Scaling MSME Sustainability Reporting
OUTLINE ICC REPORT

I. Introduction

This outline report has been developed through a review of existing literature on corporate sustainability reporting, an analysis of existing reporting frameworks – supplemented by data and insights from interviews with micro, small and medium-sized enterprises ("MSMEs") and local chambers of commerce across four regions (Europe, Asia-Pacific, North America and Latin America).

Our initial research has identified several friction points and challenges to widespread adoption of sustainability reporting by MSMEs. At a global level, these can be summarized as follows:

- Complexity of major reporting frameworks (e.g., the Global Reporting Initiative ("GRI")) relative to in-house MSME resources;
- Proliferation of standards, frameworks and ESG tools creates hesitation on the part of MSME owners;
- Some concern that voluntary sustainability reporting could expose MSMEs to legal and commercial risks;
- Limited uptake from competitors;
- No clear "business case" for MSMEs to produce sustainability reports, beyond direct requests for disclosures from multinational customers; and
- No widely accepted training tailored to MSMEs on developing a sustainability report.

II. Understanding the challenge: a story of fragmentation and complexity

Most MSMEs surveyed by ICC were not familiar with any specific reporting frameworks but were conscious of the proliferation of different standards and tools. One response captured the general sentiment succinctly: "If we put time and money into producing a report, how can we be sure to choose the correct framework?".

Many of the businesses surveyed viewed sustainability reporting as a "corporate PR exercise" for major MNCs. This view, in a number of cases, was heavily influenced by recent media reports on the fragmentation of the ESG metrics market.

A small number of MSMEs had looked at the GRI framework as a possible basis for producing sustainability reports. All considered the framework prohibitive relative to their internal resources – as well as the likely costs versus potential returns from issuing a first sustainability report. Commonly mentioned factors included:

- the complexity and number of reporting indicators;
- the likely cost of sourcing and processing data;
- lack of dedicated or specialist in-house resource;
- uncertainty as to how to determine the sphere of an organization's influence; and
- the lack of tailored training and support systems.

These results squarely correspond with previous analysis on the effects of the increasingly confused and complex sustainability reporting landscape – "lost in the right direction" as one study from 2016 aptly put it.[1] Moreover, feedback from GRI partners has long suggested that the guidelines had the possibility of becoming unduly complex or burdensome.[2]

We acknowledge the potential role of digital tools in enabling the collection and analysis of sustainability-linked data by MSMEs – indeed, ICC is currently piloting such a product with small businesses in partnership with several major financial institutions.

While such tools have the potential to reduce the time and cost of producing sustainability reports, they should not be seen as a panacea for the broader complexity of the reporting landscape. Take, for instance, once recent study which showed that the amount of water it takes to produce a one-liter bottle of Coca-Cola can vary from less than two liters of water to 70 liters, depending on the methodology used.[3]

Set in this context – just as with reporting frameworks themselves – MSMEs are likely to find themselves struggling to identify the "correct" methodologies/tools to use to calculate their sustainability performance.

[1] ACCA (2016) "Mapping the sustainability reporting landscape: Lost in the right direction."
[2] See e.g.: https://www.environmentalleader.com/2013/02/latest-guidelines-more-user-friendly-gri-says/
[3] Kenneth P. Pucker (2021) "Overselling sustainability reporting.", *Harvard Business Review*

III. Behind the hesitation: legal and reputational risks

The interviews conducted by ICC highlighted – perhaps surprisingly – a concern amongst MSME owners that voluntary sustainability reporting could expose their companies to legal and commercial risks.

This concern appears to be borne out by an initial analysis of recent legal trends. For instance:

- In the United States, Security and Exchange Committee regulations "make issuer statements to investors… potentially actionable"[4] – meaning that companies can be liable for ESG disclosures which are deemed materially false or misleading. But – when taken with the varying reporting methodologies – the ability to differentiate between accurate and misleading assertions can be difficult.

- There has also been an increase in class action lawsuits wherein consumers assert that they were misled into purchasing a product because of false and misleading statements made in sustainability reports.[5]

These risks are potentially not insubstantial. Defending against lawsuits which arise from sustainability reporting – particularly in cases where a drop in share price is reported – can take years of litigation, increasing the amount of resources needed for a company to defend them.[6]

IV. The case against mandatory reporting

ICC would caution against mandatory sustainability reporting for MSMEs in the absence of a fit-for-purpose global framework. It is instructive to note in this context that small businesses have been retrospectively carved out of disclosure regimes in several jurisdictions over the past decade.

By way of example, in France the SME reporting requirement of the Grenelle II law of 2010 was revoked in August 2018 following reports that small businesses had difficulty completing the required reporting exercise.

We understand retrospective changes to reporting regimes were introduced in Colombia and South Africa for similar reasons. A full review of legal initiatives in this space will be contained in our final report. An initial mapping of global sustainability reporting requirements is set out in Annex 1 of this paper.

V. Value chains: important drivers of progress

[4] David R. Woodcock, Amisha S. Kotte, and Jonathan D. Guynn (2019) "Managing Legal Risks from ESG Disclosures."
[5] See e.g.: https://www.lexology.com/library/detail.aspx?g=7c30ccf4-98cd-47fa-9bdf-dc77accb6e65
[6] Ibid.

Our research has identified that sustainability reporting requirements from multinational corporation customers and service providers (e.g., banks and insurers) have started to serve as clear drivers of MSME disclosures.

To take three examples:

- In Bangladesh, SMEs that have a credit relationship with banks and financial institutions have to report on some sustainability aspects to align with the banks' sustainability requirements. Examples include the Bangladesh Bank's guidelines for environmental and social risk management.
- In Colombia, credit lines powered by the iNNpulsa Program require sustainable information to be reported so the SMEs that show sustainability efforts can obtain loans with preferential interest rates or other financial incentives.
- In Turkey, there are sustainability requirements associated with renewable energy loans under which SMEs have to produce an environmental impact analysis report showing their contribution to carbon emission reduction.

While value chains appear to be an important driver of sustainability reporting, interviews with MSMEs have indicated a growing frustration at the number of disparate disclosure requests received from multinational clients and service providers. Again, this is an area that would clearly benefit from standardization.

VI. Training and capacity building

A lack of accessible training was repeatedly cited by MSME owners in our interviews as a barrier to widespread adoption of sustainability reporting.

This insight corresponds to recommendations from a range of organizations such as the OECD and UN Environment – who have long recommended that sustainability language used in communications to small businesses be less technical and/or academic to appeal to and drive greater adoption by MSMEs.[7]

We have, however, identified a number of tools/resources – both at global and national levels – which are intended to support small businesses in reporting on their sustainability performance. For instance:

- Austria provides a broad portfolio of subsidized consultancy services for SMEs, co-financed by the federal government, provincial authorities and the respective regional chambers of commerce. These services allow enterprises to receive external support for their efforts to introduce environmental management and auditing schemes, responsible business conduct programs, sustainability reporting

[7] See e.g: Beth Walker et al (2008) "Small and medium enterprises and the environment: Barriers, drivers, innovation and best practice: A review of the literature."; OECD (2015) "Environmental Policy Toolkit for Greening SMEs in EU Eastern Partnership countries."

and other measures to enhance environmental performance. In 2017, more than 2,300 Austrian SMEs received grants.

- France runs the course *Le Parcours performant et responsable* which is organized by the region Provence Alpes Côte d'Azur (PACA), the local chamber of commerce and industry (CCI) and the Agency for the environment and energy management (ADEME).Based on methodology guidance and a questionnaire from the national standards organization, Afnor, the course provides a broad scope of tools and services for SMEs to gain expertise on sustainability and market opportunities.

- Denmark has the CSR Compass, a tool that helps companies "get off to a good start with responsible supply chain management." The tool includes advice, use cases, templates and useful resources.

- At the international level, the ILO's SCORE capacity-building program is a practical training and in-factory consulting program that improves productivity and working conditions at SMEs.

  By addressing factors that potentially contribute to human rights violations, SCORE Training demonstrates best international practice in the manufacturing and service sectors and helps SMEs to participate in global supply chains. These may include a lack of information and knowledge, limited management capacity and harmful business practices.

We will look at best practices in schemes of this nature and opportunities to replicate or scale their deployment in our full report to the Working Group.

VII. What would encourage greater uptake from MSMEs?

The MSMEs surveyed by ICC were asked what could encourage them to voluntarily issue a sustainability report for the first time. The following drivers were identified in order of importance:

- a common, widely recognized reporting standard tailored to typical characteristics of SMEs. The "IFRS Standard for SMEs" (for the preparation of financial reports) was cited as a useful reference point in this regard.

- uptake of sustainability reporting by competitors in the same industry/sector (incl. the ability to benchmark performance against the market norm).

- requirements from MNC customers or service providers (e.g., banks, insurers).

- availability of trusted guidance, training and automated data collection/processing systems.

- government or commercial incentives (e.g., tax rebates, access to finance at preferential rates).

To note, the view on the utility of commercial incentives was highly nuanced. Some respondents noted they had pulled out of commercially attractive supply chain financing schemes due to reporting requirements that were deemed excessively complex.

VIII. Towards an agenda for action

Based on this initial research we recommend that consideration is given to incorporating the development of an MSME reporting framework into the mandate of the proposed International Sustainability Standards Board which, if created, would set new IFRS sustainability standards.

We suggest that such a framework should ideally:

- omit indicators that are not relevant to typical MSMEs;
- require substantially fewer disclosures than prevailing frameworks (e.g., GRI);
- enable more simplified reporting methods;
- embed simplified measurement principles;
- focus on disclosures that can made using readily available data sources;
- enable simplified materiality and sphere of influence assessments; and
- be written in "plain English" for easier understandability and translation.

In tandem with this mid-term agenda, we would encourage the G20 to consider supporting small scale pilot projects to:

- test simplified and standardized reporting methodologies;
- assess the utility of digital tools and platforms in collecting and processing relevant data;
- pilot the use of incentives (public and private) to accelerate adoption;
- develop tailored training and support programs; and
- explore potential approaches to industry-level benchmarking.

We also believe an effort is needed to better explain the core "business case" for sustainability reporting, linking this agenda to issues of immediate relevance to MSME owners such as:

- risk management;
- operational excellence and efficiency;
- certification;
- maintaining access to overseas markets; and
- brand differentiation.

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