance of small and medium-sized enterprises in Georgia*, [www.oecd.org/env/outreach/Georgia%20pilot%20project%20report%20final%20EN.pdf](http://www.oecd.org/env/outreach/Georgia%20pilot%20project%20report%20final%20EN.pdf); OECD (2015a), *Promoting better environmental performance of small and medium-sized enterprises in Armenia*, [www.oecd.org/environment/outreach/SME-greening-country-pilot-report-Armenia-en.pdf](http://www.oecd.org/environment/outreach/SME-greening-country-pilot-report-Armenia-en.pdf); OECD (2015b), *Promoting better environmental performance of small and medium-sized enterprises in Moldova*, [www.oecd.org/environment/outreach/Binder%20English.pdf](http://www.oecd.org/environment/outreach/Binder%20English.pdf).

## Conclusion

Reducing the environmental impact of SMEs through achieving and going beyond environmental compliance in both products and services is a key success factor in greening economies in EaP countries. SMEs have significant environmental impact in aggregate and are a vital channel for the development of innovative green products and services. At the same time, there are substantial obstacles which must be overcome to achieve these goals. As discussed during this chapter, these obstacles are multi-faceted and exist across a range of terrain, including the capacity of SMEs to justify and adopt green practices, the availability of information, resources, and finance, and the capacity and co-ordination of public and private sector actors. The following chapters in this Toolkit explore these questions, and provides guidance supported by good practice from other jurisdictions.

## Note

1. The surveys were conducted in 2014-15 in Armenia, Georgia, Moldova and Ukraine using a questionnaire inspired by the Eurobarometer and covered over 400 SMEs in each country (OECD, 2015a, b; OECD, 2016a, b).

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