

Engaging Small and Medium Enterprises in Environmental Performance

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EXECUTIVE SUMMARY

Implementing The Green Advantage(tm) in Small and Medium Sized Enterprises is a project based on a partnership between The City of Playford, University of Technology Sydney and Ecobusiness Consultants Pty Ltd.

The project builds on recommendations arising from the first Australia-wide survey examining the attitudes of small to medium sized enterprises (SMEs) to issues of sustainability, which was conducted by the University of Technology Sydney and Ecobusiness Consultants in May, 1999.

In particular, Implementing The Green Advantage(tm) in Small and Medium Sized Enterprises addresses the 1999 recommendations for more detailed case study research on how SMEs can implement the Green Advantage(tm).

Competition for capital and new investment opportunities is driving the environmental performance of SMEs in the 21st century. Achieving this objective requires financial performance and a commitment to innovation and best practice.

"Sustainability driven companies achieve their business goals by integrating economic, environmental and social growth opportunities in a pro-active, cost-effective and responsible manner today, so they will outpace their competitors and be tomorrow's winners."

Australian SMEs, however, do not appear to be placing sufficient focus on environmental issues. Those that continue to invest in unsustainable practices may well find their profitability deteriorating, especially SMEs that are part of global supply chains.

Integrating environmental management into the business simply to remain in the supply chain is rapidly becoming a business given. For instance, lucrative international contracts are now demanding value for money and sustainable business solutions.

However the SMEs we interviewed for this project were the last to feel the impact of these drivers and generally slow to introduce environmental management controls.

On the other hand, the very process of engagement with companies has had a positive spin-off. Through the interviewing process, larger corporations in this project became more aware of their environmental and corporate responsibilities, global supply chain implications, and the force of changing consumer preferences. They also recognised that the quality of their demand directly influences the decision-making processes regarding investment and production processes of the SMEs with whom they did business.

The project team, therefore, felt it was essential to gain a greater understanding of SMEs innovation pathways and networks. In particular, the four Continuing Phases of the Innovation Process. In summary these are: Identifying Market Signals; Setting a Strategic Concept; Searching and Selecting a Solution and; Implementation.

Recommendations in 'Implementing The Green Advantage(tm)' focus on awareness, education and innovation outcomes to bring SMEs in the region in line with 21st century business practices.

INTRODUCTION

'The Green Advantage(tm)' is the competitive advantage derived by SMEs in undertaking best practice environmental management techniques applicable to their industry.

"There is something ironic, if not contradictory in the idea that environmentally friendly companies could become the next big thing in the share market - they could form the basis of a "green boon" to rival the late 1990's..."
Shares Stockmarket Magazine

In Australia, Westpac's Eco Index, since its establishment in 1999, achieved a 26.5% return compared to the All Ordinaries Index of 21.7%. 3

In recent times, the drivers for corporate sustainability have expanded from regulatory based to financial, focussing on investment. Research undertaken by the Dow Jones (of the New York Stock Exchange) indicates that the financial performance of sustainability companies outstrips that of their competitors operating on old economy models.

"The concept of corporate sustainability has long been very attractive to investors because of its aim to increase long-term shareholder value. Sustainability-driven companies achieve their business goals by integrating economic, environmental and social growth opportunities in a pro-active, cost-effective and responsible manner today so that they will outpace their competitors and be tomorrows winners".

Financial markets are backing winners with strong environmental practices and robust returns to shareholders. Part of this process is no doubt driven by the market; the Dow Jones Sustainability Index alone is valued at around \$4.3 trillion.

"These international trends are also influencing the way we do business in Australia. In a global economy this means ensuring that our companies are in step with the compliance and reporting practices demanded in advanced economies".

Meanwhile the pace of environmental regulation continues to increase throughout the developed economies.

Companies that choose to turn their backs on these trends will increasingly face more punitive regulatory regimes. They will also experience difficulty in raising capital, especially in an environment where discerning shareholders will only invest where there is greatest market certainty and profits to be made.

This means that Australian companies wishing to break out of small domestic markets into new and larger international markets will be required by legislators and shareholders alike to improve their triple bottom line of economic, social and environmental sustainability.

For instance, Australian companies which still want to access lucrative "government-preferred purchasing programs in the US and Europe need to be able to provide environmental credentials under ISO 14000 to be even considered ... To be able to get into the supply chains of a growing number of multinationals they have to provide high level verification that their own processes are environmentally sound".

New Economy SMEs Drivers to 'The Green Advantage(tm)'

SMEs have been recognised for the important contribution they make to developing new export markets, and driving the nation's innovation efforts through the creation of new products.

Globally, the emergence of international 'best practice' companies moving into sustainable development places new demands on their suppliers, be they national, state or local companies, large, medium or small, to supply goods and services that meet sustainable benchmarks. This development through the 'supply chain' is a major driver for SMEs to address both their environmental performance and to develop first mover advantages over their competitors.

Meeting these new consumer demands or sustainable benchmarks of 'green' best practice means an investment in innovation, product development and new plant and equipment.

New investments such as these create new demands for our scientists, engineers and technicians. It is an investment in skill formation and strengthens the very fabric of the knowledge economy.

At an even more localised level, it generates sophisticated demand and new business opportunities for our machinery equipment manufacturers, precision engineering and tooling companies through to a vast network of suppliers.

Other drivers of change in environmental management affecting or are expected to affect SMEs include:

Financial: Environmental costs are increasingly being internalised in the business with such charges as water consumption and waste disposal. As these costs increase, the cost of business increases and in the ever more competitive market place these costs will either reduce the profit or sales or both of the SME. Finance and insurance requirements are also cited as drivers for undertaking good financial management.

Regulation: The legal requirements of business now include environmental laws and regulations that they may need to comply with. Acts and regulations affecting SMEs now include those on water resources and quality, air quality, contaminated land, dangerous substances, sewerage as well as those that regulate development. Compliance with these regulations can result in the internalisation of the environmental costs. Non-compliance can result in closure of the business.

Market Demand: Not only are business supply chains changing, but end consumers are making more environmental demands on business in products and services.

Employees: Safe work practices have been the feature of legislation over the last decade and campaigns by trade unions and insurance bodies have increased. Employees themselves have indicated a preference to work for good corporate citizens and this has been recognised as a major incentive for them to stay with those employers.

IMPLEMENTING 'THE GREEN ADVANTAGE(tm)'

SMEs represent some "99% of Australian enterprises employing a workforce of under 100 people and companies of under 100 people are responsible for 60% of all employment in Australia". Although individually their environmental impact may not be great, their cumulative impact is substantial.

It has been suggested that SMEs will look at environmental issues if cost benefits are attached to them and they gain a competitive advantage. But are these drivers relevant to SMEs in Australia at this point?

The results from the 1999 survey, together with consideration of international experiences, particularly in Denmark, has resulted in the implementation stage being focussed on a dialogue with a local government region.

A region, when addressing its Local Agenda 21 and its economic development plans, has an opportunity to merge the two and gain a competitive advantage over other regions by developing 'The Green Advantage(tm)' in partnership with SMEs.

A local government region is well suited to work with SMEs because they know their local business community as well as other entities that can help promote improved environmental activities such as banks, insurance companies and local chambers of commerce. Therefore, a key partner in this project was The City Of Playford.

The City of Playford is described as a local government area forming the northern boundary of the metropolitan area of Adelaide, South Australia. It covers an area of 345 square kilometres, and has a diverse range of environmental characteristics, from the Mount Lofty Ranges in the east to the mangrove region on the coast in the west. The City is a diverse area of extending urban development with a significant horticultural industry and manufacturing industry.

This part of the project aimed to establish how SMEs can be assisted with environment management issues to:

- Improve long term economic and environmental sustainability of the region.
- Identify environmental management products and services in the region that can assist SMEs to obtain economic and environmental sustainability.
- Establish a demonstration program so the program can be implemented across the region.

A web site has been developed, <http://www.ecobusiness.com.au/sme>, as a tool for the interview process and for disseminating the results of the project. A resource section for South Australian SMEs is included in this web site.

RESULTS OF IMPLEMENTING "THE GREEN ADVANTAGE(tm)"

General Observations

The results of face-to-face interviews suggest that SMEs face considerable environmental challenges, albeit it is recognised that the survey sample size is not statistically significant.

All but one of the SMEs interviewed believed that environmental issues were important to their company. They also believed that small business could solve environmental problems and that business had a role to play.

SMEs that were interviewed were generally unaware about environmental management systems (33% were aware) and only one (8%) had an environmental policy. This contrasts with the Australia-wide survey (see Appendix One), which found that 46% had an environmental policy. With the larger companies, 66.6% had heard of EMS, 33% had an environmental policy and 66.6% had an environmental plan.

Recommendations

- 1) A strategic alliance be established between local government and the relevant industry trade associations in the region to present and establish an education process for SMEs in the local government area.
- 2) This education process is to include good management principles and documentation of processes and line responsibility.
- 3) The education process provides a focus on key areas of pollution confronting SMEs, being ground water, soil pollution, energy usage and waste management.

4) Develop a mentoring role within the region. A variety of mentoring models could be used including mentoring by the local council, cluster mentoring, one-to-one business mentoring or mentoring through the supply chain. Mentors can be very valuable to SMEs in terms of helping them on the road to compliance. Through this process, mentors can also demonstrate their commitment to improved environmental performance.

Financial Benefits and Threats

These, together with regulation, have traditionally been seen as a major driver forcing industry to undertake environmental management of their business.

The perception during this process was that environmental costs and charges were largely insignificant to the businesses interviewed. The respondents generally agreed that the charges had risen over the past years and were likely to continue rising significantly into the future. However, the impression was that they were not significant enough to force action upon the businesses at this time.

This could be in the face of such issues as the GST being introduced during the interview process and this being a more significant and immediate threat to the operation of the business.

None of the business owners had considered that banks had applied any environmental criteria in their lending. Insurance companies also had not applied any environmental considerations in their assessment of insurance risks.

Recommendations

- 1) Identify environmental criteria used by lending institutions at present and their likely future direction.
- 2) Identify insurance companies' criteria for insuring against environmental risk.
- 3) Track environmental costs and charges for their degree of increase and the relative costs to the business.
- 4) Consider local government costs and charges to business and the influence that they may have on future environmental management of SMEs.

Legal Drivers and Threats

Individuals interviewed were split about whether they even knew what environmental legislation affected their business. The interviewers perceived a strong reticence about even becoming involved in this interview process. The interviewees believed that environmental information will increase and for many of the businesses a high level of risk to the future of their business is associated with non-compliance of the legislation.

This presents a worrying picture when half of the people interviewed were not confident whether they have sufficient knowledge about the environmental legislation to which they may be subject:

- 38% of the SMEs knew which environmental legislation applied to their businesses. 62% said that they knew where to go if they needed that information. However, this doesn't seem to have been translated into practice.
- In response to a question asking what risk is there for non-compliance with legal requirements, 31% identified a very high degree of risk, 23% responded with a fairly high degree of risk and 46% identified some risk.
- 67% believed that regulatory requirements would increase over the next three to five years and 33% believed they would decrease.

This contrasts quite markedly with the larger organisations, all of which knew which environmental legislation applied to their businesses. They all believed that regulatory requirements would develop over the next three to five years and that legal compliance was very important to their business. 100% of those interviewed said they believed that by reducing their environmental impact that this would improve their chances of obtaining permits to expand or develop new activities.

Recommendations

- 1) Raise their level of awareness of the SMEs environmental impact and how environmental laws may affect them by a targeted communications program.
- 2) Collate relevant environmental regulation in an understandable reference source, which would be made available through local government and trade associations.
- 3) Target the individual needs of SMEs. This is often the most difficult because it is resource intensive. The specific individual needs must be identified. It is also crucial to limit the sources of information and to this end, there needs to be coordination and cooperation between the vast number of intermediaries, such as banks, insurance companies, the EPA and trade associations.

Stakeholders' Benefits and Threats

Employees and surrounding residents are largely not seen as threatening business on environmental issues. This is largely due to the SMEs being confined to precincts and generally, not being in contact with residents. However, employees' concerns about occupational health and safety are also, in the main, key environmental risks.

The larger corporations were more concerned about public perceptions and therefore more concerned to specifically communicate any environmental concerns, to the wider public.

Marketing Benefits and Threats

The SMEs interviewed were largely unaware of the movement of larger corporations to ISO 14000 accreditation and other environmental management systems and the effects that this may have on them. This is largely due to them being second Tier suppliers and currently the 1st Tier are those being affected.

This is borne out with the larger corporations interviewed being aware of this issue and taking steps to address the environmental issues. Although none of their customers were currently making demands regarding the environmental impact of their products or services, all of them believed that over the next three to five years, their customers would begin to make such demands. 67% saw opportunities arising from meeting their customer's environmental concerns.

Recommendation

- 1) In any program instigated, the marketing benefits to be identified and highlighted.

Supply Chains and Environmental Management

Traditionally, supply chains are depicted as in Figure 1 with a 2nd Tier supplier, often the SME, supplying to a 1st Tier supplier who in turn supplies the original equipment manufacturer (OEM). Two things are happening that affect small business:

- 1) Firstly, the OEM has moved towards environmental management systems as a result of market demand, regulation or efficient production needs. This is then communicated to 1st Tier suppliers who will need to have environment management systems in place to ensure they meet the standards of the OEM. In many cases this is yet to trickle down to the 2nd Tier suppliers.

However, as this does eventually impact, SMEs that continue to disregard early warning signals will be left floundering under a combination of pressures from regulators as well as from their customers.

- 2) The second change is the move to integrated supply chains, as shown in Figure 2. This places even more pressure on 1st Tier and 2nd Tier suppliers, because as OEMs move into Environment Management Systems then the whole networked supply chain will be required to move as well. These new integrated supply chains are based more on trust and collaboration to meet the requirements of developing new products and services, together with meeting the environmental demands of final customers and consumers.

These movements in supply chains were not recognised by the SMEs interviewed although many did deal with OEMs that were moving to environmental management system certification, such as General Motors Holden, Scholle and Serco. Even retail precincts are coming under pressure as landlords such as AMP deal with environmental issues and pass their requirements to leasees resulting in the adoption of waste minimization and energy efficiency strategies.

The larger organisations interviewed tended to recognise these changes, especially those that had dealt with European markets, and had addressed the environmental issues confronting them.

Recommendation

- 1) The issue of supply chains and the impact that this could have on SMEs needs to be highlighted in information providing to them.

CONCLUSION

The SMEs interviewed recognised that small business could have an environmental impact and that they could change this impact. They were aware of regulations and many recognised that their customers were at least interested in environmental issues. Supply chains and impacts that these may have on their business were largely not understood.

In many ways, this defines the problems facing small businesses. They are engrossed, many times by necessity, in the day to day running of the business and are not able to take a strategic view of their business.

Environmental issues may be seen as unimportant to SMEs; and in Australia they may be justified in this view with the slowness of taking up environmental legislation and innovation as a whole. But world markets in the United States and Europe will see the exclusion of Australian companies from international supply chains due to environmental issues.

SMEs need to be drawn into the innovation process. The four continuing phases that make up the innovation process are:

- Identifying market signals
- Setting a strategic concept
- Research into solutions and selecting them
- Implementation

An understanding of environmental innovation networks is also a necessary step in furthering this innovation process. These networks are available to SMEs to enhance their environmental performance and they can act as a driver for the SME to perform in the environmental arena. During our interview phase it was noted that SMEs were largely ignoring the market signals around environmental innovation, while larger firms were both aware of them and had gone to the fourth stage of implementation.

It is important for a local government to recognise these signals as well, and how they impact on the SMEs in their area. As local, national and international companies follow the path of the Dow Jones Sustainability Index for their investment model and adopt 'Triple Bottom Line Management Principles', those regions that harbour 'environmentally unsustainable' business, be they SMEs or larger corporations, will cease to be attractive for new businesses and will result in disinvestment in the region.

Local government is in a prime position to facilitate this process by bringing together the various players in the cluster network to engage SMEs, using a mentoring system to educate the SME sector in the innovation and networking benefits. Local government can partner with regulatory organisations such as the Environment Protection Authority (EPA) and the Office of Energy in South Australia, both of which have extensive materials dealing with small business on environmental issues. For example, the Office of Energy has kits for energy saving and EPA cleaner production programs.

The recommendations in 'Implementing The Green Advantage(tm)' focus on awareness, education and innovation outcomes to bring SMEs in the region in line with 21st century business practices.

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