Task Force 5
2030 Agenda and Development Cooperation

Policy brief

SUPPORTING SMES IN SUSTAINABLE STRATEGY DEVELOPMENT POST-COVID-19: CHALLENGES AND POLICY AGENDA FOR THE G20

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Martina Barbagila DIG School of Management, Milan Polytechnic
Vincenzo Butticè DIG School of Management, Milan Polytechnic
Giancarlo Giudici DIG School of Management, Milan Polytechnic
John Mendy Lincoln International Business School, University of Lincoln
Tapan Sarker Griffith Business School, Griffith University
Gagan D Sharma University School of Management Studies, Guru Gobind Singh Indraprastha University
Asha Thomas Jagan Institute of Management Studies
Ambika Zutshi Department of Management, Faculty of Business and Law, Deakin University

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Università Bocconi
MILANO

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ABSTRACT

SMEs contribute substantially to global employment and economic growth. Yet constraints such as lack of capital, human resources and knowledge capability have rendered SMEs operationally incapacitated to report on environmental, social and governance (ESG) requirements. In this policy paper, we first highlight SMEs' key challenges as they try to recover from crises post-COVID-19. Next, we propose policy actions and recommendations to address such challenges by discussing the effectiveness of best practice frameworks that will help SMEs in sustainable strategy development. Additionally, we propose better policy frameworks to enable SMEs to report on ESGs and contribute to specific SDGs.

CHALLENGE

CONSTRAINTS ON SMES' SUSTAINABILITY

SMEs' long-term financial performance and sustainability are inextricably interdependent. However, it is a known fact that many SMEs have been dealing with policy challenges, environmental uncertainties and business survival, particularly as a result of the impact of the COVID-19 crisis (Accountancy Europe, 2020).

SMEs' inability to comply with ESG disclosure

Unlike larger firms, SMEs are currently not required to comply with the disclosure of non-financial information on their ESG performance across the G20 countries. While this creates a loophole for SMEs to exploit, the recent Sustainable Finance Disclosure Regulation in Europe requires banks, investors and financial consultants to disclose their approach in evaluating ESG efforts spent by investee companies and the associated risks, including the supply of finance (Gortsos, 2020). Caution is required that such regionally specific initiatives are only replicated across other G20 countries if they conform to similar regulatory requirements. Additionally, SMEs often lack the financial and human resources to collect and report vital qualitative and quantitative information, thereby impacting their ability to contribute towards achieving SDG 8 and 16 (Boffo and Patalano, 2020). Many SMEs also lack managerial skills (Gjergji et al., 2020), and competencies to analyse the highly technical data and the impacts such assessment could have on their ability to spur economic growth, productivity and digital innovation (Torugsa, O'Donohue and Hecker, 2012).

SMEs' best practice constraints to achieve SDGs

SMEs could play a pivotal role in helping to achieve the UN's SDG 8 and 16 in particular. A recent analysis shows that both public and private parties investing in SMEs can help attain more than 100 (60%) of the 169 SDG targets (International Trade Centre, 2019). However, many SMEs' capital constraints are so acute that they cannot always mobilize a sustainable flow of finance, which affects their ability to contribute, especially to SGD 8 and 16. Although the focus of this brief is on the G20, this impact on SMEs' ability to contribute to sustainable economic productivity growth and stronger governance institutions also affects other countries due to their lower GDPs and weaker financial and regulatory frameworks. Consequently, SMEs' dependence on external capital flows to finance productivity, economic growth and institutionally focused projects highlight the criticality of adopting best practice frameworks to support them in achieving the targets set. G20 countries could therefore assist SMEs by providing the requisite best-practice tools (SME United, 2019).

SMEs' resource constraints to fulfil ESGs and SDGs

Due to the growing ESG regulations in Europe, SMEs in less economically affluent and institutionally strong countries of the G20 are increasingly vulnerable in the face of similarly stringent ESG requirements in the future (Gjergji et al. 2020). The fundamental problem here is that SMEs face internal resource constraints relating to human resources, advanced knowledge acquisition and dissemination and digital innovation capability. Such challenges are more acutely felt by emerging and developing member countries of the G20 than by their developed member counterparts as the growth of ESG frameworks is primarily skewed in favour of more developed economies (Chelawat and Trivedi, 2016; Analysis & Policy Observatory, 2021). Addressing such a problem calls for the development of a novel and more encompassing framework for both developed and less developed G20 member states so that the implementation of the ESG requirements can help reduce SMEs' administrative and financial burden and thereby contribute towards achieving SDG 8 and 16. Concurrently such frameworks (which may be region-specific) need to assist with the implementation of SDG 8 and 16 across the SME sector.

PROPOSAL

To address the three major SME challenges that have adversely impacted their ability to attain environmental, economic and financial sustainability and SDG 8 and 16, this policy brief proposes the following:

PROPOSAL 1: SMES' DISCLOSURE OF FINANCIAL AND NON-FINANCIAL INFORMATION

In their current form, ESG ratings and self-assessments are primarily designed to respond to major international or listed companies' requirements (UN Principles for Responsible Investment, 2019; Task Force on Climate-related Financial Disclosures, 2020). Listed companies, in particular, have largely overlooked SMEs' reporting mechanisms, primarily as they are generally not listed on a regulatory exchange. However, financial survivability and the subsequent economic, productivity and institutional sustainability of SME businesses are central to their continued ability to contribute to the G20's economic, social, environmental and institutional viability. As such it is urgent for future policies to ease the financial and bureaucratic burdens experienced by SMEs in G20 countries.

Our first recommendation is tailoring the OECD/G20 inclusive framework on base erosion and profit sharing (BEPS) on taxation (including those involving international transactions) to suit SMEs' capacity to disclose their financial and non-financial information.[1] The proposed framework in Figure 1 shows how SMEs can be practically assisted in addressing their day-to-day challenges whilst preparing them to report on the ESG regulatory requirements.

Our second recommendation is to progressively extend the requirements for non-financial disclosure to SMEs. Practically, this could start with those companies receiving public grants and support and extend to SMEs listed in unregulated junior exchanges. In other words, the level of reporting should be proportionate to the size and financial return of the company. Triggers can be built as part of the external auditing processes to ensure that this proportionality criterium is not exploited for personal benefit by the SMEs to the disadvantage of achieving the ESGs.

The third recommendation is to provide incentives for non-banking institutions (e.g. private capital funds) to invest in the debt and equity capital of SMEs, which could lead to increased analyst coverage and so help mitigate against their investment risk and information asymmetry (see Survey on the Access to Finance for SMEs of SAFE). This would be applicable generally for the less economically affluent G20 countries. These recommendations are premised on earlier academic research (Draho, 2006), which confirms that SMEs willing to go public on stock exchanges are more transparent and adopt more sophisticated organizational and managerial tools, easing the collection and analysis of non-financial ratios (i.e. contribution to pollution, GHG emissions, employee wellbeing, energy and water consumption, recycling) and thereby developing a greater capacity to contribute to not only SDG 8 and 16 but also SDG 3, 6, 7, 12 and 13 respectively.

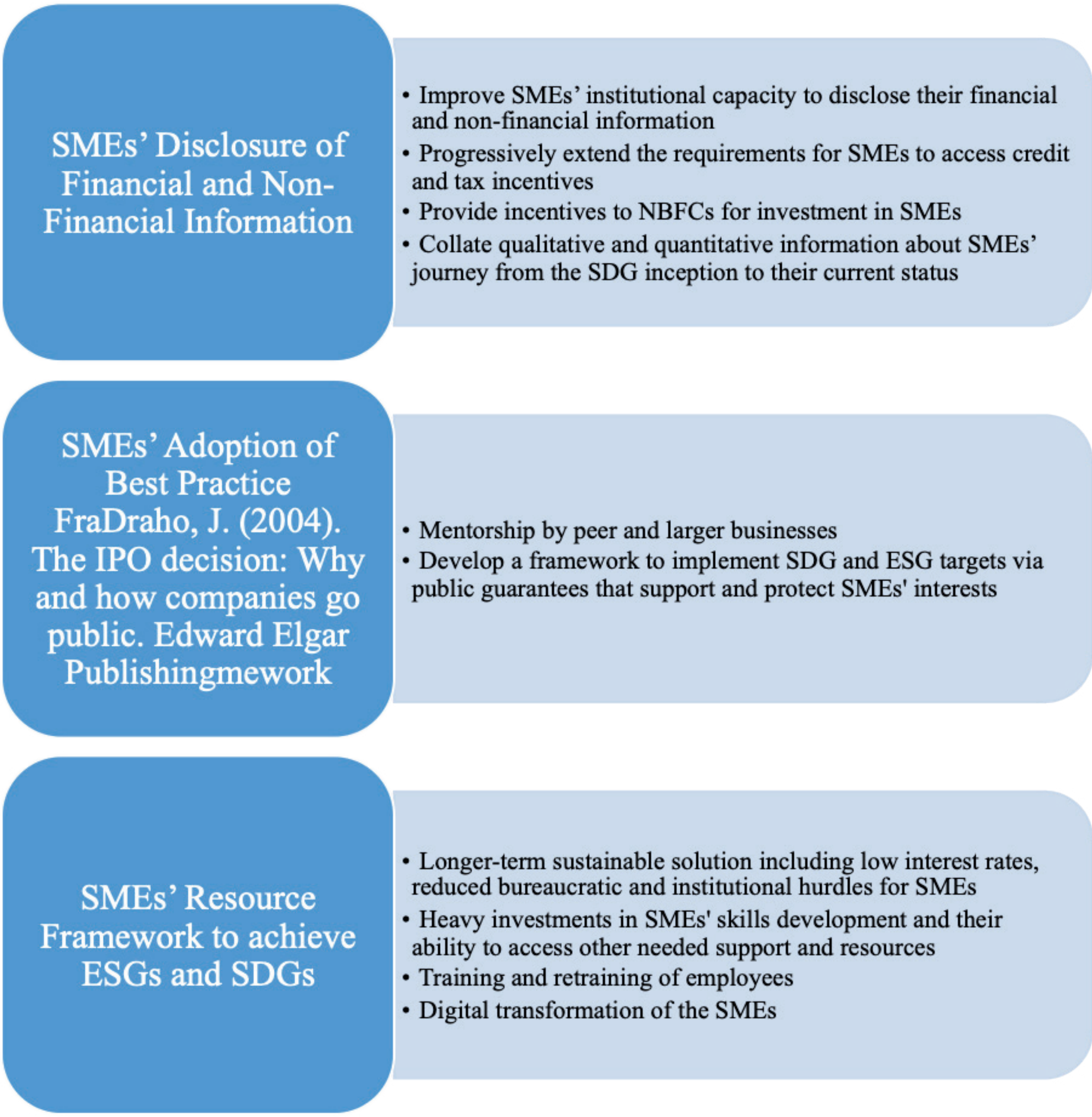

Figure 1: Proposed framework for SMEs to contribute to SDGs

The fourth area requiring attention in future policy developments and upgrades includes collating qualitative and quantitative information about SMEs and their ability to practically implement the specific SDGs stated in this policy brief. SMEs would benefit by receiving assistance (e.g., free, or subsidized fee advice; templates, resource and institutional support) in the recording and subsequent analysis of the technical data for assessing the extent to which they are contributing to ESG performance and the stated SDGs. This will incentivize SMEs to improve their ESG rating, adopt best practices, introduce and monitor continuous improvements on their ability to contribute to the specific SDGs. This transition towards getting information about sustainability-related performance would have the added benefit of encouraging large institutional investors to consider investing in SMEs that are typically neglected because of their larger financial risk and lack of recognition. Current G20 disclosure policies, therefore, require an urgent review to incorporate the above recommendations, which in turn would help SMEs to attain the SDGs and reduce their ability to report on ESGs compared with larger and listed companies.

PROPOSAL 2: SMES' ADOPTION OF BEST PRACTICE FRAMEWORK

Organizational size can be a boon or curse for SMEs. Whilst smaller sized firms allow for expedited decision-making, size can constrain an SME if it means limited access to human, technical and financial resources. Given that SMEs are generally characterized as not having the capacity for long-term or contingency planning, their business survival and ability to report on ESGs have recently come under considerable constraints. Firstly, we propose peer and larger business mentorship as further outlined below. This proposal should be complemented with the capacity-building of SMEs via complementary/subsidized training and skills development. This has the benefit of assisting SMEs to be able to implement the ESG and SDGs. An example of how this can be done is the ELITE (2021) programme initiated by Archax[2] in association with the London Stock Exchange. Additionally, mentoring programmes can be a win-win for all the parties involved as the SMEs can build long-term relationships with their larger firm mentors and their wider mentor networks. The establishment of such business relationships is sustainable in environments where the parties have opportunities that complement each other. These programmes have the added advantage of boosting the confidence of SMEs, helping them to 'believe in themselves, in their skills and capabilities' (SBP, 2021, p.2).

For some SMEs, mentoring can also provide insights into different and alternative forms of managerial and leadership skills, which they need to help them report on ESGs and achieve the stated SDGs. This is especially so for family-owned SMEs. Government grants and policies supporting mentoring programmes over an extended period (at least one year) could play an impactful role in the realization of such a proposal. Second, we propose that future policies need to develop a framework that includes the interests of SMEs' support circle, (such as their families and friends who play an irreplaceable role in SME's decision-making and actions) which have previously been omitted. Doing so facilitates smaller firms' ability to implement ESGs and contribute to the specific SDG targets identified here. COVID-19 has increased the significance of these support structures for individuals and SMEs and their role in helping them to survive during and after lockdown (Zutshi et al., 2021) and fluctuating levels of restrictions. These policies will require broader and holistic inputs ranging from governmental agencies to primary and secondary stakeholders.

PROPOSAL 3: SMES' RESOURCE FRAMEWORK TO ACHIEVE ESGS AND SDGS

COVID-19's adverse impacts on the financial viability and the operational capability of SMEs have been immense. The after-effects of mass closures (temporary and subsequently permanent), labour and raw materials supply shortages (via supply chains), additional infrastructure costs (including fixed costs such as utilities) and unemployment rates in both the developed and less developed economies of the G20 have brought about programmes such as Coronavirus Aid, relief, and Economic Security (CARES) Act in North America, and similar initiatives in countries such as UK and Serbia as well as elsewhere. These practical schemes have, however, brought about a heightened awareness of SMEs' inability to meet the eligibility criteria required because of the bureaucratic processes involved.

First, we propose a longer-term sustainable solution, which includes low-interest rates for SMEs and reducing bureaucratic hurdles and documentation. For example, SMEs can be provided with prepopulated online forms with background information and population characteristics by financial institutions and government agencies (from previously supplied demographic and basic business information). Approved payments by the respective financial/ governmental institution should be made as quickly as possible. Second, policy-makers, especially those in the developing G20 countries, should design policies whereby governments create a favourable business climate for investors to support the human and capacity-building resource capabilities of SMEs. Simultaneously, the regulatory and institutional governance framework should facilitate quicker decisions, which will help SMEs to access and develop the requisite additional resources, to obtain permits, loan and credit approvals. Most critically, the programmes launched in 2020 and early 2021 should complement, rather than contradict previous grant and financial schemes to avoid overburdening SMEs with additional compliance and cross-checking of outdated policies and requirements. We believe that additional resources, especially at the regulatory implementation decision-makers level, can contribute to alleviating some of the bureaucratic and time-sensitive challenges for the SMEs (e.g. due to delay in the processing of applications, permits and other approvals). Accordingly, post-COVID-19 recovery requires thinking beyond the enforcement of rules or having unsustainable band-aid solutions offering one-off, short-term, reactive support systems/measures and instead of having a pathway that will bolster SMEs' resilience-building capabilities.

Third, the retraining of employees in current or new skills could be supported by governments so that it incurs minimal overhead costs to the SMEs. This will allow SMEs to make strategic decisions to make full use of all their resources (human, financial, technological) and make practical decisions as to whether to continue in their current business or strategically think of alternative potential products and markets and where to get assistance for promoting the latter. Fourth, digital transformation should be fostered to ensure that SMEs can initiate and maintain individual and collectively develop relationships with their stakeholders through such platforms as WhatsApp, Telegram, MS Teams and Zoom to help them report on the ESGs and contribute to the specific SDGs mentioned in this policy brief.

CONCLUDING REMARKS

Despite the critical role played by SMEs in both developed and less developed G20 economies, the multiple challenges they continue to face have made their attainment of specific UN SDGs questionable. To resolve the financial and non-financial challenges, all G20 and SME stakeholders should work closely in adopting the three policy areas that we have developed in our proposed framework. It is through the piloting of our proposal in both developed and less developed economies and the continuous and holistic support for SMEs that the reporting of the longer-term ESGs and ability to contribute to the SDGs can not only be achieved but sustained.

NOTES

[1] The framework emphasises the role of governments to act together to tackle BEPS and restore trust in the domestic and international tax system, see, https://www.oecd.org/tax/beps/.

[2] https://archax.com/news/Archax_joins_London_Stock_Exchange_Groups_ELITE.

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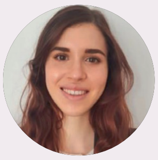
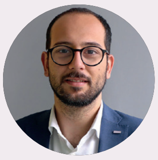
ABOUT THE AUTHORS



Martina Barbagila DIG School of Management, Milan Polytechnic

Barbaglia is a PhD Candidate at the Department of Management Engineering at Politecnico di Milano.. She also works as a researcher at the Climate Finance Observatory at Politecnico di Milano.



Vincenzo Butticè DIG School of Management, Milan Polytechnic

Butticè is an assistant professor in entrepreneurial finance at the School of Management of Politecnico di Milano. Vincenzo has been a visiting scholar at the Copenhagen Business School, at the Indiana University Purdue University of Indiana, and Shanghai Tech University. He is a managing director at the Observatory on Climate Finance at Politecnico di Milano.

Giancarlo Giudici DIG School of Management, Milan Polytechnic

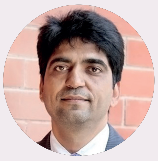
Giudici is full professor of corporate finance at Politecnico di Milano. He is the director of the Italian Observatories on Minibond and Crowdinvesting at Politecnico di Milano, School of Management. He is an adjunct professor at the Ton Duc Thang University in Ho Chi Minh City (Vietnam).

John Mendy Lincoln International Business School, University of Lincoln

Mendy is Senior Lecturer and Programme Lead for MSc HRM based at the University of Lincoln, UK. John is a Senior Fellow of the Higher Education Academy (SFHEA, UK) and a Chartered Member of the CIPD (MCIPD, UK).

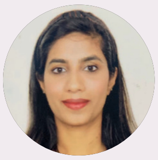
Tapan Sarker Griffith Business School, Griffith University

Sarker is an Associate Professor of Sustainable Business at the Department of Business Strategy and Innovation, Griffith Business School, Griffith University, Australia. He is a former World Bank Scholar.



Gagan D Sharma University School of Management Studies, Guru Gobind Singh Indraprastha University

Sharma is an Associate Professor in the University School of Management Studies (USMS) of Guru Gobind Singh Indraprastha University (GGSIPU), New Delhi, India. He also holds the position of Associate Director, Office of International Affairs of the University.



Asha Thomas Jagan Institute of Management Studies

Thomas is an Assistant Professor at Jagan Institute of Management Studies (JIMS), India. Her PhD is in knowledge management. She has about 12 years of experience in teaching and over three years of experience in the IT and Telecom industries.

Ambika Zutshi Department of Management, Faculty of Business and Law, Deakin University

Zutshi is an Associate Professor at the Department of Management of Deakin University. Ambika is currently an Australasian Associate Editor of European Business Review, Emerald; Editorial board member of International Journal of Consumer Studies; and Editorial Advisory Board of Management of Environmental Quality.