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INSIGHTS FROM THE FIELD:
Unlocking SME Emissions Reductions in the Green Recovery

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Recommendations

- SME-specific emissions regulation
- Renewal and expansion of NrCan's Energy Manager Program
- Flexible retrofit incentives
- SME-specific financing options
- Increased public education
- Feasibility studies - multi-tenant buildings
- Federal interdepartmental coordination task force

Canadian SMEs are currently underserved by government climate actions. In the September 2020 speech from the throne, the federal government promised that "climate action will be a cornerstone of [the Government of Canada's] plan to support and create a million jobs across the country." A number of plans and initiatives for robust climate action in the wake of COVID-19 have since been announced; most notably the Net Zero Emissions Accountability Act which legislates Canada's target of net-zero greenhouse gas emissions by 2050 and tasks the government with developing a credible plan to achieve this target. However, very little has been proposed to date to support and incentivize emissions reduction among small and medium sized enterprises (SMEs) in particular.

In a working paper with Smart Prosperity, we identified only 5 federal decarbonization policies or programs (out a total 99) that specifically targeted or engaged SMEs to reduce their emissions. In December 2020, the federal government released a strengthened climate plan, *A Healthy Environment and a Healthy Economy* which details, *inter alia*, new plans for zero-emissions public infrastructure, clean power investments, and carbon pricing scenarios, and specifically notes the significance of SMEs for Canada's green recovery. The plan commits to maintaining corporate tax cuts for companies that produce zero-emissions products and continuing consultations with businesses. However, the plan does not introduce any specific new measures for SMEs to reduce their emissions.

While provincial governments are perhaps best positioned to engage SMEs, we did not identify any provincial decarbonization programs or policies in Ontario for SMEs. Likewise, in our sample of municipalities in Ontario, we also did not identify any SME-specific programs or bylaws at the municipal level to support or regulate decarbonization.

The coming months and years will be a once-in-a-generation opportunity to realign business priorities through a green recovery. Engaging SMEs, who were the hardest-hit by COVID-19 within the private sector, will be critical. We interviewed 7 municipal policymakers, 4 federal policy makers, and 18 current and former NGO staff members who all have direct experience supporting sustainability capacity building among SMEs. This paper offers policy suggestions and insights from the field about how governments could effectively engage and support SMEs to plan and implement robust climate action in the post-pandemic green recovery.

SME Climate Action in a Green Recovery
Now, more than ever, SMEs need support. While the majority of businesses in Canada reported impacts to their operations due to COVID-19 and related shutdowns, Statistics Canada found that smaller businesses were more greatly affected compared with larger firms. In particular, small businesses were more likely to see revenue decreases, have less liquidity, and were more unlikely to be able to take on more debt. These impacts will be significant for the ability of the Canadian private sector to achieve the emissions reductions required to meet Canada's climate targets, as many will either be unable or unwilling to take on new capital projects like fuel switching or low-carbon retrofits.

Yet despite the significant challenges ahead for SMEs, the COVID-19 pandemic offers an opportunity to reset the way Canadian firms do business. The good news is that some SMEs already want to green their operations: Green Economy Canada, a national network of local sustainable business hubs, found that nearly 60% of their business members had joined and made environmental commitments primarily because doing so *aligned with their personal values*[1]. Members reported that they decided to make climate-friendly changes to green their operations mainly because "it was the right thing to do". This is in line with a recent Environics poll which found 62% of Canadians think that climate change is a major crisis, and approximately 66% feel that governments, companies and individuals need to do more. Public discourse on climate change has turned a corner; the Canadian public is ready to see change in the private sector, and ready for governments to support this change.

However, while "first movers" in the Canadian SME business community are shifting their business practices to align with changing public discourse and values on climate change, the vast majority of SMEs have yet to take action. Voluntary emissions registries for SMEs have reportedly struggled to expand their membership beyond businesses that are already environmentally conscious. An approach that relies primarily on voluntary action will not be sufficient: SMEs are less likely than larger firms to take on voluntary sustainability projects and external prompting has been shown to be critical for SME action on environmental issues. It's time for governments to take SMEs seriously as part of the Canadian green recovery.

It is understandable that governments have not moved as quickly to regulate SMEs; tackling larger emitters through the Output Based Pricing System was an important first step to move Canada towards our 2050 deadline. However, it is also likely that SMEs have been left out because federal policymakers may have less experience with SMEs than with larger firms. SMEs are notoriously difficult to reach with analogous single policies due to their diversity. They also tend to have less contact with the federal gov due to their lack of effective lobbying power at the provincial and federal level; in this sense, SMEs are underserved by the Canadian Federation of Independent Businesses and Chambers of Commerce, which have been slow to address progressive challenges such as climate change. This has likely led to missed opportunities for lobbying or engagement with governments about the specific needs and challenges facing SMEs. As a result, we find that engagement with SMEs on climate change represents a both a possible "blind spot" in the current federal plan, but also an important opportunity to transition Canada's economy toward a low carbon future.

1 Data obtained by author directly from Green Economy Canada.

Carbon Pricing

It should be acknowledged that while there are a limited number of SME-specific decarbonization policies, the federal carbon price does apply to all business and consumption across the board, and therefore does impact SMEs. Beginning in January 2019, the federal government launched a federal minimum carbon price of $20 a tonne, increasing by $10 each year until 2022. In December 2020, the federal government announced an update to the pricing plan that would increase by $15 per tonne per year to reach $170 per tonne by 2030. Carbon pricing is considered by most economists to be a critical part of any national climate strategy.

While an important piece of the puzzle, a carbon price alone is not sufficient to engage SMEs on decarbonization: pricing is “invisible” in the sense that carbon pricing isn’t as obvious as a consumption tax excised at point of purchase. While price sensitivity will certainly change the behavior of SMEs in some respects, this will not necessarily normalize the integration low-emission business practices or planning in the long-term or bring climate-friendly planning to the fore of SME business operations. There is also some preliminary evidence that SMEs may be disproportionately impacted by a carbon tax compared with larger firms: the Canadian Federation of Independent Businesses found that small businesses contribute almost 50% of the carbon tax revenues but get just 7% back in the form of grants and rebates. It is worth taking these concerns seriously, and to consider how to pair the carbon price with other policy instruments to support SME decarbonization in the long term.

Regulations

“It’s about trying to create a new culture in the community, but you know what changes culture faster? Policies.”

Of the policymakers and NGO staff we interviewed, there was near consensus that incentive programs will not be enough; regulations directed specifically at SMEs (which are currently not regulated by the federal Output Based Pricing System) will be necessary to achieve meaningful national reductions. While the carbon pricing system may indirectly push SMEs through downstream effects such as the price on energy consumption, these indirect effects are unlikely to have a substantive or transformative effect on business culture among SMEs in Canada, which would be a missed opportunity in the wake of a post-pandemic green recovery.

A green recovery will require substantial normative changes to business operations, with the long-term goal being that all businesses (regardless of size) will begin integrating environmental impact assessments and emissions budgeting into every aspect of planning and operations. The process of changing business culture will undoubtably be arduous and lengthy, however the field experts we interviewed agreed that regulations are likely the most expedient, and in the long term, the most cost-effective way to push SMEs to normalize the integration of emissions targets into regular planning.

Of course, there is a justifiable concern that introducing new regulations at a time when SMEs face challenges associated with the pandemic may place an unreasonable burden on these firms, many of whom are struggling to just survive. However, given the government's net zero emissions by 2050 target, some kind of regulation for smaller firms will be inevitable. SMEs represent 98% of Canadian businesses, employ over 70% of the Canadian workforce, and produce 30% of Canada's total national emissions—more than the combined annual emissions of Quebec, Manitoba, Saskatchewan, and the Atlantic Provinces. Getting these firms on board isn't optional if Canada is to meet its net-zero emissions by 2050 target, or to transition to a low carbon economy in the medium to long term.

Regulation is preferrable from the perspective of "first movers": field experts told us that, counterintuitively, many SMEs feel frustrated by the current permissive regulatory environment. SMEs that take on voluntary measures such as expensive retrofits will compete with firms that have not, creating a race to the bottom. Regulation creates an even playing field for SMEs by holding all firms equally accountable and ensuring that first movers aren't penalized for climate leadership.

"Small businesses are always going to be responsive to broader market trends, not necessarily the trend setters. Creating policies that are able to pull them along, as opposed to pushing them 'in the right direction', are going to be more cost-effective."

Acknowledging that regulation will be inevitable to achieve Canada's emission targets, the deferral of regulatory requirements for SMEs will actually impose new challenges for these firms. Time and time again, we were told that certainty is the most important factor in SMEs operational planning – even more so during periods of global turbulence. The introduction of regulation for SMEs and announcing plans for regulatory standards sooner rather than later, gives firms more lead time to adjust and provides SMEs with certainty and direction for capital project planning. Even the Canadian Chamber of Commerce—which fought hard against the imposition of a federal carbon price—recently changed its position in January 2021, noting the importance of policy certainty for its members.

"Certainty, certainty, certainty. Just tell me the rules and [SMEs] play within the rules."

Imposing SME-specific regulation would also put Canada at the forefront of international climate action, as a recent overview of SME-specific policies and programs suggests. We are not aware of any country that has specific regulatory emissions requirements for SMEs. Although the EU recently announced an expansion of its Corporate Sustainability Reporting Directive, SMEs are still excluded. The US Environmental Protection Agenda provides GHG Inventory Guidance for Low Emitters, but has not rolled out specific SME regulations. While there is no existing "blueprint" for successful SME-specific regulation, a good place to start would be the creation of a public directory of emissions data for all SMEs operating in Canada, potentially by expanding the existing GHG inventory for large emitters. In the medium-term, the federal government could incentivize further voluntary action by introducing a categorization system that groups SMEs by their year-over-year reductions, thereby providing public recognition for high achievers, and shaming laggards. In the long-term, these tactics would ultimately help transition SMEs towards regulation that would require all Canadian firms to achieve mandatory benchmarks for emissions reductions.

Energy Audits

A first step in preparing SMEs for emissions regulation will be to ensure that SMEs are tracking their baseline energy use. In Ontario, this is already mandated for larger buildings through the Energy and Water Reporting and Benchmarking (EWRB) program. However, as of 2023 this registry is only a requirement for buildings over 50,000 sqft; far larger than the square footage of many SMEs' operations. Providing support for SMEs to begin tracking energy and water use in advance of emissions regulation was strongly recommended by those we spoke with.

In 2019, Natural Resources Canada (NrCan) launched the Energy Manager Program, designed to help support smaller firms to measure and record their energy use. This program provided financial assistance for industrial, commercial, and institutional fleets and facilities to identify and adopt energy efficiency solutions that reduce energy use, operating costs and greenhouse gas emissions. Applicants could receive funding to hire an energy manager, conduct an energy assessment, or assess their fleet energy. The program targeted small emitters in particular, as firms subject to the Output Based Pricing System were not eligible.

> **"Incentive programs are really beneficial because they continuously drive people [to do] better than the average."**

Funded by the federal carbon pollution pricing system, the Energy Manager Program provided a total of $3.1 million in 2019-2020. However, funds were only allocated across the four provinces eligible under the federal backstop: Ontario ($2,100,000), Saskatchewan ($620,000), Manitoba ($270,000), and New Brunswick ($110,000). No funding support was provided to SMEs in provinces that implemented their own carbon pricing system. The program also only ran for one year and was not extended beyond the initial September 2019 intake, as the program was oversubscribed and met the funding cap for the first year. A renewal of the program, as well as an expansion beyond these four provinces would likely be well received.

Using the Federation of Canadian Municipalities as an intermediary to encourage municipalities across the country to employ community energy officers able to audit SMEs for free is another option. However, while engaging municipalities may be efficient from a resource allocation perspective, it is unlikely to have as strong of a "normalization" effect on SMEs, as they will still require the external expertise of municipal staff. A renewal and expansion of the Energy Manager Program is recommended to help normalize energy efficiency measurement and goal-setting as part of normal operations and planning.

Although programs like the NrCAN's Energy Managers Program are welcome initiatives, 54% of Canadian businesses only have between 1-4 employees. Hiring an Energy Manager or an external sustainability consultant far exceeds the budget and operational capacity of microenterprises such as a local bakery, hair salon, or family-run farm. Likewise, most small businesses are still unlikely to *voluntarily* contract an external sustainability consultant. It is important that other kinds of support be made available to these firms to conduct energy audits themselves, and to build knowledge and capacity to track emissions within Canadian small businesses themselves.

Retrofit Incentives

Unsurprisingly, many of the people we interviewed suggested that incentive programs: rebates, subsidies or grants, would encourage voluntary emission reduction activity from SMEs. Several field experts highlighted specific interest among SMEs for solar panel installation, energy efficient refrigeration units, and heating system retrofits as priorities. Field experts also shared that government incentives work as an effective "pull factor" for SMEs to begin environmental impact goalsetting more generally. The availability of government grants can be a foot in the door for SMEs to start thinking about other ways to reduce their environmental impact and are often the catalyst for joining voluntary sustainability or community networks which further share information (and motivation) among local businesses. "Pulling" SMEs in a low carbon direction will, of course, be most effective in tandem with regulation.

"I think the core role for federal policy is a pull-driver for SMEs."

The federal government began this work in 2018 through the creation of the Climate Action Incentive Fund using proceeds from the federal pollution pricing system. There are three streams of funding: the MUSH stream, which provides support to municipalities, universities, colleges, schools (MUSH), the SME stream, and the rebate stream (which has not been rolled out to date). Like the Energy Manager Program, eligible firms must be based in Ontario, Saskatchewan, Manitoba or New Brunswick to qualify for support.

"We need to find ways that we can increase the private sector's spending on energy efficiency through policies like tax deferrals on equipment purchases, and enhanced depreciation."

This program is an excellent first step, although we heard from policymakers and field experts that this program, too, was significantly oversubscribed, suggesting that an expansion of this program beyond the four provinces that use the federal backstop would be welcome. Importantly, several field experts highlighted that the dollar amount of the incentive programs is less important than the *flexibility* of the program: programs to support capital intensive retrofits should have rolling/continuous in-take windows so SMEs can align these opportunities with their existing long term capital budgeting processes. NGO staff shared with us that an uptake barrier is that government incentive programs, including the Climate Action Incentive Fund, have one annual in-take window that may not align with the internal planning cycles of SMEs. A rolling in-take will likely increase uptake for more transformational (and capital intensive) retrofit projects.

"No company is going to make capital commitments, even if they get half of the money, if the other half is not what they want to do. It's always got to be in their plan somewhere."

We also heard that the funding threshold for this program was too high for many SMEs to access: the program rebates up to 25% of total eligible costs between $20,000 and $250,000. However, this upfront cost is more than most small businesses are likely to have on hand, particular those in the service industry which have been hardest hit by the pandemic (such as a local restaurant or coffeeshop). In this sense, the Climate Action Incentive Fund has already screened out small businesses (recall that 55% of Canadian businesses have just 1-4 employees). Lowering the eligible costs threshold will allow smaller firms to take equal advantage of the incentive program, attracting a greater number of businesses overall which will be essential for long term normalization of low carbon business practices in the green recovery.

SME-Specific Financing

Related to both incentive programs, field experts recommended that governments set up or support SME-specific climate financing opportunities for capital intensive projects to reduce emissions. For example, governments could work with banks, provinces, municipalities or non-profits to offer localized financing programs to help SMEs fund energy efficiency projects. These non-profits would help navigate businesses through the action planning process and lend businesses the capital for climate friendly projects at reasonable, long-term interest rates. This would not only give small businesses greater financial options for taking on transformative projects, but also removes the grant application process (which can be cumbersome from both the government and applicant perspective).

> **"You also are able to develop deeper ties with businesses because you are actually lending them money, and they perceive you as having a stake in their success."**

An example of this model is the Ottawa Renewable Energy Cooperative (OREC), which develops or purchases solar power projects in partnership with schools, institutions, municipalities, and businesses. Funded projects include solar panel installation for a local Ottawa Co-op (Co-operative d'habitation Lafontaine for $45,000), a farm (Smith Farm for $166,000) and an indigenous community (Taykwa Tagamou First Nations and the property owners for $1,527,922). Partnering with new or existing organizations, or other orders of government that are closer to these business communities, to create SME-specific financing opportunities could be one way to make sure that these firms have access to both local expertise and capital.

> **"A lot of businesses have just enough awareness to start it alone. But not enough to go to the next level."**

Education and Normalization

Education and corporate culture change are, in some ways, the 'low hanging fruit', and can be an avenue by which SMEs begin thinking about more transformational change. Field experts all agreed that education is a critical component of reducing emissions in the private sector. The Chartered Professional Accountants of Canada found that the majority of Canadian businesses (63% of those surveyed) are not currently tracking, and have no plans to track, corporate emissions – let alone begin to find ways to cut emissions. While resources are a significant barrier for the implementation of transformative measures like fuel switching or energy efficiency retrofits, it is clear that the barriers to SME climate action are not limited only by access to government funding and/or financing options, as most Canadian businesses are still not implementing costless options to reduce their emissions.

For example, governments could create a SME commuter toolkit that provides incentive ideas or tactics for business owners to motivate employee behavior change, and raise awareness about existing local commuter programs, such as TravelWise. Even introducing something as simple as a **"No Idling"** policy can help businesses normalize a corporate culture of sustainability. This is not a new idea: corporate social responsibility programs have been shown to have a powerful effect on both overall job satisfaction of employees as well as employee retention. Providing ideas, distilling research, and helping to communicate the "business case" for normative changes will provide SMEs the tools and motivation they need.

Lessons learned from the pandemic may help businesses think creatively in this regard: virtual business meetings and scheduled "work from home days" can cut down on transportation-related emissions. However, as normal business travel and operations resume, making businesses aware of ways to reduce their scope 2 emissions, such as sourcing sustainable web hosting services, or scope 3 emissions, such as through aviation carbon offsets. While the ability of individual SMEs to implement these changes will be different based on industry, increasing visibility and awareness of these tactics through a public education campaign will better equip businesses to begin implementing these cultural changes, and in the long-term, normalize climate friendly business planning.

Feasibility Studies - Multi-tenant Buildings

"There are so many buildings in our communities that are owned by commercial real estate firms but are populated by 100-150 business. We need to understand and work with them in a very different way than an owner-occupied building."

We consistently heard from field experts that one of the greatest barriers to SMEs taking on voluntary emissions reductions is that many (if not most) SMEs do not own their own buildings, and as a result have little control over their Scope 1 emissions. Essentially, even if first movers *want* to take on voluntary emissions projects, their capacity to do so is substantially reduced if they do not own the building.

A feasibility study on SMEs operating in multi-tenant buildings would be an essential first step. Some of this work has already been done in other contexts: we spoke with a staff member of Sustainable Silicon Valley (SSV), an environmental NGO in California that hosts a voluntary carbon registry. In a feasibility study on multifamily housing, SSV developed a "single point of contact" system that streamlines the application process for energy upgrade programs, thereby reducing institutional barriers for landlords to take on energy retrofits. This idea was later implemented by the electric company Pacific PG&E. Conducting a feasibility study on SMEs in multi-tenant buildings in the Canadian context, would be helpful for tailoring emissions reduction support programs to the specific needs of SMEs.

"Landlords, especially smaller landlords, just don't have the bandwidth to navigate these programs. So, a single point of contact could really make a huge difference."

Both the policymakers and NGO staff we spoke with were aware of the challenge posed by multi-tenant buildings, however none were aware of any survey data that tracks the percentage of Canadian SMEs operating in multi-tenant vs. single tenant buildings or the impact that this may have for SMEs taking on voluntary climate projects. More generally, data scarcity on SMEs is a significant problem for both academic analysts and policymakers. At the federal level, the National Pollution Inventory Report tracks the emissions of heavy polluters, but no such information is collected about SMEs. The Government of Canada's Key Small Business Statistics provides a helpful overview of the number, size, and sector of Canadian SMEs operating in each province—however, no metrics about operational infrastructure, energy use, or greenhouse gas emissions are collected in the survey. This is a missed opportunity to gain vital data and learn more about the vast majority of Canadian businesses.

Institutional Change

These policy options also speak to a more general problem in governments' approach to engaging SMEs on climate change. Statistics on small businesses are collected by Innovation, Science and Development Canada (ISDC), however the majority of emissions reduction programs are hosted by Environment and Climate Change Canada (ECCC) and NrCan. If we expect businesses to do more to integrate sustainability metrics into normal business planning, governments should certainly be expected to do the same. Greater intergovernmental coordination could leverage energy efficiency expertise from NrCan, carbon accounting and regulatory expertise from ECCC, and small business support from ISDC to engage and supports SMEs to take on voluntary actions, and to prepare them for impending regulatory requirements. This interdepartmental coordination has already been done with the Clean Growth Hub, a single portal that hosts federal programs relating to clean energy. Creating a similar interdepartmental initiative or task force to house SME data and programming would be welcome.

> **"There isn't great data on where SME emissions come from…I don't see good data on which subsectors and SMEs are emitting the most. There's a data gap."**

Conclusion

While the COVID-19 pandemic is from ot yet over, there is a light at the end of the tunnel. A green recovery will not be a discrete moment in time, the impacts of the pandemic will continue to be felt, particularly by SMEs, for a long time to come. However, there is an opportunity to leverage the coming months and years to reorient the Canadian economy. The rapid introduction of programs and policies tailored specifically to the needs of SMEs to support a green recovery is not just an opportunity to make substantive progress towards Canada's 2050 target, but is also an opportunity for governments to develop a stronger relationship with SMEs, which are the backbone of the Canadian economy. This is a once-in-a-generation chance, let's make sure not to miss it.