"GOVERNANCE" OF ESG IN SMES IS KEY STRATEGY IN THRIVE IN THE FUTURE

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Introduction:

Sustainable development is one of the major worldwide trends influencing the creation of contemporary organisations. Sustainability encompasses much more than merely mitigating environmental danger. Corporate sustainability had to change in response to growing expectations for openness and conscientious business practices. ESG is a set of standards that organisations employ to manage themselves ethically.

To create a sustainable business environment, nations all over the world support the coordinated development of the Environment, Society and Governance in line with the ESG framework.

Presently supply chain is dealing with so many uncertainties. This may be due to geopolitical tensions, modern technologies, and the risk of climate change. Most of the supply chain service providers fall into the SMEs (Small and Medium-sized enterprises) segment. The role of SMEs in creating jobs, driving innovation and leading the GDP growth of the economy is well-known and well-appreciated. However a new element is on the horizon; ESG (Environmental, Social and Governance) that SMEs need to understand and address adequately to have a distinct competitive advantage.

Interestingly, SMEs in India believe ESG practices could increase their competitive edge, boost the company's reputation and attract investors, according to a survey of more than 800 SMEs across six markets - Singapore, Hong Kong, India, Indonesia, Mainland China, Taiwan - in Asia conducted by DBS and Bloomberg Media Studios in August 2022.

Understanding What the ESG Means

ESG means using Environmental, Social and Governance factors to evaluate companies on how far advanced they are with sustainability.

Each of the three elements of ESG – environmental, social, and corporate governance – comprises a number of criteria that may be considered, either by socially responsible investors or by companies aiming to adopt a more ESG-friendly operational stance.

KPIs for ESG:

ESG indicators that are required to be assessed or monitored depend upon the sector of industry, countries in which it is operating as well as serving, legislative requirements of law of land and financial requirements of the organisation.

A few common KPIs are indicated below:

Environment	Social	Governance
• Carbon/ GHG Emission	• Total Workforce	• Board Composition- Structure; Diversity
• Energy Consumption	• Attrition Rate	• Board Committees & Independence
• Renewable Energy Generation	• Gender Diversity	• Business Ethics and Code of Conduct, Integrity
• Waste Generation and Disposal	• Training & Development	• Bribery & Anticorruption Code
• SOx Emission	• Direct & Indirect Benefits	• Supplier Code of Conduct
• NOx Emission	• Policies for Human Rights	• Corporate Governance, Board Evaluation
• Water Consumption	• Child & Forced Labours	• Materiality, Training, Responses
• Wastewater Utilization	• Amenities at a Worksite	• Compliance & Grievance
• Bio-diversity	• Safety- LTIFR / Incidents	• Penalties, Court Cases
• EHSMS Certifications	• Local Procurement	• R&D
	• Community & Social Work	

Importance of "G" in ESG

In SMEs, in general, the following governance issues are being observed:

- Focus on profit-making only
- Gender diversity and equity including equal compensation and mobility for women.
- Health & hygiene, working conditions

As described above, the "G" in ESG refers to the governance factors of decision-making, from policymaking to the distribution of rights and responsibilities among different participants in the organisation, including the owner, key management personnel, board of directors, managers, shareholders, and stakeholders.

When analysing environmental, social, and governance factors, the "G" element is often forgotten amid considerations over climate risk, societal implications and other "E" and "S" risks and opportunities.

However, understanding governance risks and opportunities in decision-making is critical, as poor corporate governance practices have stood at the core of some of the biggest corporate scandals. Volkswagen's emissions test scandal, Facebook's misuse of data and other recent incidents have caused significant financial damage to these companies. In the face of companies' missteps and expanding awareness of global diversity and income inequality, governance assumes to have become a core component of ESG.

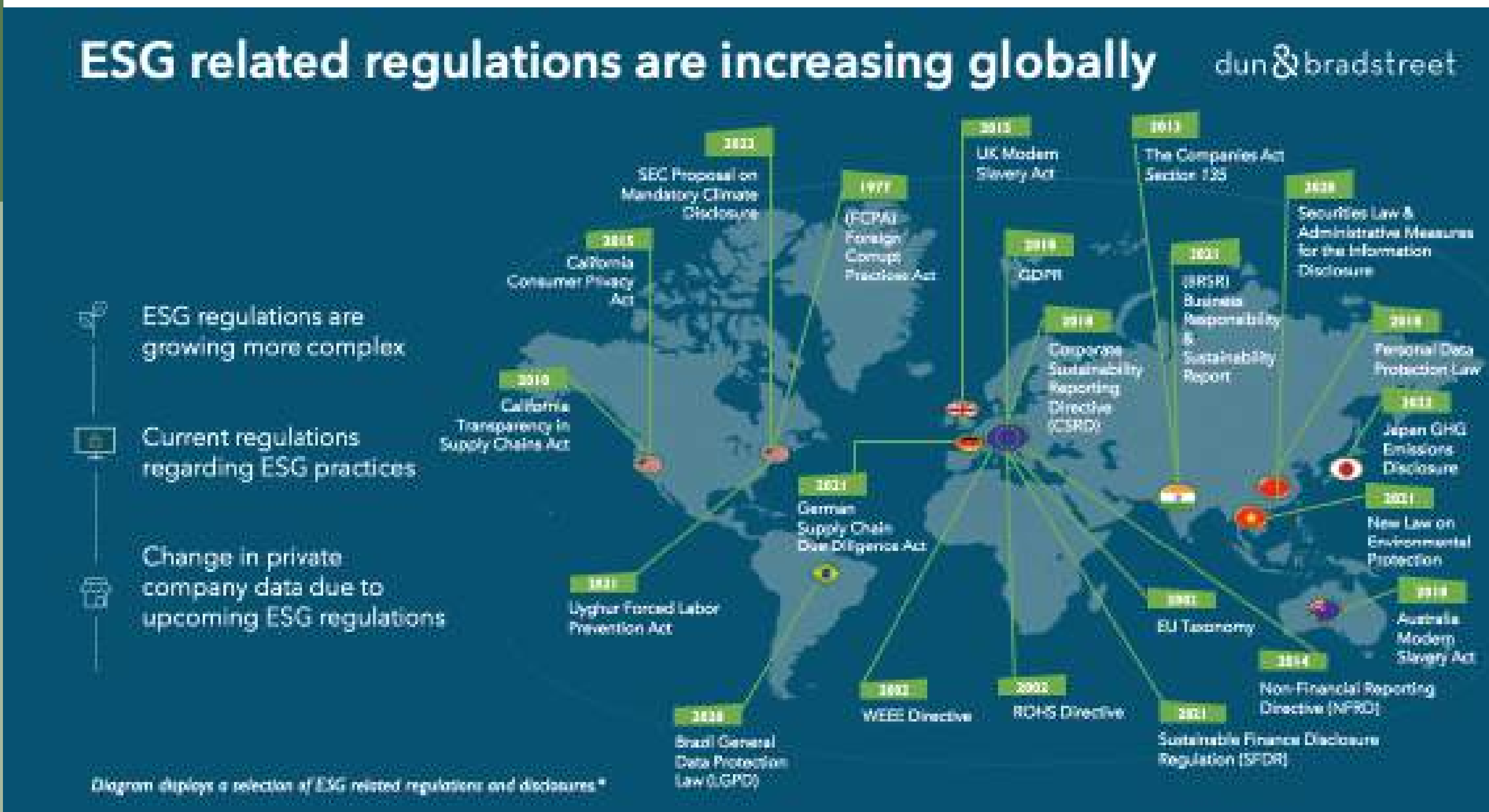
The risk profile of SMEs is much the same way that they evaluate large companies. Raising funding as a small or medium-sized company is no easy feat. It's hard enough to report on financial performance, let alone on issues such as your carbon footprint or your business continuity plan should another Covid variant emerge. Private Equity and Venture Capital companies – a vital source of funding for companies in the small and medium segment – use several ESG metrics to determine physical and transition risks (including market, regulatory and technology risks) and other aspects of a company's ESG program and strategy and make their investment decisions accordingly.

ESG Regulative Requirement for SMEs

ESG regulations are increasing day by day as indicated in the figure below. SMEs are coming under the preview, in an indirect way, as a supply chain member from the customer or main supplier side confirming to their ESG policies and requirements.

In India or internationally many large corporates are undertaking Supply Chain Due Diligences (SCDD) as part of mandatory ESG disclosers for them. A few references are given below:

- BRSR Disclosure of the top 100 companies in India need to disclose the SCDD results and assessment.
- As per the European Union, the Corporate Sustainability Reporting Directive (CSRD), all companies with over 500 employees publish regular reports on their ESG activities. Even from 1st January 2026; listed SMEs, small and non-complex institutions, and captive insurance undertakings will be also in the ambit of CSRD disclosures. Similar requirements are also present as per German Supply Chain Due Diligence Acts.



SMEs need to confirm the acceptance of their supply chain policies and give a declaration that they are confirming various ESG provisions. Any non-compliances need to be addressed through Action Taken Reports and/or face the site audits by a third party. SMEs need to understand and be geared up for this such assessments otherwise they face the consequences even as a termination of contracts and further business with the organizations.

Besides the above there is pressure on SMEs to adopt clean or green fuels such as solar or renewable energy reduce single-use plastic in packing, waste segregation and disposal, conserve water and eliminate wastewater discharge.

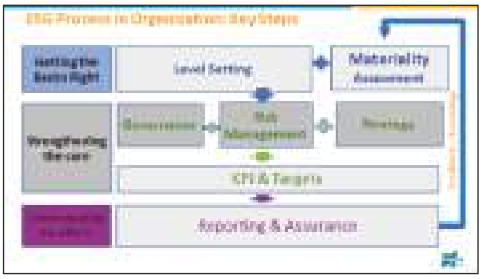
Four-Way Approach for Addressing ESG in SMEs:

Function Legally – complications from legal obstructions will constantly threaten the sustainability of the SMEs. However, preventing legal non-compliances, and in case of need; addressing the legal ramifications and ensuring no disruptions from these issues is the first and most essential step. It is generally expected that the SMEs are complying with the laws of the land, the countries in which they are providing services as well as the expectation of the customers whom they are serving. Compliance management processes need to be established as a part of governance in SMEs.

Work Ethically – freedom of employment and association, eradication of child labour, safe and hygienic working conditions, appropriate pay and working hours, humane and non-discriminatory treatment, anti-bribery and corruption, and environmental awareness is the key area where actions are required otherwise overcoming trappings of ethical dilemmas is paramount.

Behave Responsibly – SMEs need to have equal or more focus on social responsibility than just bottom-line results. In simple words "do more good and less bad." Process and policies for communication with various stakeholders and engaging them effectively is the need of the hour.

Operating Sustainably – SMEs should examine practices, suppliers, and the impact of their activities.; mainly in the environment and social elements. Even technological interventions or process upgradation are required to be eco-friendlier. Environmental issues concerning pollution monitoring, climate change, carbon footprint, and depletion of natural resources and waste management are the current issues impacting SME's businesses.



Ways to ensure ESG governance in SMEs:

- Make TOP Executive responsible for ESG
- Make understood the importance and aspects of ESG required for SMEs at all levels of the organization.
- Assess where you are (Materiality Assessment): Identify, prioritise and validate the most material ESG issues that the company should focus on so as to optimize the use of resources
- Develop an ESG strategy that is accepted by management. Incorporate ESG into strategic planning.
- Determine KPIs and targets to measure and evaluate ESG performance, with an aim to improve ESG performance in the short, medium or long term. For example, use of solar power and bio-diesel, phasing out the inefficient process technology, improving the working conditions; etc.
- Disclose the company's ESG vision, strategy and performance in different communications channels, e.g. annual ESG reporting or website or through supply chain assessment.
- Definitely, SMEs may not have the in-house expertise to understand and implement ESG. Expert help in this case is more fruitful in expediting the ESG implementation. Expert intervention may be high during the initial period but will decrease over the period.

Clear benefits of early action

- The financial, compliance & risk and reputational benefits that can be realized by paying early attention to developing an ESG strategy are substantial in the SME segment.
- Moreover, by delaying the ESG plan to tomorrow and waiting for the worst-case scenario of having to scramble around putting a rushed ESG framework into place when new ESG regulations do take effect or an investor calls to ask for their ESG plan.

Conclusion:

To put it in a nutshell, ESG is not a one-time solution, rather it is a journey. It is highly required that the management of SMEs are understanding the importance of ESG and initiating "Governance" in the organization with focused ESG Targets.

Fortunately, there is no need for SMEs to make seismic shifts to their operations to demonstrate their efforts w.r.t ESG. Rather ensuring smaller improvements can still be effective such as investing in green energy, LED lighting, reducing or removing paper waste, transitioning to more digital forms of communication, etc. SMEs can make small changes in a short space of time and record an immediate impact, benefitting the planet and showing the company's commitment to sustainability.

The systematic approach will definitely gain low-hanging fruits in the form of productivity or energy conservation at the initial stage and over the period transform the sustainable or ESG-compliant organization. Yes, but ESG journey should begin……