

The role of public sector intervention in product development within SMEs – managing the sustainability message

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Small and Medium Sized Enterprises (SMEs) make a significant contribution to national economies through providing employment, harnessing entrepreneurial activity and creating competition. Although placed outside the scope of much national environmental legislation, the activities of SMEs have a significant cumulative impact on the environment and on the communities in which they operate. It is becoming increasingly clear that market-based incentives and macro-economic framework conditions have been largely ineffective in addressing the sustainability challenge. The interaction between knowledge sub-systems, business, policy and governance requires new approaches to move the agenda forward. This requirement will be accelerated by recently proposed legislative frameworks and increasingly global markets. While much effort has been placed on improving the end-of-pipe performance of industry, ecodesign has been recognised as one of the key approaches to improving resource efficiency and competitiveness. To date, implementation of ecodesign in SMEs has been limited. From an organisational perspective, SMEs are well positioned to regularly interact with a number of external stakeholders and many SMEs currently operate within collaborative networks. These networks help to develop economies of scale, maintain competitiveness and to strengthen the company's position in the market. SMEs developing a product will also interact with a number of external stakeholders, including financiers, suppliers and external design agencies. There are a number of opportunities within this process for public sector intervention to manage and communicate the sustainability message. From a policy perspective, there is a need for greater focus on the communication networks and multi-stakeholder interactions within the SME supply chain, as opposed to relying on company oriented strategies. Even without a formal product policy, design, business and environment support services can still influence the product development process. This paper outlines how Welsh policy measures to promote innovation and improve the environmental performance of SMEs can increase the level of ecodesign implementation.

Keywords: Ecodesign, SMEs, stakeholder communication, public sector intervention

1 Introduction

It has long been recognised that there should be no trade-off between economic growth and environmental and social sustainability. This suggests that environmental and social sustainability needs to be properly integrated into conventional paradigms of economic development. While products and services contribute significantly to human prosperity, wellbeing and quality of life, their production and consumption result in many environmental and social impacts. In the last few decades, as the international environmental policy agenda evolved from command and control measures to addressing life cycle impacts of product and services, some environmental and social gains have been made. These gains have been achieved primarily through improved eco-efficiency and cleaner production. These developments have helped to reduce the resource intensity of certain aspects of the global economy although issues such as a booming global consumer class and the rebound effects of eco-efficiency have questioned the sustainability of these approaches. The role of design in decoupling negative environmental and social impacts from economic growth has moved to the top of policy agendas in recent years. This is partly because approximately 80% of a products' environmental cost is locked-in at the design stage (German Federal Environmental Agency *et al.*, 2000), while design plays a significant role in influencing consumer behaviour.

It is widely accepted that SMEs play a significant role in the design and development of new products. Unfortunately the application of ecodesign and life cycle thinking in these companies has remained low. Internationally there have been a number of publicly funded initiatives seeking to encourage SMEs to apply ecodesign and life cycle thinking. While there were some short-term successes, many of the initiatives failed to embed ecodesign and lifecycle thinking in the SMEs. There were a number of reasons for this such as a broad focus on supply side activities, poor market signals and fragmented support mechanisms (O'Connor and O'Rafferty, 2005). In relation to barriers to ecodesign and life cycle thinking in SMEs, much emphasis has been placed on the role of managerial systems, operational resources and supply chain issues. Less attention has been placed on the role of public sector intervention and national innovation systems (IS) in assisting SMEs to implement ecodesign. Recent developments in product policy, such as Integrated Product Policy (IPP) place greater emphasis on the role of cooperation and communication in stimulating innovation. Using Wales as an example, this paper will highlight opportunities for public sector intervention in product development processes with a view to encouraging and enabling life cycle thinking and ecodesign.

2 Background

2.1 The changing product policy landscape

The development of product policies within the context of sustainable development (SD) is a complex task due to the interdependence and overlap with numerous policy areas. In the European Union (EU), the environmental and product policy agenda has traditionally been reliant on command and control measures. The emphasis has now shifted from addressing point source pollution from industrial facilities to looking at wider issues such as the environmental and social impacts of products and services. This policy mix aims to promote sustainable innovation through a mix of legislation, economic instruments, voluntary agreements and market-based incentives. For example, the European Commission's IPP is a strategic instrument to establish an optimal mix of policy measures to encourage the

development of products and services¹ with reduced environmental impacts throughout their entire life cycle. While IPP seeks to reinforce and refocus existing legislative measures it will introduce new approaches where necessary. Within the UK, there are a number of existing and planned policy measures (mainly arising from the EU) that seek to improve the environmental performance of products. It is clear that while individual product impacts are addressed, the regulatory landscape is fragmented.

The emphasis on economic instruments, voluntary agreements and market-based incentives within the context of IPP raises a number of questions for SMEs. The use of economic instruments, such as taxes and tradable permits, has a number of perceived advantages such as offering dynamic incentives, flexibility and non-distorting cost internalisation. These advantages must be weighed up against issues of uncertainty in relation to environmental costs, implementation delays and competitive disadvantage through the unequal intensity of economic instruments in different markets. The use of voluntary agreements has been increasing in the EU, predominantly in countries with mature environmental regulatory frameworks. One such example of a voluntary agreement is the Environmental Management and Auditing Scheme (EMAS). This provides a voluntary measure by which companies can register improvements in their environmental performance through management systems, policies and review programmes. For larger organizations, voluntary agreements can be a cost effective mechanism for compliance while their effectiveness for SMEs will often depend on the strength of the local and regional support networks. The effectiveness of market-based incentives can be less for SMEs than for larger organisations. For example, if public procurement is used as a market-based incentive this can stimulate growth and innovation in companies. This type of approach may require preferential treatment for SMEs such as the pooling of suppliers to match procurement demand.

2.2 National innovation systems

The changing product policy landscape and the broad challenges of SD emphasize the importance of innovation. Innovation drives the exploitation and synthesis of new ideas and this principle is the basis of IPP and ecodesign. Innovation is an elusive term and there is no “one-size-fits-all” implementation model. What is clearer are the factors that contribute to successful innovation. In a Confederation of British Industry/Design Council survey of UK industry, some of the primary factors contributing to innovation included the use of cross-functional, multi-skilled teams, financial and non-financial incentives and consultation and collaboration with customers, competitors and researchers (Forum for the Future, 2005).

The role of national and regional IS also has a bearing on the dynamics and scope of innovation. The application of systems thinking in innovation is relatively new although within the EU there has been specific policy support through Regional Innovation Strategies. IS are multi-dimensional and have been defined as an “interactive networks of agents, institutions and organisations involved in the process of technological change” (UNIDO, 2005). This paper focuses on the policy structure and framework conditions, components (business sector, business support infrastructure, networks and interactions) and sub-systems (knowledge subsystem, the business innovation subsystem) of an IS, see Figure 1.

¹ From this point the term “product” shall include services

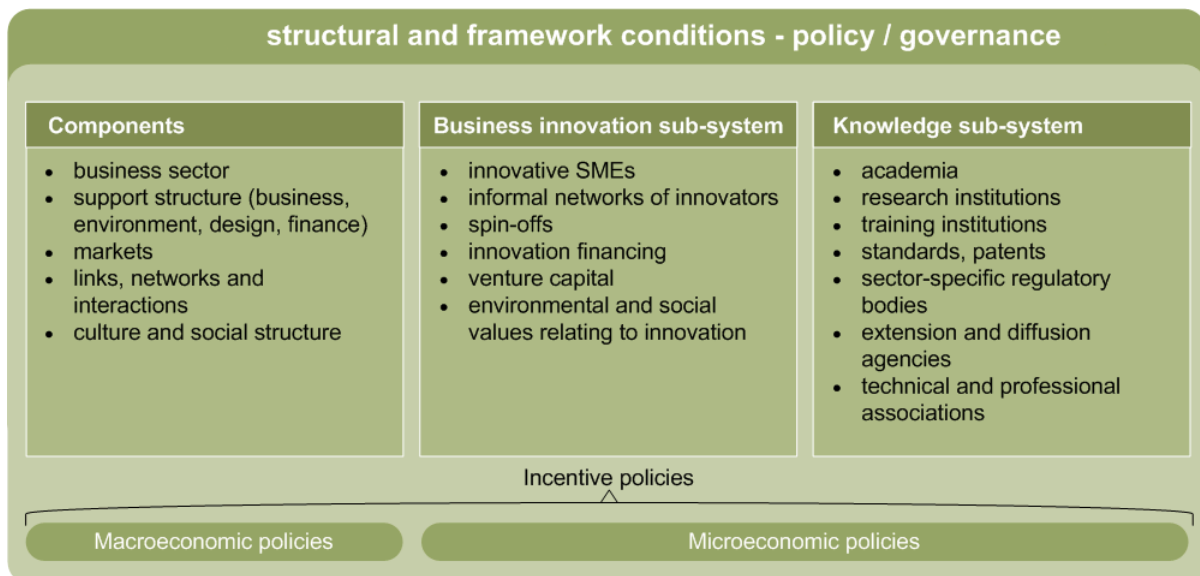


Figure 1: generic scaled-down innovation system (adapted UNIDO, 2005)

2.3 Public sector interventions to encourage ecodesign and the lessons learned

There have been a number of public sector initiatives and interventions seeking to encourage the application of ecodesign and life cycle thinking in SMEs. It is clear by the low levels of long-term application of ecodesign and life cycle thinking that these forms of interventions fell short of what is required. The authors identified a number of issues that contribute to this poor uptake such as a focus on supply-side activities, a failure to engage with the indigenous design sector, a failure to embed ecodesign and life cycle thinking in education and the wider business and environment (B&E) support network, a lack of clear market signals and fragmented post initiative support mechanisms (O'Connor and O'Rafferty, 2005).

In many cases the appropriateness of the tools and methodologies being employed were not assessed prior to implementation. For example, the use of prescriptive and complex methodologies such as full Life Cycle Analysis (LCA) can be useful for particular product groups but rarely suit the SME environment. LCA is a useful tool for assessing environmental impacts but it doesn't provide a methodology for developing design solutions.

The timescale of the funded projects also restricted the capacity to broaden the implementation support for SMEs. For a project to be successful the timescales need to be flexible and mindful of the commercial realities facing the companies. This includes the likely variations in lead-times for different product groups and the existing capabilities of the company.

Another noticeable aspect missing from previous public sector interventions was the issue of culture change, at a company level and on a broader level. From an organisational perspective, culture can be regarded as the shared assumptions in relation to work practices. If sustainability and innovation are to be embraced by an organisation they need to be integrated into all aspects of the business. The first step to culture change within an SME is active engagement with, and commitment from, top management.

3 SMEs and product development

3.1 The importance of SMEs in SD

It is well documented that SMEs represent a significant element of national economies. To some they are a seedbed of innovation, utilising information and technological systems to create niche products in a flexible and customized manner. Because SMEs account for over 90% of businesses world-wide they help to form systems of national productive capacity which ultimately leads to interlinked and resilient economic systems (Raynard and Forstater, 2002).

From an economic perspective SMEs make a significant contribution to the development of long-term growth dynamics facilitating the transition to larger enterprises. Although the figures vary regionally, some studies suggest that SMEs account for 65% of GDP in Europe (EURAB, 2004). From a social perspective, SMEs have increased employment across the urban/rural divide and have made income distribution more equitable through reducing regional income disparity (UNIDO, 2002). SMEs are represented across all major manufacturing and industrial sub-sectors. From an environmental perspective, SMEs have a significant impact on the environment of the communities in which they operate. It has been estimated that, in Europe, SMEs account for over 50% of overall pollution from industry (Ecotec, 2000). While company specific impacts may be relatively small and outside the scope of national regulations, the cumulative impact of their activities represents a significant challenge to sustainability.

3.2 Product development and ecodesign in SMEs

While systems of product development in large companies are very well understood this is not the case in SMEs. For many SMEs and micro-businesses the product development process is fragmented. This is primarily due to managerial and operational resources and, commonly, the lack of internal design capability. Studies have also shown that a number of SMEs in the manufacturing sector typically fail to harness the strategic considerations required to lead successful product development processes (Millward and Lewis, 2005). While these small businesses may produce successful products, the nature of product development in SMEs is flexible and idiosyncratic. It is interesting to note that studies show that UK SME managers are more sceptical of tools and methodologies to aid the product development process and this has consequentially lead to low product success rates (15% in the UK compared to 50% in the US) (Millward and Lewis, 2005). This scepticism raises specific concerns in relation to the implementation of ecodesign and life cycle thinking in SMEs, beyond the widely accepted issues of poor access to capital, skills and time. Ecodesign, while being flexible to encourage innovation, is a systematic process.

In larger organisations, ecodesign strategies often dovetail reactive compliance strategies. Environmental compliance in itself holds little added value for business and our experience shows that compliance remains low on the list of priorities of SME managers. This suggests that other entry and leverage points are required in encouraging ecodesign in SMEs. While supply chain pressures and contractual arrangements for 1st and 2nd tier suppliers are important drivers, the market response to ecodesign and sustainability issues remains slow.

3.3 Barriers to product development and ecodesign in SMEs

Other than internal barriers, factors that contribute to the low level of ecodesign and life cycle thinking implementation in SMEs include a policy framework and business support system that is currently oriented towards larger firms. For example, European policy measures focussing on the environmental impacts of packaging are primarily driven by targets such as tonnage reduction. These measures fail to address the cumulative impacts of SMEs. This policy framework lends itself to inappropriate support systems that focus on the needs of larger organisations. Support systems should be considerate of SME-specific constraints. They should not place an overly complex regulatory burden on SMEs, thus putting them at a competitive disadvantage.

In relation to the appropriateness of support systems, it is interesting to note that in a study on small firms and politics, conducted by the Open University Business School, small firms were asked about their views of government intervention and commercial assistance arising from such interventions. Only 18% of the smallest firms (0-4 full-time employees) felt that government intervention could definitely be beneficial. This is compared to 30% of firms in the 20-49 employee range. The views differed between sectors. For example 29% of manufacturers agreed that government intervention definitely pays dividends, while only 11% from the retail/distribution sector agreed² (Open University Business School, 2003). This of course raises questions about current forms of intervention, the format of the support and the interface between the public and private sectors.

3.4 SMEs and networks

In the context of IPP, the three themes of integration, cooperation and communication make the respective roles of networks, clusters and stakeholder interaction very important. To assist in developing economies of scale many SMEs operate within collaborative networks. In general these collaboration and cooperative activities include partnerships and strategic alliances, licensing agreements, business networks and joint ventures. These activities enable SMEs to maintain their competitiveness and to strengthen their position in the market. The complexities of product development require a micro-SME³ to interact with a wide number of stakeholders throughout the process.

4 The Welsh context

4.1 Structural and framework conditions

The Welsh Assembly Government (WAG) has a statutory obligation to promote SD in the exercise of its functions. While Wales has no formal product oriented policy, there are a number of action plans that seek to stimulate economic growth through innovation and environmental best practice. The 'Living Differently' theme of the SD Action Plan seeks to address the structural aspects of SD while the Business and Environment Action Plan (BEAP) sets a strategic vision for environmental best-practice as a competitive device. The BEAP recognises that SD requires a long-term vision as a balance to the increasingly short-term

² This survey is based on the responses from a panel of over 350 small businesses (predominately small firms with fewer than 50 employees) situated in the northern, midland and southern regions of the UK.

³ A micro-SME is defined here as a company employing up to ten employees.

pressure facing business. The BEAP has been developed around three primary themes in the context of resource efficiency:

- Strategic Framework - assigning overarching roles/responsibilities within a SD context
- Sustainable Solutions - seizing new business opportunities in Wales to provide the technology and services (locally and internationally) to enable change
- Greening Welsh Business - pursuing the goal of ‘making more with less’

Following the development of the economic strategy for Wales, “A Winning Wales”, the WAG set out the strategic vision of transforming the Welsh economy through innovation. More recently a new WAG economic strategy document, “Wales: A Vibrant Economy” (WAVE), was sent out to consultation. As a strategic framework for economic development, WAVE reaffirms the importance of innovation in encouraging high-growth and sustainable economic development. Supporting this, the Innovation Action Plan (IAP) establishes a vision for the successful exploitation of knowledge and creative ideas through wide-ranging programmes. The IAP was developed in close partnership with the key stakeholders and is built upon five action areas:

- Communicating what can be achieved through more innovation
- Developing more high growth potential businesses
- Better equipping people to innovate
- Simpler, more effective, business innovation support
- Maximising the economic development impact of our universities and colleges.

4.2 Delivery mechanisms

Wales has an extensive network of Business & Environment (B&E) support. This network of support, while having a high degree of regional penetration, has a clear emphasis on the production/manufacturing and end-of-life phases of a product life cycle. It has predominantly focussed on providing ‘end-of-pipe’ solutions to prevent pollution and recycling solutions to minimise waste. More recently, WAG has established mechanisms to encourage resource efficiency with an emphasis on moving the waste agenda upstream.

There are a wide number of financial support programmes available to businesses in Wales. Although a number of these financial support mechanisms are not tailored to the needs of SMEs, some have been applied successfully to assist in the development of new products. Recently there has been an amalgamation of the existing portfolio of funding and a proposal for a single innovation and R&D grant scheme.

Wales also has a number of successful mechanisms for stimulating innovation and fast-growing company incubation. These mechanisms include design (including ecodesign) and manufacturing support services, centres of excellence (facilitating sectoral clustering) and funding programmes. These offer an integrated approach to business and technical support to companies. In recent years there has been a move towards providing enhanced support (including mentoring, coaching and leadership development) to businesses with growth potential. For example, the WAG recently launched the “Knowledge Bank for Business”, a new way of supporting high-growth potential companies in Wales.

5 Opportunities for public sector intervention in product development

5.1 The broader conditions

The statutory obligation of the WAG to promote SD presents significant and exciting challenges. It provides the scope for assessing how SD can be delivered through all aspects of policy, including innovation. There are contradictory opinions on the role of government intervention in stimulating innovation in the context of SD. Many believe that the government has a duty to intervene and correct market failures while some see a reliance on government intervention as a market failure in itself. We believe the government can play a key role in establishing the right market and policy conditions for mobilizing the IS around SD objectives.

Experience has shown that the implementation of product policies suffer from a mix of government and market failure. There is the ongoing risk of monopolies of action, implementation lags and a slow market response in relation to improving the environmental performance of SMEs. An example of the implementation lag is the dependence on market dynamics to stimulate sustainable innovation throughout the supply chain. It is often the case that the expected supply chain interactions, knowledge transfer and organisational support from the private sector, do not occur, leaving the company dependant on networks, clusters or public sector intervention.

These market failures must be balanced against government failures in the form of bureaucracy, information deficit and inefficiency leading to high implementation cost. An example of this has been the recent delay of implementation of some high profile producer responsibility legislation in the UK. The confusion and frustration that this creates, while felt industry wide, disproportionately affects SMEs. Aside from the international competitiveness issues, a lack of clarity in regulatory requirements makes any meaningful strategic planning difficult. This highlights the need to establish coherent regulatory conditions through coordinated and cooperative policy mechanisms.

The education system is another important point of intervention in setting the correct conditions for long-term sustainable innovation through embedding ecodesign and life cycle thinking in design and engineering programmes. The application of a holistic approach to ecodesign requires cross-functional teams incorporating actors from all aspects of the business including marketing, purchasing and finance. We would therefore argue that it is crucial that SD, ecodesign and life cycle thinking is also embedded in mainstream business and management programmes.

The cultural environment is a key factor in the long-term implementation of ecodesign. Culture and social structure play an important role in the understanding and adoption of sustainability principles by business. There is scope for cultural transformation within the framework of a national IS. There are a number of interdependent activities that contribute to the cultural change with other policy mechanisms, including consumer awareness campaigns, frequently playing a key role.

The importance of public procurement in stimulating ecodesign and sustainable innovation has been well documented (Tukker *et al.*, 2000). The focus on supply side activities in previous initiatives has been a prominent reason for their failure in embedding ecodesign and

life cycle thinking. Some countries, such as Japan, have used public sector procurement to create the initial market for ecodesigned products.

5.2 Applying life cycle thinking to public sector intervention

SMEs interact with the public sector at a number of different stages in the product development process. Figure 2 shows a generic life cycle map highlighting some of the interactions that occur between a Welsh SME and other components of the Welsh national IS along the product development life cycle. The map is divided between the broad components of the innovation system that support the product development process, and the delivery mechanisms that have active functions at each stage of the life cycle. This map is indicative and does not profess to be a complete map of the delivery mechanisms and organisations in Wales. The map highlights the level of internal and external communication and interaction that can occur throughout the product life cycle. Many SMEs are dependant on these interactions when developing business and design capabilities.

This map highlights the opportunities for mobilizing the IS around the Welsh SD objectives through assisting the implementation of ecodesign. For this to happen there is a clear need for an integrated, life cycle approach. The need for “joined-up thinking” requires a high level of coordination and recognition of the interdependence of policy areas (economic, industrial development, environmental, research, education and science) and delivery mechanisms.

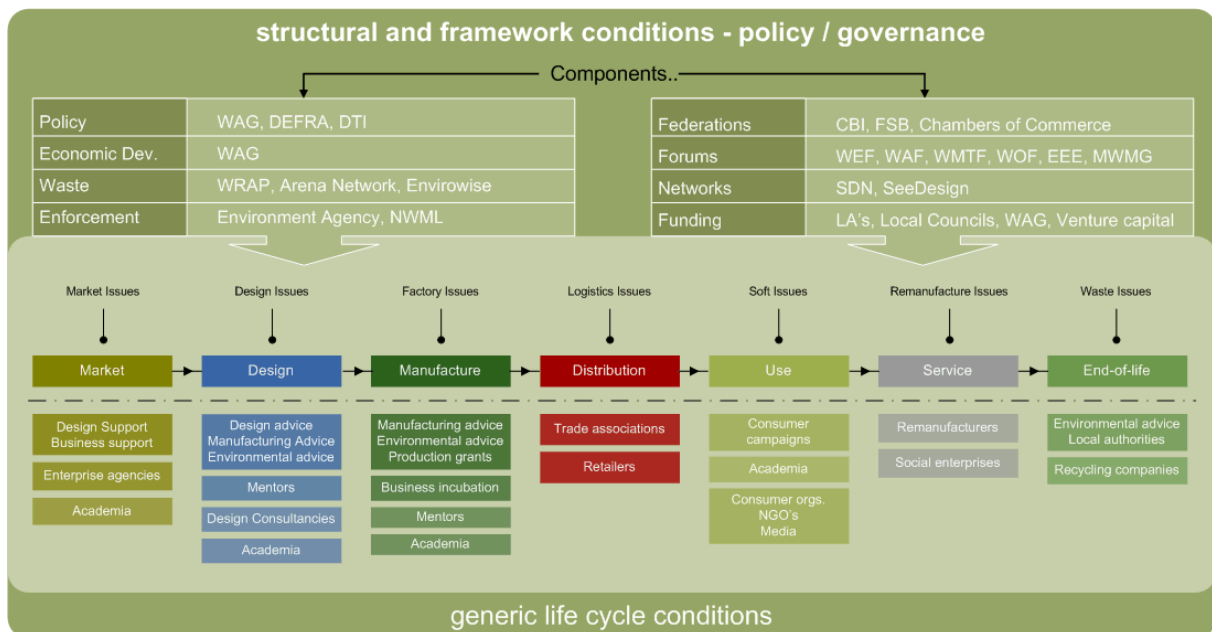


Figure 2: a life cycle map of the Welsh innovation system (See Glossary)

5.3 Case example: A Welsh SME implementing ecodesign

Riochem™, a micro-SME⁴ based in Wales, produces innovative instruments for chemical titration. When Riochem set about producing their flagship product, the TinyLab™, the company was in an early stage of development and had no internal design capabilities. Riochem became an active member of a regional innovation network and sought funding, business development advice and design advice.

⁴ A micro-SME is defined as a company of between one and ten employees.

With the intervention of Design Wales, the company was able to place greater structure on the product development process. This included defining roles and responsibilities, developing a design brief and identifying long-term product strategies, including ecodesign. The initial steps that were taken to address the life cycle impacts of the product included broad systems definition and identification of where ecodesign could make a positive intervention to improve the environmental performance of the product. This process of scenario building is often enhanced with the involvement of a number of stakeholders with different specialist skills. Working closely with Design Wales, Riochem™ established an ecodesign strategy and a process to manage the interactions between the various stakeholders with a view to the ecodesign objectives. This cooperative, multi-stakeholder approach required facilitation by Design Wales. It resulted in an ecodesign benchmark product for the company. It also increased the awareness and knowledge of ecodesign and life cycle thinking in the various stakeholders.

Figure 3 outlines a basic model of the main stakeholders involved in the development of the TinyLab™. The model allows for quick identification of those stakeholders directly and indirectly involved in the development of the TinyLab™. Those connected with a solid line are directly involved while those connected with a dotted line are indirectly involved. Even with this basic model we can see that there was significant interaction between the various stakeholders.

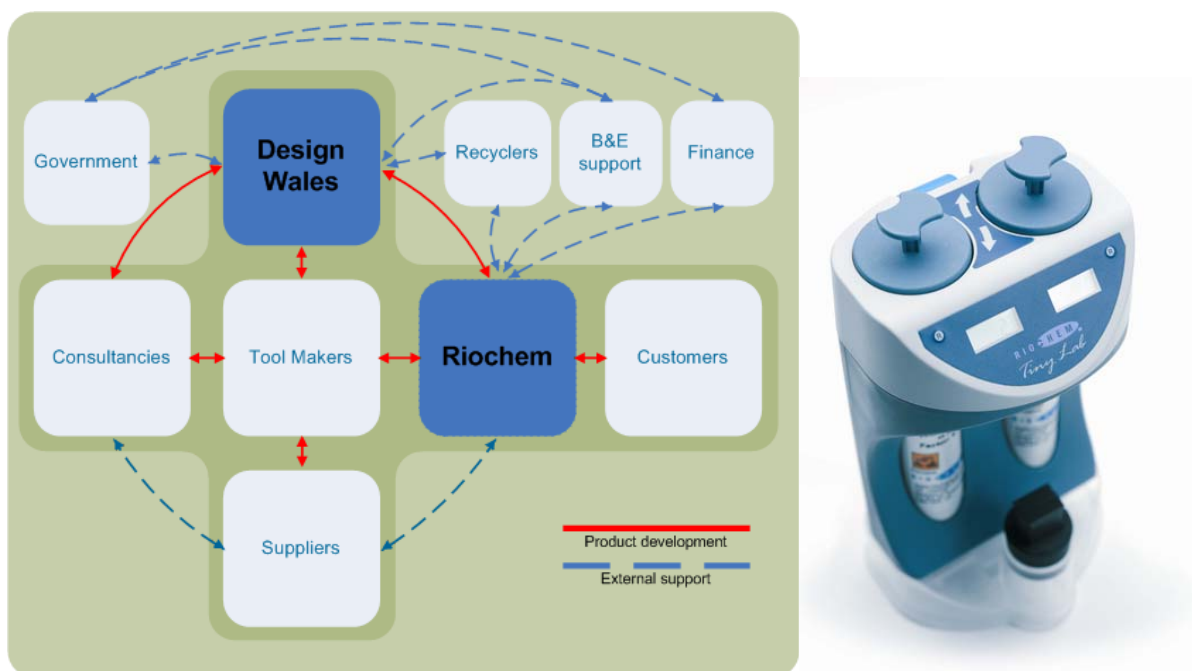


Figure 3: basic model of communication network (with product)

This case study above suggests that there are opportunities for a formalisation of the cooperative, multi-stakeholder approach, around the basic model in Figure 3. The case study also highlights the opportunities for strengthening the existing IS support mechanisms from a sustainability perspective. While some background knowledge for ecodesign implementation exists in the Welsh IS, the awareness of ecodesign and life cycle thinking in all support mechanisms needs to be increased. These new knowledge will be complimentary to their existing expertise in the area of finance, innovation and product development.

6 Conclusion

Recent approaches to product policy such as IPP seek to align environmental and social issues with core business functions through the encouragement of innovation and life cycle thinking. IPP seeks to work with IS through cooperative measures and communication. IS are founded on a complex set of relationships among those stakeholders in the system. These include academia, B&E support, research institutions, and business. From a policy perspective it is important to understand the relationships in that system making the identification of leverage points for intervention possible. It is reasonable to suggest that if life cycle thinking is a base principle of ecodesign it should be applied to those policy measures that seek to improve the environmental performance of products and services. Any aspect of product policy will have deep complexities but we believe that beginning with the foundational themes of integration, cooperation and communication will greatly aid successful delivery.

It is clear that to overcome previous shortcomings in public sector intervention an integrated and life cycle oriented approach must be taken. A strategy for public sector intervention with a view to encouraging ecodesign and life cycle thinking in SMEs needs to be multi-dimensional. This can be achieved through an integration of existing mechanisms of support alongside a programme of information, guidance and training, enhanced support and promotion. The principles of engagement, education and empowerment need to be embedded in long-term economic development and environmental strategies. This paper has provided a case example of the role of public sector intervention in product development and ecodesign in Wales. We believe that this approach can be refined over the coming years with a view to delivery in other regions.

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Glossary for Figure 2

CBI – Confederation of British Industry
DEFRA – Department for Environment, Food and Rural Affairs
DTI – Department of Trade and Industry
EEE – EEE Focus Group
FSB – Federation of Small Businesses
LA's – Local Authorities
NGO's – Non-governmental organisations
MWMG – Mid Wales Manufacturing Group
NWML – National Weights and Measures Laboratory
SDN – Sustainable Design Network
SeeDesign – Sharing Experience in Design Support Network
WAF – Welsh Automotive Forum
WAG – Welsh Assembly Government
WEF – Welsh Electronics Forum
WMTF – Welsh Materials Technology Forum
WOF – Welsh Opto-electronics Forum
WRAP – Waste & Resources Action Programme

About Design Wales

Design Wales is entirely funded by the WAG to provide free and independent advice on all aspects of design to Welsh industry and to offer strategic design advice to the WAG (www.designwales.org). Based in the National Centre for Product Design and Development Research (PDR), University of Wales Institute Cardiff (UWIC) the main objectives of the service are to raise the profile of the effective use of design and facilitate Welsh companies in realising and achieving their design related objectives on a one to one basis. Design Wales has recently been commissioned by the WAG to run a comprehensive ecodesign initiative. Beginning in April 2006, the initiative will initially run for two years and focus on ecodesign demonstration projects with SMEs. The aim is to encourage and enable a long-term strategic approach to ecodesign in Wales.