



Department for  
Business, Energy  
& Industrial Strategy

# Energy efficiency scheme for small and medium sized businesses

Summary of responses



**OGL**

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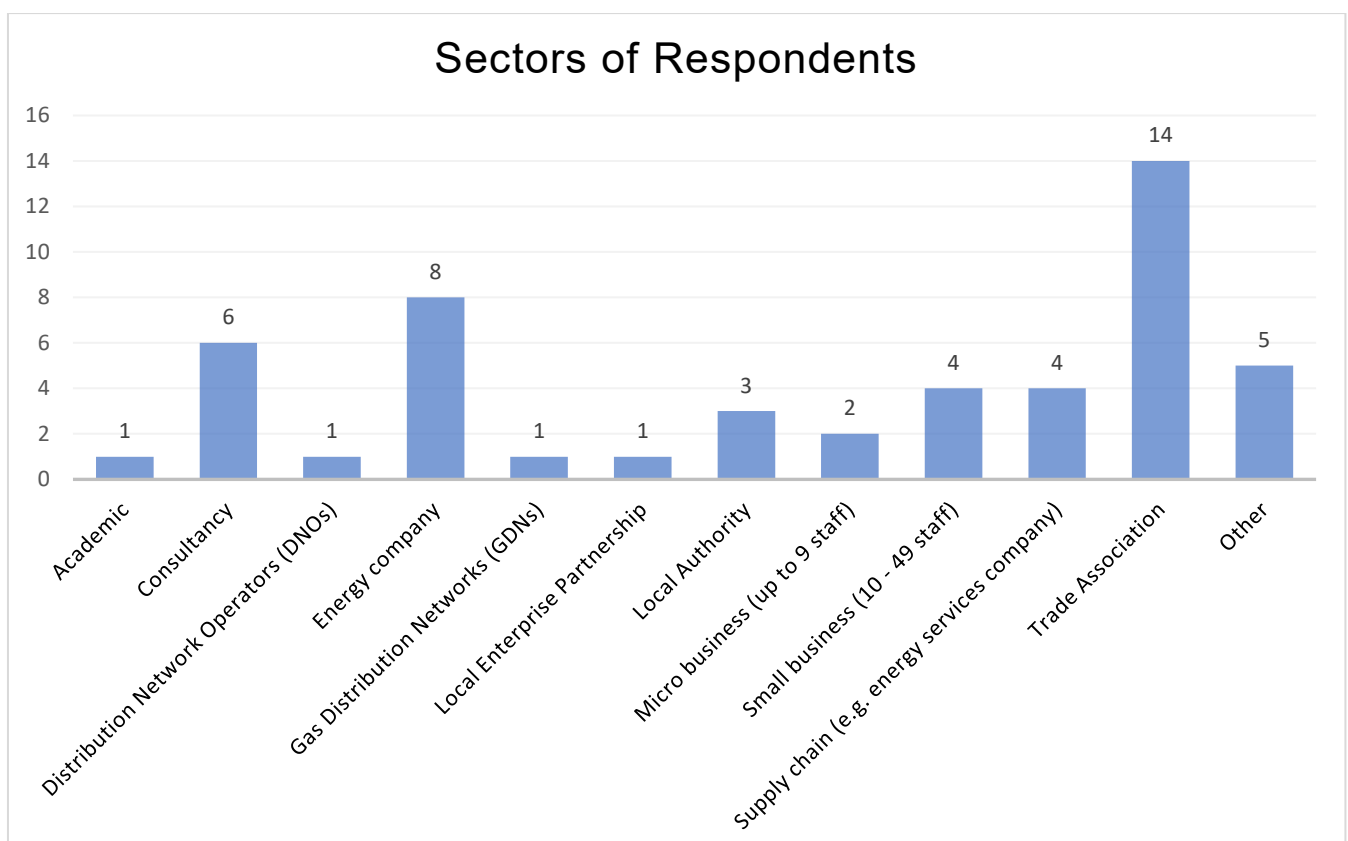
# Chapter 1: Introduction

In June 2019, the UK Government announced that it will eradicate its net contribution to climate change by 2050. In doing so the UK became the first major economy to set a net zero emissions target in law. Clean Growth is one the four grand challenges of the UK Government’s Industrial Strategy and energy efficiency is a vital part of the ambition. The Industrial Strategy is paving the way for increasing the UK’s productivity, creating good jobs and boosting earning power as we work to protect our environment and lead the world in seizing new green opportunities. Supporting businesses to improve the way they use energy is a hugely important part of what we are trying to achieve. The Clean Growth Strategy (CGS) sets out our commitment to growing our national income while cutting greenhouse gas emissions. The strategy provides the ambitious framework for decarbonising our economy throughout the 2020s, while ensuring a secure and affordable supply of energy for businesses.

In the CGS we set out our ambition to work with businesses to improve their energy efficiency by at least 20% by 2030. The case for doing this is strong. It could save businesses up to £6 billion in cost savings annually from 2030 and contribute up to 22MtCO<sub>2</sub>e of savings towards the fifth carbon budget. We want to help businesses unlock savings on their energy bills and support them to reduce harmful emissions.

Our Call for Evidence (CfE), for an Energy Efficiency Scheme for Small and Medium Sized Businesses, set out three indicative options and asked respondents for their opinions on them. In total, we received 50 responses via Citizen Space and email. The CfE was open from 13 March 2019 to 8 May 2019. We received a wide range of responses including from trade associations, energy companies and energy service providers. You will find a breakdown of the sectors of the 50 respondents below.

**Figure 1: Sectors of respondents**



## Summary of responses

This Summary of responses provides an overview of the opinions and input of respondents to the Call for Evidence. Each chapter begins with a short outline of the questions asked, followed by a detailed summary of the responses to the questions.

Due to the number of questions, some have been grouped together where similar themes were raised.

Since not all responses answered questions directly, these contributions have been summarised under the most relevant questions.

## Chapter 2: Energy Efficiency Auctions

In the Call for Evidence, questions one to four asked respondents for their opinions on the possibility of using auctions to support delivery of energy efficiency measures in SMEs. The questions delved into the challenges of how to design such an auction and how best to fund it.

### Question 1

To what extent do you think that competitive tendering could be an effective mechanism to achieve energy savings through energy efficiency? What do you see as the pros and cons?

We received 39 responses from a range of stakeholders including energy companies, trade associations, supply chain companies, energy consultancies, local authorities and academics.

The answers focussed on three main issues: the energy efficiency market, the design and implementation of the auctions, and the cost.

#### **Energy efficiency market**

Regarding the market, some respondents believed that an auction would help to build the energy efficiency market. They cited the ECO scheme (the domestic Energy Company Obligation in the UK) and questioned its efficacy at building a market. An auction could, they argued, provide a more open competitive instrument that could help to build the energy efficiency market which would be needed to enable businesses to meet our 2030 ambition.

Respondents highlighted that auctions can be technology neutral (contrasting with most energy efficiency obligations) which could allow different technologies to compete against each other on a level playing field, rather than specific measures being chosen from an approved list. They suggested that this could support innovation within the market and allow the best value measures to be funded.

Conversely, other respondents were doubtful about an auction's potential to have a positive impact on the market. Some were concerned that auctions could cause peaks and troughs, although this would depend on the size and frequency of the auctions. There was also concern, particularly from smaller market players, that large companies in the market could potentially use an auction to stifle competition.

#### **Auction design and implementation**

As for the design of the auction, some respondents favoured the way auctions can be tailored to achieve certain outcomes. They liked that auctions can be open to all technologies, which could encourage more market players to participate. Also, the fact that it would likely be a third party who would bid and then implement the measures on behalf of SMEs was seen favourably because it reduces the administrative burden on small businesses.

However, respondents also highlighted that the success of an auction would be reliant on enough market players participating in the auction to make it competitive. There were also concerns that the quality of work carried out could be poor and that measuring the outcomes

would need to be kept simple; it would also be important to hold participants to account for the energy savings they included in their bids.

Other areas of concern included payback periods, with several respondents arguing that they needed to be long enough to allow more expensive, tailored solutions to be installed. Also, the entry requirements must ensure that all bids are deliverable and savings verifiable, without adding undue barriers to entry.

## **Cost**

Respondents pointed out that the competitive nature of an auction should create a downward pressure on costs, delivering outcomes with good value for money which should allow the money to spread further. However, there was concern that as participants would not necessarily know how many installations or to whom they would be delivering them, they would cost that risk into the bids, possibly keeping prices artificially high.

## **Question 2**

**What are the different ways of designing an auction, and which would be the most appropriate for energy efficiency measures targeted at SMEs?**

There were 33 respondents to question 2. Responses again came from a good range of stakeholders including energy companies, trade associations, local authorities, supply chain operators and businesses.

A number of respondents stressed the importance of properly understanding and communicating the aim of the auctions. This included deciding how to determine what participants bid for (e.g. kWh, or CO<sub>2</sub>e), and whether to make decisions based on annual savings or estimated lifetime savings. Some respondents recommended that an auction should target those who need it most, not simply quick wins. For example, the auction could take the payback period into consideration as measures with a longer payback period may be more difficult for SMEs to fund by themselves.

Furthermore, one of the strongest messages to come from the respondents to this question was to ensure that any auction process is as simple as possible for SMEs to benefit from. Otherwise it would risk low levels of uptake. They also noted the heterogeneity of the non-domestic building stock and the fact that installing measures would potentially be disruptive to some businesses. These factors are well known barriers to SMEs taking up energy efficiency measures which we hope to address with this scheme.

Some respondents noted the various pros and cons to operating a sealed bid vs descending clock auction. Two trade associations suggested that, on balance, a sealed bid auction would be simplest.

An important decision for the model of the scheme will be whether to hold “open” and/or “closed” auctions (auctions that are open to all technologies or auctions that are only open to specific technologies, respectively.) A supply chain company suggested that having open and closed auctions could reduce competitiveness between measures which could result in those with lesser benefits getting funding. However, one trade association suggested that both open and closed auctions could allow for a range of measures to be funded and help to expand the whole market.



One energy supplier said the auction should be “technology agnostic” which would encourage innovation and efficiency in the process.

Some respondents also identified several risks arising from this approach. One energy supplier warned of the risks of non-delivery, noting that strong delivery incentives will be required to avoid clearing prices that are untenably low. They suggested financial penalties could be put in place to ensure delivery.

A significant risk of the auction model is the risk of low uptake, due to its voluntary nature. Some respondents raised the need to design a scheme that is low-risk and easy to enter, or the barriers to entry could be too great.

One energy company highlighted the risk of higher prices for measures if the market lacks liquidity or depth because there would not be sufficient competition. They highlighted possible mitigations, such as in the Swiss auction where the full budget can only be awarded if the bids are worth at least 120% of the total budget.

## Questions 3 and 4

What approach should Government consider for funding a business energy auction scheme?

What level of co-funding would maximise the value for money from the auctions and minimise competitive distortions, while providing a sufficient incentive for SMEs to take up the measures?

There were 30 responses to question 3 and 23 responses to question 4. Respondents for both questions included energy companies, trade associations, energy consultancies, market players and local authorities.

In question three, two suggestions were the most popular: using taxes to fund the scheme and using a co-funding model. These answers therefore relate to two connected but slightly different issues. The first looks at how Government should raise the money to fund the scheme. The second looks at what proportion of funding should be provided by the scheme to install the measures for businesses. These answers on co-funding link to Question 4, which gave the opportunity for respondents to discuss this matter in greater depth.

### **Approach to funding**

Where funding was concerned, many respondents voiced their support for funding the energy efficiency scheme from taxation, be it general taxation or using funds raised through environmental levies like the CCL. The respondents advocating this funding route were diverse, including some consultancies, trade associations and energy suppliers.

In general, respondents argued that a new levy would be regressive and lead to market distortions because some SMEs could find themselves funding energy efficiency for their competitors, while not receiving the benefits themselves. An energy company noted that while domestic customers might accept using a general levy to help the fuel poor as is the case for the domestic ECO, a levy system in which some SMEs would pay but not benefit, thus subsidising their competitors, might not be accepted in the same way.

## Why co-fund

Some respondents suggested financing models that combined public and private funds in a matched-funding or co-funding system, pre-empting the subject of question 4. This option was suggested by four trade associations as well as an energy consultancy and a supply chain company.

One trade association claimed that if SMEs contributed to the cost it would help them understand the benefits of investing in energy efficiency measures, including lower energy bills. However, it was also pointed out that the more a business had to pay, the larger the barrier to entry, which could limit the policy's impact and effectiveness.

## Choosing the level of co-funding

On question 4, the responses demonstrated the inherent tension of a co-funding approach in that the more an individual SME would have to contribute, the less likely they might be to want to participate. However, on the other hand, some respondents argued that if SMEs do not have to contribute, they may not fully appreciate the value of the measures and the overall funding pot will not spread as far.

A handful of respondents suggested that measures should be fully funded, as happens with the domestic ECO. They argued that the major advantage of this approach is that it largely reduces the barriers to entry meaning the scheme could encourage high levels of uptake including among difficult-to-engage SMEs. One respondent said the first priority should be providing incentives for businesses to install these measures, and any level of required co-funding from business would reduce this.

However, other respondents stressed the importance of having a fair level of co-funding. They said it was important for SMEs to co-fund because they would benefit from the measures and if they receive the measures for free, they might not appreciate their value.

Many respondents advocated for a set level of co-funding from SMEs ranging from 40% to 70%. Some felt that if SMEs had to contribute any more it could create too high a barrier for SMEs to participate.

Respondents, including one energy supplier, argued that SMEs making a contribution will add value to the market, and that co-funding could help to support the delivery of more expensive measures such as air source heat pumps. They highlighted that market-based measures should create downward pressure on prices.

One energy technology company questioned the value of funding energy efficiency measures for SMEs through an auction, arguing that it would result in poor value for money. They believe the scheme would be taken advantage of by large companies delivering low cost projects, which could have been paid for by savings on bills.

Two trade associations advocated a competitive, flexible rate of co-funding, much like the Swiss and German models. This would allow auction participants to bid for a level of co-funding of their choosing, which could let them make a more competitive bid. This method could be more competitive which would help the funding go further, resulting in better value outcomes.

A few other respondents saw value in having a level of flexibility that depended on the type of measure. They argued more funding should be available for measures with longer payback periods to encourage their uptake.

One trade association suggested that to encourage businesses to take on the energy efficiency measures, the access to finance option could be developed in tandem to provide finance support to SMEs that are offered measures from the auction. This could help businesses overcome the financial barriers. However, they recognised that the challenge of SMEs needing to understand and value the benefits of the more energy efficient equipment would remain.

## Chapter 3: Business Energy Efficiency Obligation

Questions five to nine gave respondents the opportunity to provide their thoughts on a Business Energy Efficiency Obligation (or Business EEO). As well as exploring the merits of such a scheme, the questions also examined respondents' attitudes regarding whom an obligation should be placed on and how to get the best value outcomes.

### Question 5

What are the pros and cons of implementing a new business EEO?

We received 45 responses to this question. Those who responded included small and micro businesses, consultancies, local authorities, trade associations, academics, GDNs, companies involved in the supply chain, and energy companies.

#### Pros

A local council, companies involved in the supply chain and a trade association thought that a business EEO would bring about a range of improvements in a similar way to the domestic ECO, which has helped consumers reduce their energy bills and keep their homes warmer, as well as reducing carbon emissions.

One trade association and an SME explained that the implementation, monitoring and auditing systems were already in place under the domestic ECO so these could be used for a new business EEO to introduce it quickly and efficiently. Some respondents including consultancies, a Local Enterprise Partnership and a small business explained that a business EEO could build on the existing experience of suppliers and help to ensure reduced set up costs.

Some academics highlighted that good quality evidence exists from other countries showing that well-designed EEOs can deliver significant, cost-effective energy savings over many years.

Finally, a handful of respondents including trade associations and consultancies highlighted one of the main pros of a business EEO would be that suppliers could make use of their established relationships with small businesses, although there are several ways of defining a SME. The same respondents also felt strongly that existing supply chains from the domestic ECO could be used for a business EEO.

#### Cons

##### **Burdening obligated parties and SMEs**

One of the main criticisms of introducing a new business EEO, shared by over ten respondents, was increased costs for energy bill payers (as an EEO is usually funded through a levy on bills) and the impact this would have on their competitiveness. This was highlighted by trade associations, energy companies, companies involved in the supply chain and

consultancies. Many respondents suggested that a business EEO should be funded by general taxation or be offered as an interest free loan.

Another criticism of a business EEO was that it would impose extra burdens and increase the workload on the businesses who are obligated. If it were a supplier obligation, this could create a two-tiered market where larger suppliers are obligated and smaller ones are not, leading to competitive distortions. Alternatively, all suppliers could be obligated, although smaller suppliers may not be well-placed to deliver an obligation.

### **Differences between companies**

The heterogeneity of SMEs was raised by a number of respondents including energy companies, trade associations and network operators. The fact that SME buildings are so diverse would mean that trying to install standard energy efficiency measures in SME premises would be particularly challenging. Instead respondents believe that SME buildings may require more bespoke measures which would only be possible through detailed energy assessments. This could make an EEO-based scheme very expensive.

Furthermore, three respondents raised concerns about large players dominating the market with a business EEO. From their experience of the domestic ECO, they stated that tended to discourage smaller, more innovative entrants into the market.

Some respondents were concerned that a business EEO would create a competitive disadvantage for some SMEs. Only some SMEs would benefit from the scheme, others may not due to the material characteristics of their premises.

### **Improving the market**

Other respondents felt that supplier obligations risked acting as a barrier to innovation in the energy efficiency market, questioning whether the domestic ECO has had a positive effect in the market. Additionally, they explained that the creation of an obligation scheme for SMEs was at odds with the overall policy direction for retail energy markets, under which a new business EEO might run contrary to the current BEIS/Ofgem<sup>1</sup> review into the future of the energy retail market.

A couple of respondents believed that a business EEO could be open to abuse with installers motivated to install the products they can provide irrespective of the needs of the building, which could impact trust in the market. Several respondents also cited issues related to the domestic ECO, such as the risk of low quality of work, and were concerned that a business EEO could suffer from similar problems.

### **Tenancy issues**

The landlord/tenant split incentive was identified by a handful of energy companies as a challenge for a new business EEO as approximately 64% of private SMEs in England and Wales rent their premises from landlords<sup>2</sup>. Therefore, many SMEs have less interest in energy efficiency as they may be on a short-term lease or have no legal right to install energy efficiency measures. One energy company explained there is already a clear driver on

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<sup>1</sup> <https://www.gov.uk/government/publications/future-energy-retail-market-review>

<sup>2</sup> This is an estimate calculated using building weights from the Buildings Energy Efficiency Survey (BEES) from 2015

landlords to invest in energy efficiency measures in order to comply with the regulations<sup>3</sup> that will enable them to continue to let their buildings to businesses.

### **Barriers to success**

Energy companies and network operators cited lack of experience as a problem of implementing a new business EEO. They explained that it was unlikely that existing teams would have the technical skills or expertise to meet the challenges of a new obligation in the SME sector, and that significant lead in time would be necessary to ensure whomever the obligation was placed upon could deliver it effectively. Additionally, energy companies reiterated that existing systems which are used for the domestic ECO cannot be used for a business EEO, therefore this would mean entirely new teams, systems and processes would need to be built and run as there is a vast difference between the domestic and non-domestic market.

Finally, respondents explained that barriers such as the information barrier will continue to be a challenge. A trade association argued that more needed to be done to raise the overall awareness of the benefits of energy efficiency to enable a fair playing field. One energy supplier explained the role for trusted third parties to highlight energy efficiency opportunities to its members and to also persuade businesses to change their behaviour. Another supplier highlighted the key to driving engagement was energy insight and being able to demonstrate a clear line between an energy efficiency investment and real cost savings.

A local council said that additional incentives should be offered for those hard-to-reach SMEs who have numerous barriers to adopting energy efficiency. Small businesses suggested that getting buy-in will be difficult, and an energy company highlighted that SMEs will be less keen on installations which disrupt business activities.

## **Question 6**

**What are the relative merits of placing the obligation on suppliers, network operators, generators and other bodies?**

We received 38 responses to question 6 from a range of micro and small businesses, local authorities, consultancies, companies involved in the supply chain, energy companies, academics, DNOs and trade associations.

### **Suppliers**

The merits of placing an obligation on suppliers were highlighted by trade associations, small businesses and organisations working in the supply chain. Some of the reasons included that suppliers already have experience and expertise of working on the domestic ECO, so they can use their existing supply chains, processes and systems. They also argued that energy suppliers also have relationships with SMEs.

Whilst most trade associations didn't see many merits of a business EEO on suppliers, two did explain that suppliers would be well placed to deliver due to their existing experience and that the UK was unique in Europe for only having a domestic ECO.

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<sup>3</sup> The government is preparing to consult on energy efficiency regulations in due course.

However, suppliers strongly opposed a supplier obligation, preferring the auction proposal. Suppliers argue that SMEs are a technically challenging sector and putting an obligation on suppliers would be placing an unacceptable risk on them to deliver a large number of energy efficiency measures.

Suppliers also stated that a business EEO would be contrary to wider developments in the retail energy market, the landlord/tenant split incentive would make it difficult to get SMEs on board and the heterogeneity of SMEs would create greater complexity. Some energy suppliers highlighted that if the Government chose to go down the obligation route, significant lead-in time would be required to ensure the obligated party could deliver effectively and that the scheme would need to include a range of energy efficiency measures to drive innovation.

### **Network operators**

The merits of placing an obligation on network providers was highlighted by stakeholders including an LEP, energy company, organisations involved in the supply chain, one network operator, one gas network operator and a trade association. These included potentially lower network costs and sustained demand reduction as network operators could look to target the scheme where demand is reaching network limits and therefore delay or avoid the costs and disruption of traditional network reinforcement.

One network operator highlighted that their distribution networks division was already involved in delivering innovation projects to encourage customers to engage in energy efficiency. Additionally, one gas network operator supported a network obligation, noting that costs could theoretically be passed through only to the businesses that benefited, and this would also decouple energy efficiency measures from the suppliers who sell the energy.

However, one network operator disagreed with an obligation. They stressed the difficulties of engaging and recruiting SMEs to take part in the scheme. Despite noting that network operators have access to low borrowing costs which could be beneficial, they also argued that a government guarantee could be used to secure finance without involving the networks.

Stakeholders including an energy company, trade association and small business also said that network operators had no experience of working on an EEO and did not have strong relationships with SME consumers. An LEP said that obligating the networks would lead to a regionalised approach whereby there could be unfair discrepancies between network areas.

### **Generators and local authorities**

There were no merits identified by stakeholders of placing an obligation on generators as they have no relationship with SME businesses and have no experience of working on energy efficiency obligations, therefore delivery would be challenging. One company working in the supply chain explained that when energy generators were obligated under the Community Energy Saving Programme (CESP) they tried to contract out or buy their way out of the obligation as they had no link to the end user, and in at least one case this led to them failing to meet their target. One academic supported an obligation on LEPs and local authorities as they were trusted independent actors who could facilitate the marketing and take up of the EEO programme.

Finally, some respondents suggested that if an obligation is considered, funding should be separated from delivery. This would allow more flexibility for obligated parties to meet their obligation. For example, the obligation could be placed on network operators and suppliers could then bid for delivery work alongside other parties where they can use experience gained from ECO delivery.

## Question 7

### What models of EEOs would minimise costs while delivering efficiencies?

We received 30 responses to this question from micro and small businesses, trade associations, energy assessors, Gas Distribution Networks, local authorities, academics, companies involved in the supply chain, Distribution Network Operators and energy companies. Most of the responses centred around the themes discussed below.

#### **Obligate energy suppliers to minimise costs**

A number of respondents including trade associations, small businesses and companies working in the supply chain, explained that costs would be minimised if the obligation mirrored the domestic ECO and an obligation was placed on suppliers. They argued that suppliers could build on the existing expertise rather than start from scratch which would reduce set up costs and time. However, they stressed that lessons would need to be learned from the domestic scheme to ensure the measures are effective and of a good quality. One respondent cited the Dieter Helm<sup>4</sup> review which advocated that those who benefit from any scheme should pay into it rather than expecting the entire customer base to contribute.

#### **Rural sub obligation**

One LEP said rural sub-obligations are important to ensure a proportion of the business EEO is directed towards rural SMEs where the cost per pound for lifetime savings is likely to be higher than for urban programmes.

#### **Central pot/trading**

One energy supplier and trade association were keen on having all obligated parties contributing into a central pot, in lieu of delivering, or being able to trade some or all of their obligation to other obligated parties or delivery agents. This could encourage more innovative delivery from other actors such as ESCOs.

#### **Importance of quality assurance/transparency**

Quality assurance was highlighted by some as being very important to protect consumers from work being undertaken which was substandard. It was stated that although cost effectiveness was important, more focus should be put on ensuring that solutions are delivered to a high quality, to ensure a more trusted, sustainable market is established<sup>5</sup>.

#### **Features of an obligation**

Generally, energy suppliers were not in favour of an obligation, but they did list some important features which would be important if an obligation was introduced.

- Firstly, any EEO should obligate all licensed suppliers within the specified target market to participate and meet their fair share of the total obligation. To do otherwise will create an unfair playing field in the retail market.

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<sup>4</sup> <https://www.gov.uk/government/publications/cost-of-energy-independent-review>

<sup>5</sup> Could add something about the PAS work if in EWP?



- Secondly, it should keep the design simple from a verification of savings perspective by using deemed scores for determining the level of energy savings for each type of eligible measure.
- Thirdly, it would be important that there is a target that spans a number of years in order to allow obligated parties to deliver their targets in the most cost-effective way.
- Fourthly, any obligation should allow for trading between parties, which could help to meet overall targets.
- Fifthly, there should be a buy-out regime which allows obligated parties to buy-out their obligation to avoid non-delivery penalties. To maximise incentives on obligated parties, any buy-out fee should be paid into the fund and recycled.
- Finally, it is important that there are little or no constraints over either the type of measures that are eligible and therefore qualify as contributing towards the delivery of the target, or the type of business customers that are eligible to benefit from the obligation. This will help to encourage innovation within the marketplace and keep search costs down to a minimum.

### **Competition**

One trade association and a company working in the supply chain said that encouraging competition between obligated parties would help to ensure best value for money.

### **Community Energy model**

One respondent highlighted the importance of community energy organisations and the importance of including them in any SME energy efficiency scheme.

### **Reducing exemptions**

Some stakeholders explained the importance of not preventing certain organisations from taking part and instead opening up a new obligation to a greater number of participants to drive innovation and avoid market distortion.

## **Question 8**

**A number of countries operate EEOs, what can we learn from their experiences?**

We received 19 responses for this question from trade associations, energy companies, local authorities, academics, micro businesses and businesses involved in the supply chain.

### **Denmark**

A supply chain company and trade association highlighted the success that the Danish EEO has had for larger industry in contrast with SMEs, where it does not seem to have made much of an impact.

The supply chain company also noted that there have been issues with additionality so the UK Government would have to consider what payback period to fund to ensure that the measures are providing additional value to businesses and would not have been carried out anyway.

## **Australia**

One supply chain company discussed their experiences with energy efficiency schemes in Australia, with particular reference to a white certificates trading scheme in two states. The respondent compared their perspective on the relative benefits and drawbacks of an EEO versus a white certificates trading scheme. They commented that, for white certificates, it was useful to have an online register and the flexibility of trading between energy suppliers, installers and other market participants, and that was advantageous over the UK ECO.

## **Ireland**

Several respondents commented on their experience of the Irish EEO. They described the rollout of the scheme and also said that it was beneficial to put the obligation on all sources of fuel, rather than just electricity and gas, to make sure that there would be no incentive to use a more carbon-intensive fuel. Other comments included potential issues created by having uniform sectoral targets for different suppliers, in which every supplier has to implement a set proportion of energy savings in commercial premises (75%), residential premises (20%) and fuel poor households (5%). However, different suppliers have quite varied customer bases which makes it proportionally more difficult for some suppliers to find the requisite number of each type of premises, increasing costs.

Concerns from multiple respondents included whether the type of measures covered by the Irish EEO, that is cheaper, more scalable measures, would be valuable in the UK market. They felt British SMEs may require more bespoke solutions.

## **France**

A supply chain operator and trade association gave their reflections on the French EEO. They noted that the obligation can be achieved by implementing their own energy efficiency measures, by incentivising consumers to make energy efficiency savings or by providing funding to projects that reduce fuel poverty or support education. While the scheme is for both homes and businesses, the respondents noted that 70% of the obligation was for domestic properties, so the French EEO model would not necessarily work for SMEs in the UK without further policy development.

## **Question 9**

What level of co-funding would maximise the value for money from an EEO and minimise competition distortions, while ensuring a sufficient incentive remains for SMEs to take up the measures.

There were 24 responses to this question from trade associations, energy companies, local authorities, small and micro businesses, an academic, consultancies and companies involved in the supply chain. The main themes which came up are highlighted below.

### **Co-funding**

Mixed views were expressed on co funding. Some academics said that the level of funding should be based on the payback. Measures with shorter paybacks, such as LED lighting, could see a larger contribution from the SME beneficiary. Measures with longer paybacks would require greater amounts of funding to persuade SMEs to adopt these measures. One LEP explained that any level of upfront co-funding could create a barrier to uptake. As such,

whatever the SME co-funding level(s) adopted, consideration should be given to how to minimise the upfront business contribution required from SMEs.

Energy companies thought co-funding would bring value to the market and allow funding provided by the obligation to support a larger number of measures. However, they also highlighted that there were issues with data sharing in the domestic scheme, which makes understanding its potential impact more difficult.

### **Low cost measures free of charge**

One company working in the supply chain spoke of the lack of interest for SMEs to pay for energy savings upgrades, and therefore suggested low-cost quick-win measures should be offered free of charge, with other measures subsidised to at least 60% in the first phase of any scheme.

## Chapter 4: Access to Finance

Questions ten to thirteen sought views on opportunities in making finance more readily available to SMEs, alongside the challenges that lenders may face in this market.

### Questions 10 and 11

How could the ESCO 'pay as you save' (PAYS) model be adapted for SMEs?

Do ESCOs and banks see additional risks operating in the SME market?

There were 33 responses to question 10, and 16 responses to question 11. Respondents were diverse including trade associations, energy companies, market players, supply chain companies, local authorities and academics.

#### **Build on past experience**

Eight respondents referred back to the Green Deal policy and suggested there were elements of that scheme that could be effective. They recognised that a PAYS model can have difficulties and made suggestions that could help overcome these problems. The suggestions included:

- Regulation could be used to create fiscal incentives to encourage businesses to install energy efficiency measures.
- Government could underwrite a PAYS scheme to ensure attractive interest rates for consumers and limited risk for ESCO companies.
- The PAYS scheme could be promoted alongside the main scheme (such as an energy efficiency auction) which would generate demand for the finance.

Other respondents, such as a trade association, believed that a wider variety of financial products should be made available to target a broader section of SMEs.

#### **Simplicity**

Many respondents stressed the need for simplicity as being important for the success of a new PAYS scheme. There were some concerns that an SME PAYS scheme could become too complicated and SMEs would therefore choose not to engage with it.

One energy company specifically warned against using the domestic Green Deal as a blueprint for a new PAYS scheme, arguing that it would be too complex, and the technicalities would not easily transfer over to a PAYS scheme for SMEs.

#### **Impetus for SMEs**

Many respondents identified one of the biggest risks to the scheme was that SMEs may not want to take on additional financial commitments.

One trade association noted that many SMEs do not pursue energy efficiency measures due to other barriers, and therefore do not reach the stage of actively looking into the merits of finance products. However, they also stressed that a lack of finance could end up being a major barrier

if it is not in place. Another trade association stressed the need for a larger policy package alongside increased access to finance options to ensure there is enough demand generated.

### **Reduce the Risk for ESCOs**

Respondents identified the need to reduce the risks associated with providing finance to SMEs through ESCOs in question 10 and this issue was explored further in question 11. The insights have been summarised below.

One trade association remarked that the success ESCOs have had so far has been through developing relationships in the public sector and with large organisations where there are substantial opportunities for energy improvements. With small and medium sized businesses, the transaction costs are proportionally higher per organisation.

The respondent also highlighted the risks inherent in smaller businesses, which are more likely to go into administration than large businesses and moving to a new property is relatively common.

Responses to question 11 showed that the majority of respondents (12 out of 16) believe that banks and ESCOs see additional risks when operating in the SME market.

The risks are detailed below, and they include:

- Low returns for the ESCO;
- SMEs are more likely to withdraw or go out of business;
- ESCO set up costs can be expensive for SMEs;
- Lack of appetite from SMEs.

Several respondents gave detail about what they see as the financial risks for ESCOs operating in the SME market. One supply chain business explained that there is a higher risk associated with SMEs because they often have a smaller revenue than larger businesses and are more likely to close down due to financial difficulties. However, the respondent also mentioned the opportunities for ESCOs in the SME sector, noting the large number of SMEs in the market and the potential for a longer financing relationship with new clients, lasting beyond the initial loan.

A large energy supplier detailed the set-up costs to put an energy performance contract in place which do not vary much depending on the client. These costs, it suggests, would likely make ESCOs prohibitively expensive for most SMEs. Regarding energy savings, the energy supplier mentioned the challenges in the bespoke requirements that different SMEs have and the difficulty in forecasting energy savings, as the way businesses use their buildings may be different to how it was expected.

## Questions 12 and 13

Do you believe a scheme encouraging and helping lenders develop more innovative and attractive finance products will help generate interest amongst SMEs?

What types of innovative finance products or banking initiatives would attract SMEs into taking action on energy efficiency? Please provide examples.

There were 32 responses to question 12 and 26 responses to question 13. Respondents included trade associations, local authorities, energy companies, energy consultancies, and small energy businesses.

Of the 32 responses to question 12, a slim majority agreed that a scheme encouraging and helping lenders develop more innovative and attractive finance products would help generate interest amongst SMEs. Of those who disagreed, several made suggestions they believed would help to generate more interest amongst SMEs.

Some of the respondents that agreed with the thrust of question 12 did so with caveats. For example, a trade association argued that uptake amongst SMEs of finance products would only be increased marginally by a new scheme, in part because there are several other barriers (information barriers, capacity barriers, internal competition for funding) that a scheme would not necessarily remove.

Some respondents noted the possibilities of combining a new scheme with one of the previous options, namely an energy efficiency auction, as a potentially effective way of encouraging SMEs to seek finance for energy efficiency measures. It was widely recognised that any scheme would fail if there was little demand from SMEs.

Several respondents disagreed that a scheme would encourage uptake of such finance products among SMEs but said that a scheme could be part of the solution if the other barriers were dealt with too. This would likely include ensuring more provision of tailored, trusted advice to SMEs, and boosting the expertise of energy consultants and financial institutions.

Those respondents who did not believe that new financial products for SMEs would encourage interest in finance, stated reasons such as increased complexity in the market and that other barriers would block uptake.

The responses to question 13 gave a good range of ideas for finance products and banking initiatives that could help to attract SMEs into taking action on energy efficiency. Most suggestions centred around having better value or interest-free loans for energy efficiency projects and more favourable terms than would otherwise be available.

For example, one respondent explained how Suffolk County Council offer businesses grants and interest free loans, which are popular because they reduce the financial barrier for businesses to take up energy efficiency measures.

Another local authority suggested a loans scheme like Salix for the private sector and SMEs. Salix<sup>6</sup> provides interest free loans in the public sector to promote energy efficiency.

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<sup>6</sup> <https://www.salixfinance.co.uk/>

One example detailed the Carbon Trust interest free loans for businesses in Wales, which it said had been very popular, and in Scotland, where loans set up by the Government have included cashback incentives to further encourage uptake.

## Chapter 5: Other Suggestions

In the final question of the Call for Evidence, respondents were given the space to make further suggestions which would contribute to the development of an energy efficiency scheme that fitted outside the parameters of the previous questions.

### Question 14

Do you have an alternative model for the business energy efficiency scheme that we should consider?

Question 14 received 36 responses. Respondents included trade associations, energy companies, consultancies, local authorities, academics, and supply chain businesses. While the question asked for alternative models of business energy efficiency scheme, the answers tended instead to give recommendations of things to bear in mind for any scheme, as well as other policy changes that could help support the aim of the potential scheme.

#### **Building standards regulation**

The most popular suggestion among respondents was for strengthening buildings standards regulations. Almost one third of respondents cited it as a possible solution. Supporters included a consultancy, four energy companies, three trade associations, a local authority and small businesses.

Given that a large majority of SMEs rent their premises, a large number of respondents feel that tighter regulations on privately rented commercial buildings could drive effective change. There was support for the Green Finance Taskforce's recommendations of legislating to achieve minimum EPC B standards in privately rented commercial buildings by 2035<sup>7</sup>.

One energy company thought that regulations should apply regardless of ownership, i.e. they should apply to non-domestic owner occupier properties as well.

Overall, there was a strong appetite from respondents for stronger regulations in this area, particularly from energy companies and trade associations. They see a need for regulation to underpin other efforts.

#### **Fiscal incentives**

The second most popular suggestion was providing fiscal incentives to businesses. This was recommended by eight respondents, including energy companies, trade associations, small and micro energy businesses and a supply chain business.

There was clear support for ensuring that SMEs and landlords are financially incentivised to install energy efficiency measures. Some respondents also highlighted the issue of energy efficiency measures leading to an increase in the rateable value of a business' premises which actually raised business rates.

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<sup>7</sup> The government is preparing to consult on energy efficiency regulations in due course.



Respondents, including an energy company, believed that a link between business rates and energy efficiency premises would encourage SMEs to either take direct action in their premises or move into a more energy efficient building. Concurrently, landlords would be incentivised to improve the energy efficiency of their building to appeal to businesses attracted by the prospect of lower business rates.

Fiscal changes are seen by some as a necessary prerequisite to other schemes delivering successful energy efficiency measures.

### **Local action**

Approximately one fifth of respondents suggested further action at a local level, engaging with community groups and devolving more powers to local authorities. They explained that groups such as community energy organisations may be well placed to engage with local businesses and provide appropriate solutions. One energy company suggested that businesses would be more trusting of local organisations which could encourage higher uptake.

### **Further suggestions**

Other popular suggestions included improving the provision of financial products (see Chapter 4), ensuring businesses have access to good quality, tailored advice on energy efficiency measures, and government funding/grants. They argue that such measures would help to remove some of the significant barriers to entry that SMEs face in regard to energy efficiency installations. They could be used in tandem with a larger energy efficiency scheme, helping to boost uptake and bring about wider benefits.

A response from academics suggested considering carefully how information can be tailored to the specific needs of each SME and be provided by a trustworthy source. They urged government to make use of experts and networks in existing organisations. This suggestion was echoed by several other respondents.

## Annex A: List of Respondents

- 1 2EA Consulting Limited
- 2 arbnco
- 3 Athene Advisory Ltd
- 4 British Ceramic Confederation
- 5 British Glass
- 6 Cadent Gas
- 7 Confederation of British Industry
- 8 Centrica
- 9 Community Energy England
- 10 Cornwall and Isles of Scilly Local Enterprise Partnership
- 11 Centre for Research into Energy Demand Solutions (CREDS) & UK Energy Research Centre (UKERC)
- 12 Drax
- 13 E.ON
- 14 EDF Energy
- 15 Elmhurst Energy
- 16 Energy Networks Association
- 17 Energy UK
- 18 Excellence in Electrotechnical & Engineering Services (ECA)
- 19 Federation of Small Business
- 20 Global Energy Partnership Ltd
- 21 Good Energy
- 22 Greater London Authority
- 23 Gregg Woodall Associates
- 24 Gwasanaeth Amgylchedd Williams Environment Services
- 25 Happy Energy Solutions Ltd

- 26 I&C Shippers and Suppliers Group (ICoSS)
- 27 Inverter Drive Systems Ltd
- 28 Jay Tech Venture CIC
- 29 Kent County Council
- 30 Kingspan Insulation
- 31 Make UK - the Manufacturers' Organisation
- 32 Mineral Wool Insulation Manufacturers Association
- 33 National Energy Action (NEA)
- 34 Northern Powergrid
- 35 PICON Ltd
- 36 Renewable Energy Association (REA)
- 37 Scottish Power
- 38 Smart Metering Systems
- 39 Socomec
- 40 Solar Trade Association
- 41 SSE plc
- 42 Suffolk County Council - Suffolk Climate Change Partnership
- 43 Sustainable Energy Association
- 44 The Association for Decentralised Energy
- 45 Third Stone Ltd
- 46 Tudor Edward
- 47 USUS Consulting Engineers Ltd
- 48 Utilita Energy

Two private individuals also responded.

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This publication is available from: [www.gov.uk/government/consultations/energy-efficiency-scheme-for-small-and-medium-sized-businesses-call-for-evidence](https://www.gov.uk/government/consultations/energy-efficiency-scheme-for-small-and-medium-sized-businesses-call-for-evidence)

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