

Policy Briefing

Drivers and Performance Outcomes of Net Zero practices: Evidence from UK SMEs

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Firms typically implement a portfolio of net zero practices across different technological and organisational business domains. Theory indicates that the uptake of net zero practices is driven by both external and internal (business-level) factors. Also, net zero practices vary in their effects upon environmental and business performance. The results of our empirical analysis show that external drivers such as *regulations or taxes* and *customer demand* induce SMEs to commit to net zero practices. Our findings stress the importance of internal motivations, whereby SMEs adopt net zero practices in order to *improve their image*. Our results point out that, technological net zero practices improve the environmental performance of SMEs, whilst organisational net zero practices affect environmental performance indirectly. Finally, our evidence highlights that even in the context of the COVID-19 pandemic, net zero practices can boost business performance.

Key findings

The results of the econometric analysis, which employs new data from 1,019 SMEs based on the Business Futures Survey, suggests:

- *Environmental regulations or taxes* induce investments on both technological and organisational net zero practices.
- *Customer demand for low-carbon products/services* is a crucial driver of both technological and organisational net zero practices.
- Internal motivations in *improving image and reputation* are driving the uptake of net zero practices.
- *Government grants or subsidies* constrain organisational net zero practices. Similarly, *external funding from banks* constrains investments in technological net zero practices.
- Technological net zero practices such as *changes in production or distribution processes, new low carbon products and services, and renewable energy* have a strong and significant impact upon reducing carbon emissions. Organisational net zero practices exert an indirect effect upon environmental performance.
- There is a strong statistically significant relationship between both technological and organisational net zero practices and business performance, proxied by employment growth.

Our results suggest that even in the context of the COVID-19 pandemic, net zero practices can boost business performance.

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Net zero drivers and outcomes – Theory and practice

Earlier works on environmental economics indicate that government policy plays a central role in accelerating investments into low-carbon practices, whereby *environmental regulations* could restrict or limit the use of GHG intensive technologies. Recent evidence from the literature on eco-innovation advocates the importance of government innovation policies that provide incentives in the form of *government grants or subsidies*, so that they increase or shift investments towards green R&D. The road map towards net zero can be swayed by consumer behaviour as *customer demand for low-carbon products or services* could be a key driver of net zero practices. Organisational literature highlights the importance of businesses' motivation to improve their *image and reputation* and to *reduce costs*. Finally, prior literature indicates that whilst some types of net zero practices decrease carbon emissions (e.g. carbon capture filters), they do not necessarily improve firm growth. Identifying those net zero practices that do both – the so-called 'win-win scenario'.

In practice, our results provide strong evidence that a 'win-win scenario' is feasible in the UK: SMEs can adopt net zero practices that ease the trade-offs between environmental and business performance. Our findings inform owners or managers of SMEs that technological net zero practices (such as *changes in production or distribution processes*) are able to reduce carbon emissions and to stimulate firm growth. Organisational net zero practices do not seem to affect environmental performance directly, yet, we highlight their significance as we detected indirect mechanisms, whereby synergies amongst technological and organisational net zero practices drive performance.

Implications for policy and practice

Our results are relevant to policy makers, as the current conditions provide an opportunity to introduce a mix of policies that may support businesses to transition towards net zero. We point out two priorities of a net zero policy mix: First, environmental regulations and taxes could induce investments on net zero practices. Second, consumer demand for low carbon products/services could drive the uptake of net zero practices. However, consumers are not always willing to pay the premium associated with low carbon products or services. Green/sustainable procurement (at the national or city/region level) could boost demand for net zero products and services and provide the opportunity for green SMEs to scale-up.

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