

Overcoming ESG-related challenges for small and medium-sized businesses

With Kevin Hollinrake MP, Parliamentary Under Secretary of State at the Department for Business and Trade
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Introduction

Lenders and larger businesses increasingly require ESG data from small and medium sized enterprises, which account for 99.9% of UK businesses (UK Government). The roundtable engaged with the priority of making ESG frameworks simpler and assisting uptake by resource constrained SMEs. Other topics of discussion were: standardisation, data, and digitalisation of reporting. The roundtable benefited from the presence of SMEs who shared their experiences with ESG, particularly with regard to reporting on Scope 1, 2 & 3.



Key takeaways

Opportunity vs cost

- The priority for any SME should be to turn a profit. From an ESG perspective, this objective can be achieved by transitioning to more responsible practices and reporting on them, using sustainability as a “sales tool”; or by choosing not to deploy ESG altogether, thereby avoiding additional costs. As far as most businesses are concerned, “any time spent by an SME on ESG compliance and disclosure is too long,” said a major UK SME lender.
- SMEs who do not disclose risk being “unbanked”, the overarching policy objective is to engineer transition, not to punish businesses.
- ESG is becoming the standard for capital allocation, few SMEs can afford to ignore it. UK companies should be encouraged to think of the opportunity, not the cost.

Filling capacity gaps

- Larger businesses should help fill SMEs' knowledge and skills gaps, which are typically considerable. This is not straightforward. "Accelerating" standards and transferring knowledge can be "overwhelming" for smaller companies.
- Bigger corporations should collaborate to establish SME-friendly standards.

Standardisation

- The International Sustainability Standards Board's (ISSB) standards will be published in June, building a platform for SME-friendly ESG reporting requirements. Furthermore, there is plenty of scope for SME exemptions, but more urgency, and leadership, is needed.

Data – granularity vs limited compliance burden

- Simplifying reporting requirements is a key objective, which is challenging due to the need for granular information.
- However, data is available and can be extracted efficiently via smart accounting tools – e.g. Sage Earth.
- Accounting software can facilitate Scope 1, 2 & 3 disclosures. Scope 3 is more challenging, however the potential is there. "Your scope 3 emissions are someone else's scope 1."
- Moreover, disclosing emissions and other ESG data does not make a business sustainable, but does require a considerable amount of investment – particularly scope 3 for SMEs, "the transition to net zero is expensive as well as reporting on it."

Issues raised

Investment

- A representative of an SME stated they would like to become more ESG compliant, but they are faced with a sizable capital investment (a "brick wall") and Government funding is lacking.

Danger of "unbanking"

- Concerns were raised that SMEs that do not aim to become more sustainable will be penalised - e.g. a brick manufacturer that continues to use natural gas risks being "unbanked". While not all businesses will be converted to more responsible practices, many can be, which underlines the need for a net zero "flight path", sending out market signals to businesses.

Common functions to assist the flow of data

- SMEs are extraordinarily heterogeneous, which makes standardised, but unburdensome frameworks across the E, the S and the G challenging. However, they all have four common functions and relationships, accounting, Government, banking, and energy, which can be mobilised to make disclosures straightforward. Energy providers can pass on emissions data. This point was raised by the British Business Bank, which also highlighted the danger of burdensome ESG reporting being dissuasive.

Policy recommendations

- RFPs to provide support: Requests for proposals should include support for ESG reporting. The Government should take a lead by including this kind of provision in public procurement.
- UK Leadership: The vast majority of businesses are SMEs, not only in the UK but worldwide, supply chains are global. Developing international SME-friendly ESG frameworks is therefore critical. The UK is taking a lead in this area, but can go further by leveraging networks like the Commonwealth.

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