

The Path to Net Zero

A Primer on How to Assess SME Progress



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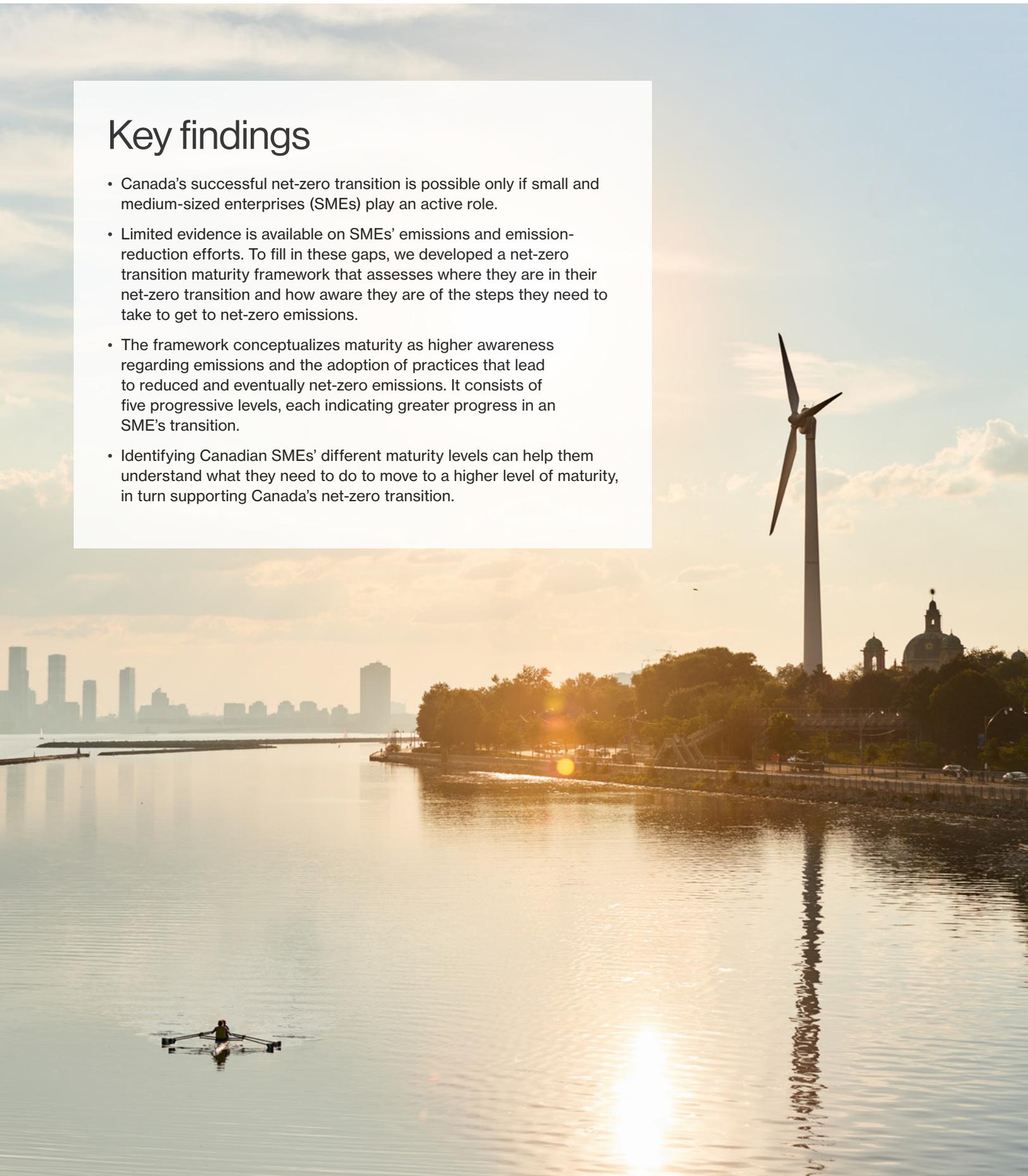
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Key findings

- Canada's successful net-zero transition is possible only if small and medium-sized enterprises (SMEs) play an active role.
- Limited evidence is available on SMEs' emissions and emission-reduction efforts. To fill in these gaps, we developed a net-zero transition maturity framework that assesses where they are in their net-zero transition and how aware they are of the steps they need to take to get to net-zero emissions.
- The framework conceptualizes maturity as higher awareness regarding emissions and the adoption of practices that lead to reduced and eventually net-zero emissions. It consists of five progressive levels, each indicating greater progress in an SME's transition.
- Identifying Canadian SMEs' different maturity levels can help them understand what they need to do to move to a higher level of maturity, in turn supporting Canada's net-zero transition.



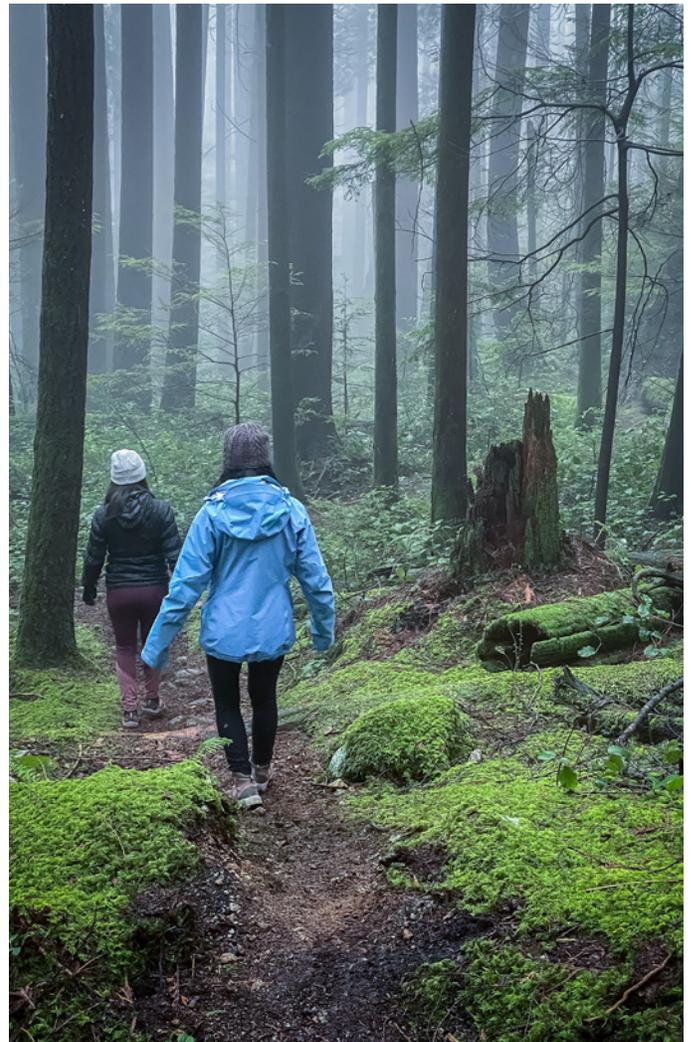
Introduction

Addressing climate change requires action from all players: businesses, governments, and individuals. As part of a growing international effort, Canada has joined more than 120 countries in committing to achieving net-zero emissions by 2050.

To support this effort, The Conference Board of Canada's Global Commerce Centre (GCC) and Export Development Canada (EDC) partnered on a survey of small and medium-sized enterprises (SMEs) to understand where they are in their net-zero transition and how aware they are of the steps they need to take to get to net-zero emissions.

This report, the first of two, lays the groundwork for the analysis of the survey results in the second report by:

- highlighting the key role SMEs play in ensuring the success of Canada's net-zero transition;
- developing a clear definition of net-zero transition maturity and building a framework to identify how far along SMEs are in their transition;
- using the framework to guide the design of the SME survey.



SMEs' role in the net-zero transition

The 2021 *Canadian Net-Zero Emissions Accountability Act* commits Canada to achieving net-zero emissions by 2050.¹ This goal requires significant change in Canada's economy and pose challenges for all players. On the business side, most of the research and literature focuses on large emission-intensive businesses. SMEs are often excluded from the discussions on decarbonization and, consequently, the required support. A 2020 study by the Smart Prosperity Institute revealed that out of 99 identified federal and provincial policies on climate change mitigation, only five are strategically targeted toward SMEs.²

Our analysis of the federal government's 2030 Emissions Reduction Plan, which outlines a potential pathway to meet Canada's 2030 target of reducing greenhouse gas (GHG) emissions to 40 per cent of 2005 levels, finds that only a few initiatives target SMEs.³

The lack of targeted support for SMEs isn't just a Canadian phenomenon. The Organisation for Economic Co-operation and Development (OECD) analyzed SME financing trends and policies for 48 countries from 2007 to the first half of 2021. It found that SME-related policies regarding greening and sustainability represent only 2.44 per cent of financial support across all assessed countries and 5.0 per cent for the European Union (EU).⁴

SMEs don't generate high emissions individually, but collectively, they're significant. Globally, SMEs create more than 50 per cent of GHG emissions. European SMEs generate 60 to 70 per cent of industrial emissions in the EU.⁵ A 2018 study by Climate Smart estimates the total emissions from Canadian SMEs to be more than 200 million tonnes of carbon dioxide equivalent (CO₂e)—nearly 30 per cent of the national total.⁶

This evidence suggests that a country's successful net-zero transition is possible only if SMEs play an active role. Such an approach is especially important in Canada given that SMEs are major drivers of economic growth and employment in the country.⁷ In 2021, SMEs made up 99.8 per cent of employer businesses in Canada and employed 85.0 per cent of the total labour force.⁸ They contributed to more than 50 per cent of Canadian GDP in 2019.⁹ Nearly 15 per cent of Canadian SMEs are fully owned by women, another 14 per cent are 50 per cent women-owned, and more than one-quarter of SMEs have primary decision-makers who were born outside of Canada—so Canadian SMEs are critical to inclusive growth.¹⁰ The OECD contends that SMEs “are neither an exception nor a supporting actor in the [transition]; on the contrary, they are an essential engine to the green transition.”¹¹

1 Government of Canada, “Net-Zero Emissions by 2050.”

2 Pedersen-Macnab, *Insights From the Field*.

3 These initiatives include the Industrial Research Assistance Program, the Sectoral Workforce Solutions Program, the Skills for Success Program, and the Apprenticeship Service. However, these programs aren't sufficient and don't clearly outline a pathway for SMEs to guide their transition.

4 Organisation for Economic Co-operation and Development, *Financing SMEs and Entrepreneurs*.

5 Koirala, “SMEs: Key Drivers of Green and Inclusive Growth.”

6 Climate Smart, *200 Million Tonnes of Opportunity*.

7 Statistics Canada considers a small enterprise to be one with fewer than 100 employees, including those that don't report any employment. Medium-sized enterprises have 100 to 499 employees, and a large one has more 500 or more employees.

8 Statistics Canada, “Canadian Business Counts,” and “Employment by Establishment Size.”

9 Innovation, Science and Economic Development Canada, *Key Small Business Statistics: 2022*.

10 StatsCAN Plus, “Small and Medium Businesses.”

11 Kauffmann and Cusmano, “No Net-Zero Without SMEs.”

Carbon emissions and international trade

SMEs are also crucial to Canada's international trade, and they need to be ready to trade in a global world where climate change requirements could become more stringent. In 2021, Canada exported \$575.1 billion in goods, 42.7 per cent of which was attributed to SMEs.¹² Of the 47,701 Canadian establishments that exported goods, 97.6 per cent were SMEs.¹³

Increased trade leads to increased production, consumption, and transportation of goods and services, thereby leading to increased GHG emissions.¹⁴ Even SMEs that don't directly export may be part of the supply chains of businesses that export. A 2016 McKinsey report found that more of the environmental impact associated with the production of consumer products is embedded in a company's supply chains than is generated by its own operations. An average consumer company's supply chain accounts for more than 80 per cent of GHG emissions.¹⁵

Trade policy measures such as environment-focused clauses in free trade agreements or the imposition of border carbon adjustments (BCAs) can influence GHG emissions and the way goods and services are traded. Canada's current free trade agreements don't have stringent climate change provisions. For instance, although the Canada–United States–Mexico Agreement contains greater environmental provisions in the form of pollution prevention and conservation of wild flora and fauna, it doesn't address climate change.

The Canada–European Union Comprehensive Economic and Trade Agreement, while more advanced, requires only that parties pay special attention to removing trade barriers on technologies that mitigate climate change and that they cooperate on climate change issues.¹⁶

But GHG emissions are an increasing priority in trade agreements. The EU has, more than any other trading entity, taken the lead on governing climate change through its trade agreements, incorporating a wider variety of provisions related to climate change in its agreements.¹⁷ As well, five countries—Costa Rica, Fiji, Iceland, New Zealand, and Norway—have launched negotiations around the Agreement on Climate Change, Trade and Sustainability.¹⁸

BCAs are another trade-related tool that can address climate change. BCAs involve introducing a charge on the carbon embodied in imported products from a jurisdiction with a lower level of carbon pricing than the importing country or on imported products whose embodied carbon wasn't otherwise priced.¹⁹ BCAs aim to reduce carbon leakage, maintain the competitiveness of domestic companies, and support the climate ambition of the country that imposes BCAs.

The EU became the first jurisdiction to impose a BCA when the first phase of its Carbon Border Adjustment Mechanism went into effect on October 1, 2023. The imposition of BCAs by any of Canada's other trading partners would also affect Canadian businesses, so they need to be aware of their carbon emissions and transition progress to ensure they don't lose global competitiveness.

¹² Statistics Canada, "Trade in Goods by Exporter Characteristics."

¹³ Ibid.

¹⁴ On the upside, international trade can also help reduce emissions if exporting businesses are exposed to best environmental practices in other countries or the trade facilitates the transfer of climate-friendly technologies and know-how: World Trade Organization, *World Trade Report 2022*.

¹⁵ Bové and Swartz, "Starting at the Source."

¹⁶ Morin and Jinnah, "Can Preferential Trade Agreements Address Climate Change?"

¹⁷ Ibid.

¹⁸ New Zealand Government, "Joint Statement."

¹⁹ World Trade Organization, *World Trade Report 2022*.

Limited evidence on SME net-zero transition progress

Limited evidence is available on SMEs' GHG emissions and emission-reduction efforts. The *National Inventory Report (NIR)*, Canada's federal GHG inventory report, estimates the annual GHG emissions across all sectors of the economy, but the report doesn't provide data on GHG emissions by business size. The Canadian Energy and Emissions Data Centre hosts a database on GHG emissions by industry, but this database also isn't broken down by business size.

The data on SME emissions often cited by researchers and policy-makers in Canada are the projected emissions estimate from Climate Smart.²⁰ The calculation is based on industry data, business counts of SMEs in each industry, and the NIRs. While this estimate is useful, it provides data at only one point in time, limiting the ability to understand where SMEs are in their transition.

Other evidence on how SMEs are adjusting to climate change includes Meta's 2022 *Global State of Small Business* report. Meta surveyed 22,000 SME leaders in 30 countries and found that Canadian businesses are the most worried about supply chain disruptions caused by climate change. Other expert studies have highlighted that SMEs lack an in-depth awareness of sustainability and climate change issues and falsely assume they have enough accurate knowledge and capacity to act on their own. This lack of understanding can create a barrier for SMEs when they're trying to access support.²¹

A survey of SMEs in Manitoba revealed that 75 per cent of SMEs don't have a climate action plan to reduce carbon emissions or to adapt to climate change impacts.²² The Canadian Manufacturers & Exporters (CME) 2022 *Low-Carbon Transition Survey* found that only 11 per cent of small businesses and 17 per cent of medium-sized businesses in the manufacturing sector had set targets to reduce carbon emissions by 2050. The survey also found that businesses of all sizes consider it difficult to reduce emissions from their supply chains.²³

Measuring the progress of SMEs on a transition maturity framework

For SMEs, measuring transition progress isn't straightforward or easy. The limited amount of data at the macro level reflects the lack of data at the company level. To help fill in this gap, the GCC and EDC built a net-zero transition maturity framework to assess the progress of SMEs. Maturity frameworks measure the ability of an organization to improve in a particular area. Most maturity models emphasize that progress is achieved incrementally.²⁴

Few maturity frameworks have been developed to assess the green transition of SMEs. The following three reviewed frameworks guided the development of our own framework, but they weren't a perfect fit.²⁵

20 Climate Smart, *200 Million Tonnes of Opportunity*.

21 Pedersen-Macnab, *Insights From the Field*.

22 Manitoba Chambers of Commerce and International Institute for Sustainable Development, *Survey on Climate Action*.

23 Canadian Manufacturers & Exporters, *CME Low-Carbon Transition Survey*.

24 Haryanti, Rakhmawati, and Subriadi, "The Extended Digital Maturity Model."

25 The maturity frameworks reviewed and studied were those identified here as well as the EDC ESG framework, the UN sustainable development goals, Cagnin's business sustainability maturity model, Baumgartner's sustainability profiles and maturity levels, the Embedding Project, and various other sustainability standards and certifications.

The Municipalities for Climate Innovation Program

The Municipalities for Climate Innovation Program has developed a maturity framework in association with the Federation of Canadian Municipalities²⁶ to help Canadian municipalities assess where they are in their organizational integration of GHG emission reduction on three competencies:

- 1. Policy**
- 2. Human resources and governance**
- 3. Technical capacity**

The policy competency focus on “putting in place context-specific policies that support the implementation of a vision to reduce local GHG emissions.”²⁷ The human resources and governance competency focuses on “ensuring staff and council are equipped with the mandate, understanding, skills and knowledge needed to increase capacity for reducing municipal GHG emissions.”²⁸ And technical capacity focuses on “preparing the tools needed to reduce GHG emissions and track progress.”²⁹

The maturity framework begins at a conceptual framework and has five milestones that establish a progressive scale from the original concept to continuous advancement in reducing GHG emissions in municipal processes.³⁰

26 Infrastructure Canada, *2020 Evaluation of the Municipal Asset Management Program*.

27 Ibid.

28 Ibid.

29 Ibid.

30 Manidaki and others, *Net-Zero Strategy and Carbon Maturity*.

31 EcoVadis, *Carbon Maturity Report 2022*.

EcoVadis

EcoVadis, a sustainability assessment company founded in Paris in 2007, uses a carbon maturity framework to assess the carbon-management performance of companies globally. This framework consists of five progressive levels:

- 1. Insufficient:** Minimal or no GHG management programs
- 2. Beginner:** Some elements of a GHG management system and/or reporting practices
- 3. Intermediate:** Core elements of a GHG management system, including public reporting
- 4. Advanced:** Comprehensive GHG management system and reporting in line with global standards, including third-party data verification
- 5. Leader:** Best-in-class GHG management system underpinned by actions with approved science-based targets in place³¹

British Business Bank

The British Business Bank has developed an SME net-zero transition framework and measures the maturity of British SMEs on the transition based on three key dimensions: awareness and engagement, knowledge and capabilities, and physical actions. The framework weighs each of the components and ranks companies across four different maturity levels based on their scores, ranging from 0 to 100 (with 0 being the least mature and 100 being the highest level of maturity). Based on maturity levels, the surveyed companies were also assigned one of four personas:

- 1. Carbon nimble:** Services companies that have lower emissions, are small, have high transition maturity, and are proactive
- 2. Carbon complacent:** Services companies that have lower emissions, are small, have low transition maturity, and don't prioritize emissions
- 3. Carbon correcting:** Primary or secondary industries that have higher emissions, are relatively large, have high transition maturity, and are proactive
- 4. Carbon exposed:** Primary or secondary industries that have higher emissions, are relatively large, have low transition maturity, and are reactive³²

32 British Business Bank, *Smaller Businesses and the Transition to Net Zero*, 21.

Our framework was also guided by OECD research indicating that most SMEs, including those in Canada, limit their emission-reduction actions to basic interventions such as energy efficiency measures and waste reductions. More complex interventions, like production or service process redesign, upstream and downstream supply engagement, and external environmental auditing, are broadly lacking across the general SME population.³³ Advanced maturity on the transition path, therefore, needs to have a broader systemic approach to reach net-zero emissions.

Our maturity framework

While we recognize that progress isn't necessarily linear, our framework is structured as a sequence of five levels of transition maturity, presenting a clear evolution from occasional initiatives to purpose-driven change toward achieving lower carbon emissions through the company's overall actions. (See Exhibit 1.)

Exhibit 1

The five levels of transition maturity



1. Getting started

No established GHG emission measurement or reduction goals. Limited awareness of the current level of emissions, with no clear reduction plan or target. Ad hoc initiatives may be in place for mandatory reporting only.



2. Compliance

Management recognizes the need to track and measure emissions for compliance. Work is under way to measure some emissions categories. Reporting on progress is compliance-driven.



3. Operational footprint strategy

Management develops a strategy to reduce Scope 1 and Scope 2 emissions, setting targets for each component of the business's operational footprint. Some aspects of Scope 3 are measured. Business decisions consider operational footprint impacts.



4. Full emission-reduction strategy

Management develops an emission-reduction strategy that includes Scope 3 emissions. Targets are set for the most material emissions categories. Business decisions consider the impacts of Scope 3 emissions.



5. Net-zero ambition

Emission-reduction strategy is aligned to a net-zero pathway. Business decisions consider the ability to meet net-zero targets.

Sources: The Conference Board of Canada; Export Development Canada.

³³ Organisation for Economic Co-operation and Development, "Financing SMEs for Sustainability."

Within each of the five levels, five questions are considered.

1. Does decision-making in the company factor in GHG emissions and emission reductions?

Emission reduction can be successful only if it's a core component that impacts decision-making.

2. Does the company have a reduction goal and a target date for this reduction? The adoption of a goal represents commitment, which represents higher maturity.

3. How expansive are the emission-reduction actions adopted? GHG emission reductions can be successful in the long term only if a company takes a multitude of actions, such as those aimed at supporting the company's emission reductions (e.g., measuring GHG emissions) or those aimed at the wider ecosystem (e.g., raising awareness among suppliers, lobbying politicians in the area).

4. Are all three scopes of emissions measured? The GHG Protocol Corporate Standard categorizes GHG emissions from an organization into three scopes:

- **Scope 1:** direct emissions from owned or controlled sources
- **Scope 2:** indirect emissions from the generation of purchased energy
- **Scope 3:** all indirect emissions (not included in Scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions³⁴

5. Does the company report its GHG emissions to the Government of Canada's GHG Reporting Program (GHGRP)? The GHGRP is mandatory only for facilities that emit 10 kilotonnes or more of GHG, in CO₂e units, per year. However, voluntary reporting signals a higher degree of commitment to reduction.

Our framework in Table 1 shows the five questions within each of the five levels of transition maturity.

The framework will guide our assessment of the net-zero transition maturity of the surveyed SMEs. The framework can also be used over time to assess an SME's change in maturity, including the factors contributing to the SME's positioning at a particular level and what the SME changed to move to a higher level.

While the main objective of this project is to identify the maturity of Canadian SMEs, this framework can also be applied to SMEs in different countries. Eventually, it can help us assess how Canadian SMEs differ from those in other parts of the world.



³⁴ World Resources Institute and World Business Council for Sustainable Development, "Greenhouse Gas Protocol: FAQ."

Table 1
Maturity framework

| | 1. Does decision-making in the company factor in GHG emissions and emission reductions | 2. Does the company have a reduction goal and a target date for this reduction? | 3. How expansive are the emission-reduction actions adopted? | 4. Are all three scopes of emissions measured? | 5. Does the company report its GHG emissions to the GHGRP? |
|--|---|--|---|---|---|
| Level 1: Getting started | Doesn't impact decision-making very much at all | Has no reduction goal | Doesn't undertake most actions | Scope 1 only if mandatory | Only if mandatory |
| Level 2: Compliance | Impacts decision-making to a degree | Has a reduction goal and target date | Has started work to measure and analyze GHG emissions, reduce waste, increase recycling, and choose green infrastructure or equipment | Some aspects of Scope 1 and 2 | Yes |
| Level 3: Operational footprint strategy | Is a core component that impacts decision-making | Has a reduction goal and target date | Does Level 2 actions plus reports on GHG emissions, reduces energy consumption, encourages employees to optimize transportation to work, raises awareness on GHG emissions among company's suppliers, and promotes environmentally friendly ways of working | Scope 1 and 2 and some aspects of Scope 3 | Yes |
| Level 4: Full emission-reduction strategy | Is a core component that impacts decision-making | Has a reduction goal and target date | Does Level 3 actions plus switches to renewable energy, chooses sustainable suppliers, raises awareness on GHG levels with partners and customers, and purchases carbon offsets | Scope 1, 2, and 3 | Yes |
| Level 5: Net-zero ambition | Is a core component that impacts decision-making | Has a reduction goal and target date | Does Level 4 actions plus has net-zero targets and lobbies politicians in the area to be active in emission reduction | Scope 1, 2, and 3 | Yes |

Sources: The Conference Board of Canada; Export Development Canada.

Next steps: Survey results and analysis of SMEs' transition maturity

We conducted a survey of 381 Canadian SMEs in November 2022.³⁵ Our framework helped determine the survey questions. The SMEs we surveyed were spread across Canadian provinces and industries and were asked to respond to their awareness of, engagement in, and actual reductions of emissions. Based on the survey responses, we mapped the SMEs across the various levels of our transition maturity framework.

The results from this exercise will provide evidence on how SMEs across industries and provinces vary in maturity and how SMEs at a lower level can progress to a higher level. These results will be discussed in our forthcoming report.

³⁵ A total of 1,344 SMEs started the survey, but only 381 were included in the analysis. Those who weren't included in the analysis worked at a company that was not trade exposed (252), didn't know enough about the strategy of the company they worked for (32), didn't discuss GHG emissions at all in their business (499), weren't familiar with their companies approach to GHG reduction (49), large companies (80), or companies that didn't identify their size (51).

Appendix A

Methodology

To understand the challenges around measuring SMEs' progress as they transition to net-zero emissions, EDC and the Conference Board's Global Commerce Centre reviewed literature and policy documents released by international institutions, policy institutes, and statistical agencies across different countries, including Canada. We studied Canada's 2030 Emissions Reduction Plan to understand how SMEs are being supported in their transition.

To construct our maturity framework, we reviewed frameworks built by agencies/institutions for other countries' studies and adopted similar criteria. Our research also gained insights from the feedback of our research advisory board members.

Appendix B

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ABOUT EXPORT DEVELOPMENT CANADA

Who are we?

Export Development Canada (EDC) is a financial Crown corporation dedicated to helping Canadian businesses make an impact at home and abroad. EDC has the financial products and knowledge Canadian companies need to confidently enter new markets, reduce financial risk and grow their business as they go from local to global. Together, EDC and Canadian companies are building a more prosperous, stronger and sustainable economy for all Canadians.

For more information and to learn how we can help your company, call us at 1-800-229-0575 or visit www.edc.ca.

Canada





Where insights meet impact