FROM OBSTACLES TO OPPORTUNITIES: ENABLIGH ESG ADOPTION IN SMEs

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Abstract

The objective of this article is to delve deeply into the role of Environmental, Social, and Governance (ESG) factors within Small and Medium Enterprises (SMEs), their impact on competitiveness and resilience, and the significant influence large companies have in promoting ESG adoption among their SME suppliers. The primary research, conducted in large corporations during the latter half of 2021 and the early part of 2022, lies at the heart of this paper. This research, although limited in its reach due to the ongoing pandemic, provides crucial insights into these corporations' Corporate Social Responsibility (CSR) practices before the enforcement of the Corporate Sustainability Reporting Directive (CSRD) by the EU.

Our study illuminates the extent to which these companies integrated ESG reporting into their operations before introducing the CSRD, offering a distinctive pre-regulation perspective. Findings from our research questions revealed that 50% of large companies' respondents incorporated CSR activities as a significant part of their marketing communication, while over 54% reported intensive CSR activities within their companies. These results indicate a proactive engagement in CSR practices among respondents despite the absence of regulatory compulsion.

Nevertheless, in the context of new EU directives and increased demands for ESG non-financial reporting, our data suggests that many large companies were not sufficiently engaged in non-financial reporting, primarily when it was voluntary. However, the introduction of the CSRD necessitates a radical shift in approach, requiring companies to demonstrate an authentic commitment to ESG, a step that we posit could engender greater stakeholder trust, an enhanced reputation, and better financial performance. Despite the limitations and challenges of our research, the insights gleaned provide a meaningful foundation for future study in a post-CSRD landscape.

Keywords: Corporate Sustainability Reporting Directive, ESG factors, greenwashing, non-financial reporting, sustainable report

JEL klasifikace: G32, M14, Q01, Q56

1 Introduction

The urgency and necessity of integrating environmental, social, and governance (ESG) considerations into business operations are increasingly recognized by businesses worldwide. For Small and Medium-sized Enterprises (SMEs), the path towards ESG integration can appear fraught with challenges, including limited resources, lack of expertise, and a perceived focus on short-term goals. However, it is the central argument of this paper that ESG adoption in SMEs, while indeed presenting certain obstacles, is not only an investment for the future but also a source of immediate and long-term opportunities. Based on Buniamin (2020), ESG has become an emerging part of competitive strategy, and it can lead to gaining a unique advantage that can pave the way for sustainable development, both for their organizations and the world at large. According to Bolognesi and Burchi (2023), ESG reporting can strengthen the firm's core competitiveness and enhance long-term value. For Chen et al. (2023), expanding disclosures is essential for enterprises to maximize returns on their ESG investment. By doing so, creditors, investors, and other stakeholders gain deeper insights into the enterprise's ESG rating in a timely and appropriate manner, facilitating greater support for their continued growth and success.

In scientific research, different proposals are discussed to ensure the best way of implementing the forthcoming mandatory ESG reporting. Faccia et al. (2021) highlight the necessity for a systematic, regulated, and quantifiable ESG-focused disclosure in a Value-Added Income Statement format. Getting a global perspective, in another research study, Shallhoob and Hussainey (2023) highlight that SMEs in Saudi Arabia regard social activities as the most relevant aspect of ESG practices. The study further identifies the SWOT analysis elements that can influence the adoption of ESG practices. Participants perceived environmental practices as fundamental to sustainability, advocating for resource allocation in this domain considering the limited resources of SMEs and the necessity of a clear sustainability strategy. There is a crucial need for SMEs to gain understanding and awareness of ESG and its reporting, and acknowledge its significance. In this research study, as per interview findings, the complexities of corporate legislation and lack of awareness do not support SMEs in implementing ESG practices (Shalhoob & Hussainey, 2023). Samans and Nelson (2022) provide a highly practical and comprehensive guide, equipping companies across industries and nations with the tools to create sustainable enterprise value and implement effective frameworks through their corporate governance, strategy, reporting, and partnerships. Crucially, SMEs constitute a substantial proportion of the supply chains of large corporations. As such, their ESG performance has significant implications for the ESG performance of these larger entities. In this light, ESG adoption is not just about meeting regulations or mitigating risks for SMEs; it represents a strategic move that can increase their value in the eyes of their business partners and enhance their competitiveness.

Furthermore, while ESG adoption requires initial efforts and investments, it holds the potential to unlock a plethora of benefits for SMEs. These activities range from improved operational efficiency and risk management to enhanced stakeholder relations and access to new markets. Hence, ESG adoption by SMEs should not be seen merely as a response to external pressures but rather as a proactive strategy that can spur innovation, resilience, and growth. In their study, Sheehan et al. (2023) identify two primary challenges on the journey to achieve profits that align with environmental and social responsibility: (1) the ESG issue-assessment barrier, which pertains to a corporation's struggle to assess and manage ESG initiatives properly, and (2) the shareholder value barrier, associated with the belief that corporate responsibility solely lies in maximizing shareholder returns. To address these hurdles, they propose an ESG mindset model, providing insight into the issues related to ESG assessment and shareholder value belief and offering strategies for their mitigation (Sheehan et al., 2023).

Thus, this paper shifts the perspective from viewing ESG adoption in SMEs as a daunting task to recognizing it as a substantial opportunity. It explores how the challenges of ESG integration can be navigated and how the benefits can be reaped. Furthermore, it discusses how larger corporations can support SMEs in this journey, turning high-quality supply chains - characterized by strong ESG performance - into a shared goal and mutual benefit.

2 Theoretical background

In the evolving landscape of business sustainability, Environmental, Social, and Governance (ESG) criteria have emerged as critical drivers of innovation, competitiveness, and resilience. Long et al. (2023) examine the critical relationship between ESG performance, corporate green innovation, and digital transformation. The research findings emphasize the significance of fostering an environment conducive to both macro-level corporate ESG performance enhancement and digital transformation, alongside cultivating the subjective willingness of companies for sustainable development and digitalization at the micro level. This holistic approach empowers organizations to make significant strides in developing their green innovation capabilities, marking a pivotal step towards a more sustainable and innovative future.

While much of the focus has been on the role of large corporations in advancing ESG practices, Small and Medium-sized Enterprises (SMEs) play a significant and often overlooked part in the global sustainability equation. In every country, they constitute a substantial portion of the economy, and their role in the supply chains of large companies positions them uniquely to effect meaningful ESG progress. Therefore, the theoretical background section of this article delves into four key themes crucial to understanding ESG adoption in SMEs: Identifying the key ESG factors relevant to SMEs, Assessing the role of large companies in promoting ESG practices among their SME suppliers, Exploring the barriers SMEs face in adopting ESG criteria, and Evaluating the impact of ESG adoption on SMEs' competitiveness and resilience. These themes will be unpacked and supported by relevant literature, laying a robust theoretical foundation for the discussion. By focusing on these sub-themes, the authors are confident that the research article could provide valuable insights for SMEs and large companies, highlighting the importance of ESG practices for improving supply chain sustainability and overall business performance.

2.1 Identifying key ESG factors relevant to SMEs

In relation to SMEs, it is crucial to discuss which ESG factors (e.g., environmental impact, labor practices, governance structure) are most pertinent to SMEs' practice and how they can integrate these factors into their business models and strategies. SMEs operate in diverse industries and contexts, so the relevance and application of ESG factors can vary significantly. It is imperative to discern and elucidate the key ESG factors, including environmental stewardship, labor and human rights practices, and governance structure, that have a substantial bearing on the operations of SMEs.

The process of implementing ESG (Environmental, Social, and Governance) reporting within Europe is regulated by The Corporate Sustainability Reporting Directive 2022/2464 of 14 December 2022 (hereinafter CSRD), which amends Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU. The CSRD is complemented by the Environmental Social Reporting Standards, where Appendix D of this Directive regulates the structure of the non-financial report. There is general information and three areas that companies are required to report on, i.e., environmental, social, and governance information. Based on this information, the company then defines KPIs in each area and measures its environmental, social, and governance impact.

Regarding *environmental impact*, SMEs must consider the direct and indirect effects of their operations on the environment. It includes energy usage, waste management, resource conservation, and the integration of green technologies or practices into their business models. These environmental aspects can have regulatory, reputational, and financial implications, and their proactive management can lead to improved operational efficiency and market differentiation. In their research, Jiwei Li et al. find a positive association between ESG disclosure level and firm value, suggesting that improved transparency and accountability and enhanced stakeholder trust boost firm value (Li et al., 2018).

Labor practices are another crucial ESG factor for SMEs. This factor encompasses fair labor practices, safe working conditions, employee well-being, diversity and inclusion, and opportunities for learning and development. By prioritizing these aspects, SMEs can foster a more motivated, productive, and loyal workforce, greatly enhancing their competitiveness and resilience. In light of the current situation, while all aspects of labor practices are undeniably crucial, the opportunities for learning and development stand out prominently. As we aspire to remain competitive, continuous learning becomes paramount, underpinning not only the acquisition of new knowledge and skills but also strengthening our social license to operate. This, in turn, is no longer an optional aspect; rather, it is a vital component in maintaining our competitive edge and cultivating trust and goodwill among our stakeholders. As underscored by a McKinsey research article, imperfections are expected on any journey towards embracing ESG efforts: *"Because ESG efforts are a journey, bumps along the way are to be expected. No company is perfect. Key trends can be overlooked, errors can be made, rogue behaviors can manifest themselves, and actions can have unintended consequences. But since social license is corporate "oxygen"—thus impossible to survive without it—companies cannot just wait and hope that things will all work out"* (McKinsey, 2022).

In terms of *governance structure,* it is important for SMEs to demonstrate transparency, accountability, and ethical behavior in their management and business dealings. Sound governance can promote trust among stakeholders, including employees, customers, suppliers, and investors, thereby strengthening the SMEs' reputation and long-term sustainability.

Moreover, resilience, a critical aspect of business sustainability, acts as a bridge between strong governance and entrepreneurial adaptability, providing the necessary fortitude to navigate through challenges and uncertainties, ultimately fortifying the long-term sustainability of SMEs. Due to their experience navigating uncertain environments and confronting adversity within often informal organizational contexts, entrepreneurs are generally highly resilient. This resilience equips them with capabilities that foster resilience within Small and Medium Enterprises (SMEs). Therefore, entrepreneurial resilience can be seen as a foundational element for the resilience of SMEs (Branicki et al., 2018). Building upon this concept, the resilience inherent in entrepreneurs and subsequently fostered within SMEs is not only about weathering storms. Instead, it can act as a catalyst for integrating ESG factors into SMEs' business models and strategies. Integrating ESG factors into SMEs' business models and strategies goes beyond mere compliance or risk mitigation. Instead, it provides SMEs with an opportunity to innovate, differentiate, and create value within a rapidly evolving, sustainability-focused business environment. This strategic adaptation not only propels SMEs forward but also fortifies their resilience, preparing them to navigate future challenges effectively. In this process, the social aspects of ESG prove to be indispensable.

2.2 Assessing the role of large companies in promoting ESG among their SME suppliers

The business operations of large companies and SMEs are dependent on each other. Therefore, to succeed in ESG implementation is equally important to both types of companies. Thus, it is important to explore how large companies can support their SME suppliers in adopting ESG practices, such as through capacity building, providing resources, sharing ESG-focused training materials, or setting ESG requirements for suppliers, including the bidding process.

With respect to supply chain dynamics, a proactive approach from SMEs is paramount. Based on Dai and Tang's (2021) research underscores the crucial importance of well-calibrated ESG principles as a central guiding force in shaping firms' day-to-day supply chain management practices. Larger companies often possess the advantage of easily replacing supply chain partners if required, which may not be the case for their smaller counterparts. Therefore, it becomes particularly crucial for SMEs to be cognizant of the ESG criteria numerous firms prioritize when selecting partnerships. Being vigilant and responsive to these criteria can secure their positions within existing supply chains and open doors for potential collaborations.

Elaborating on the topics mentioned above, the authors would like to highlight the symbiotic relationship between large corporations and SMEs, underscoring the fact that the achievement of ESG objectives is a shared responsibility and a collective benefit. With their extensive resources and influence, larger companies' strategic actions can play a pivotal role in driving ESG implementation throughout their supply chains, including SMEs.

Large corporations are in a unique position to promote ESG among their SME suppliers through various means. For instance, they can facilitate capacity-building initiatives, offering education and training programs on ESG topics. These initiatives can equip SMEs with the necessary knowledge and skills to integrate ESG practices into their operations. Moreover, larger organizations can provide resources, such as access to sustainable materials or technologies, and shared ESG-focused training materials, enabling SMEs to implement ESG practices more effectively and efficiently. Their help can also include establishing ESG mentorship programs, where large corporations provide hands-on support to their SME suppliers.

Large companies can also enforce ESG requirements for their suppliers as part of their procurement policies. It could involve integrating ESG criteria into the bidding process, encouraging SMEs to adopt these practices to remain competitive. By doing so, large corporations can create a ripple effect of sustainable and responsible practices across the business ecosystem.

It's vital to note that these supportive actions by large companies are about more than just ensuring compliance or mitigating risks.They represent and should be viewed as a strategic investment in the sustainability and resilience of the supply chain, thereby contributing to the long-term success and competitiveness of both the large corporations and their SME suppliers.

2.3 Overcoming barriers to ESG adoption in SMEs

It is inevitable to investigate the real challenges faced by SMEs in adopting ESG practices (e.g., limited resources, lack of expertise, short-termism) and propose solutions for overcoming these barriers.

While the benefits of ESG adoption are increasingly recognized, the journey towards sustainability can present several challenges for SMEs. They often need help with issues such as limited resources, lack of expertise in ESG matters, and a short-term business focus, which may pose significant hurdles in embracing ESG practices.

The nature and magnitude of these challenges can vary greatly depending on various factors, such as the sector in which the SME operates and the type of business it is engaged in—whether it's a goods-producing business or a service provider.

For instance, SMEs in the manufacturing sector may face substantial environmental challenges due to the resource-intensive nature of their operations. They often struggle with issues like waste management, energy efficiency, and reducing carbon emissions. In contrast, service-oriented SMEs, like IT companies or consulting firms, might grapple more with social and governance issues such as employee welfare, diversity and inclusion, and data privacy. Moreover, goods-producing businesses might face more pressure to adopt ESG practices as they are more exposed to regulations and public scrutiny due to their tangible environmental footprint. On the other hand, service-oriented businesses, while less tangible in their environmental impact, can face significant reputational risk and client pressure for poor ESG performance.

The sector-specific nuances underline the need for tailored solutions to overcome the ESG adoption barriers. For example, for a resource-constrained manufacturing SME, solutions might involve exploring partnerships for joint waste management initiatives or seeking governmental or non-governmental support for transitioning to energy-efficient technologies. For a service-oriented SME struggling with ESG expertise, investing in ESG-focused training and development or seeking external consultancy services might be beneficial.

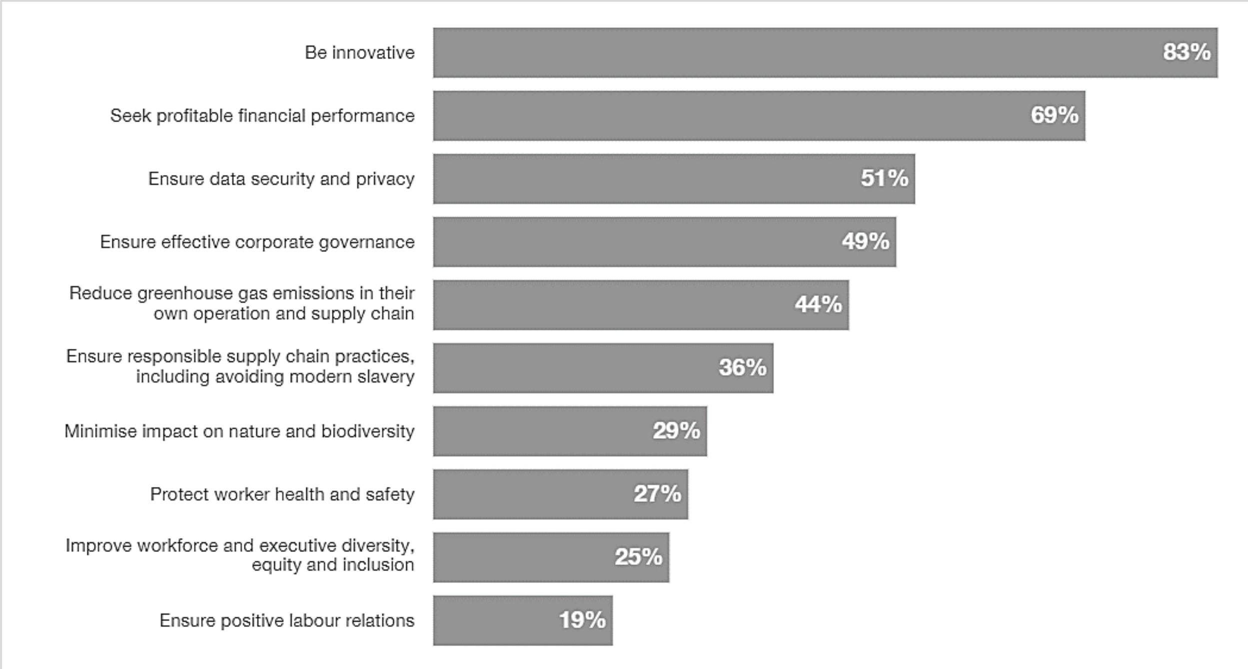
Therefore, recognizing the distinct challenges faced by different SMEs and addressing them through sector-specific and business-specific strategies can significantly aid in overcoming the barriers to ESG adoption, thereby accelerating the path to sustainable and responsible business practices.

2.4 Evaluating the impact of ESG adoption on SMEs' competitiveness and resilience

Last but not least, the managers involved in the ESG adoption need to examine how ESG practices can help SMEs become more competitive, especially in the global market, how to attract investors, and increase their resilience to various risks (e.g., climate change, social unrest, regulatory changes).

As key decision-makers in the ESG adoption process, managers of SMEs are tasked with understanding how integrating ESG practices can enhance their competitiveness and resilience. It is paramount for SMEs to understand the investor perspective, especially within the global market context. Adherence to ESG principles can serve as a significant differentiator, attract conscientious investors, and fortify resilience against myriad risks such as climate change, social unrest, and evolving regulatory landscapes. Insight into investor priorities, such as those highlighted in PwC's Global Investor Survey 2022 titled "The ESG execution gap: What investors think of companies' sustainability efforts", can prove instrumental. In this survey, held in September and October 2022 (Fig.1), invited respondents comprising 227 investors and analysts across 43 territories were asked to identify the top priorities they believe businesses should be concentrating on delivering, with the ability to select up to five outcomes. However, it's important to note that any outcomes chosen by less than 10% of the respondents were not included in the results.

Fig. 1 Outcomes that investors see as top priorities for business



Source: (PricewaterhouseCoopers, 2022)

Though Environmental, Social, and Governance (ESG) factors have been gaining increased attention, the survey results reveal that investors still place the highest importance on business innovation. Indeed, 83% of investors identified the development of innovative products, services, and ways of operating as their top priority for businesses. Profitable financial performance followed closely behind, being identified as a crucial factor by 69% of respondents. Despite these often prioritized business objectives maintaining prominence, it’s clear that ESG outcomes are also being recognized as vital business priorities by investors.

While ESG standards might currently be more pronounced in regions such as the EU, it’s essential to understand that the ESG wave is rapidly gaining global momentum. Businesses worldwide are recognizing the value of adopting sustainable and socially responsible practices. Therefore, even for SMEs operating outside the EU, aligning with ESG principles can provide a competitive advantage.

In terms of enhancing global competitiveness, SMEs with robust ESG practices can differentiate themselves by showcasing their commitment to sustainability and ethical operations. It can improve their reputation, facilitate access to new markets, and attract customers who prefer businesses with strong ESG credentials. Moreover, ESG-focused SMEs can attract a wider range of investors, particularly those prioritizing sustainable and responsible investments. In recent years, there has been a significant increase in the amount of capital directed towards ESG-compliant businesses. Thus, SMEs that successfully integrate ESG practices can unlock new funding opportunities. Based on Alkaraan et al. (2022), environmental, social, and governance (ESG) practices are important as a moderating factor in the relationship between disclosure and financial performance. The research reveals that companies with superior ESG performance show greater engagement in disclosure and exhibit better financial performance.

Finally, ESG practices can boost the resilience of SMEs against various risks. For instance, environmentally responsible SMEs might be better equipped to adapt to regulations aimed at mitigating climate change. SMEs with solid social practices, such as employee welfare and community engagement, may demonstrate greater stability during periods of social unrest.

Furthermore, SMEs prioritizing good governance can more effectively navigate regulatory changes, demonstrating agility and resilience. Hence, by adopting ESG practices, SMEs can not only enhance their competitiveness but also build a more resilient and sustainable future, regardless of their geographical location or the maturity of ESG standards in their region.

In light of these developments and the growing recognition of ESG's importance and its far-reaching implications, the need for SMEs to integrate ESG practices into their operations becomes increasingly urgent. The forthcoming Directive of the European Parliament and of the Council (EU) 2022/2464 further underscores this urgency (Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 Amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as Regards Corporate Sustainability Reporting (Text with EEA Relevance), 2022). The Corporate Sustainability Reporting Directive (CSRD) represents the European Union's most recent endeavor to enhance the quality and comparability of corporate disclosures in the realms of environmental, social, and governance factors (ESG). Following its introduction, EU member states are granted an 18-month timeframe to incorporate the directive into their respective national laws.

According to Article 5, Transposition, letter c) of this Directive, a clear deadline is established for SMEs to commence providing sustainability reports for financial years beginning on or after 1st January 2026. While the implementation of ESG practices has hitherto mainly been voluntary for SMEs, this forthcoming obligation indicates a shift in regulatory expectations and sets a definitive timeline for action. It is, therefore, incumbent upon SMEs to start working diligently towards adopting ESG practices without delay. Not only will this proactive approach ensure regulatory compliance, but it can also unlock numerous benefits, ranging from enhanced competitiveness and resilience to increased investment opportunities. As the landscape of sustainable business continues to evolve, SMEs that respond swiftly and strategically to the call of ESG will be better positioned to thrive in the marketplace of the future.

3 The Corporate Sustainability Reporting Directive (CSRD)

Like other European countries, the Czech Republic and Slovakia have been taking strides to incorporate sustainability and corporate social responsibility into their business practices, which also extends to SMEs. Examples of successful ESG integration could be found across different sectors, including manufacturing, retail, IT, and others.

Numerous SMEs illustrate successful ESG integration, having successfully incorporated ESG practices that demonstrate the advantages they have gained in areas such as innovation, market differentiation, and long-term sustainability. Some companies are proactive in this regard, but many firms still need to be more confident about ESG implementation.

Clear guidelines for disclosing ESG-related non-financial information applicable to any business or company have been established. The timeline provided below indicates the dates companies are required to start reporting and the planned dates of ESRS (European Sustainability Reporting Standards) adoption.

Fig. 2 The Corporate Sustainability Reporting Directive (CSRD)

Source: own elaboration based on (Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 Amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as Regards Corporate Sustainability Reporting (Text with EEA Relevance), 2022)

4 Methodology and results

This paper's subject, "Enabling ESG Adoption in SMEs," is relatively new, with limited or only indirect data available. Nonetheless, selected unpublished data from primary research conducted among 45 large companies operating in the Czech Republic will provide insight into this area. These findings form part of the analytical section of a dissertation thesis "Education-based Marketing in the Context of Modern Marketing Communication," defended at The Prague University of Economics and Business in October 2022.

4.1 Selection criteria for respondents

In the process of selecting respondents, the author employed a purposive selection method combined with elements of quota sampling. The respondent selection was conducted using the professional social network LinkedIn while adhering to ethical principles of engagement. The respondents were chosen from companies that met the following purposive selection criteria:

1. Company Size - Respondents were drawn from owners, CEOs, and marketing managers of large companies (i.e., those with more than 250 employees).
2. Geographical Location - The surveyed firms operate not only in the capital city of Prague but also in 13 other regions of the Czech Republic.
3. Turnover - Companies with a turnover exceeding CZK 10 million (average for the last three years) were selected.

During the selection process, the defined filtering criteria for the respondent sample were verified regarding the business sector, i.e., production, trade, and services. The data collected from the research helped to validate these filtering criteria - see Fig. 3.

Fig. 3 Research 1 - structure of the sample of respondents in terms of business sector

Type of company	Structure of the respondents' sample	
	Share in %	Number of firms
Manufacturing	40,91 %	18
Trade	31,82 %	14
Services	27,27 %	12
Remark: 1 respondent skipped answering this questions		

Source: own elaboration

4.2 Data collection

The research survey was conducted over the period from **August 15, 2021, to January 31, 2022.**

Data was gathered via an *online questionnaire* and the **online application Momentive**.

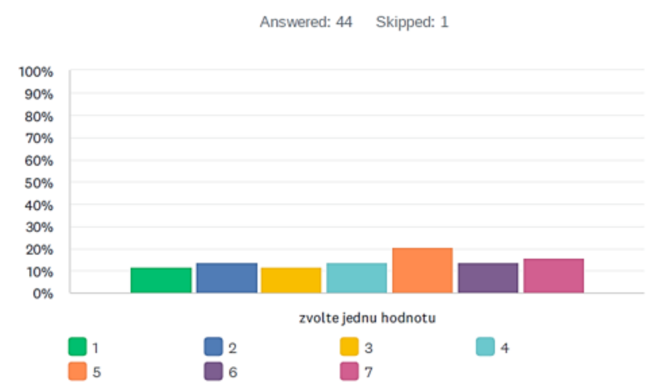
The total number of respondents was **45.**

4.3 Selected Research Questions from the Primary Research

For the purpose of this study, the authors selected two questions related to the CSR activities and CSR-oriented perspectives of the respondents from large companies. The original numbering from the dissertation thesis questionnaire has been retained.

Q10: To what extent are the details about your CSR* activities included as part of your marketing communication utilizing content marketing tools? (1 = they are not published at all; 7 = they constitute a significant part of marketing communication) *CSR - Corporate Social Responsibility.

Fig. 4 Research question Q10 - results



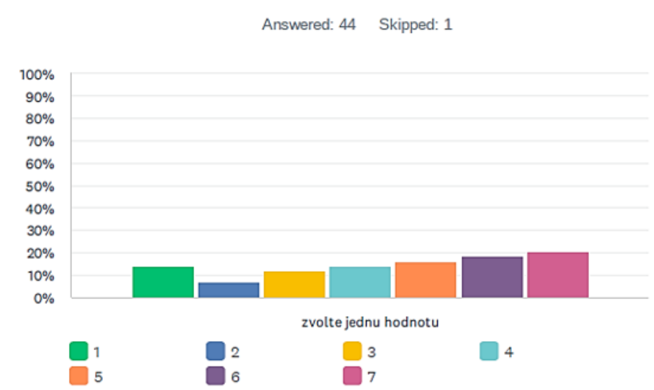
	1	2	3	4	5	6	7	TOTAL
Choose one option only	11.36% 5	13.64% 6	11.36% 5	13.64% 6	20.45% 9	13.64% 6	15.91% 7	44

Source: own elaboration

For the evaluation of question number 10, a 7-point Likert scale was used. The sum of points 5, 6, and 7 reach 50.0%, with 15.91% of respondents indicating that CSR activities constitute a significant part of their marketing communication.

Q11: How extensively do you report on CSR activities within your company? (1 = we do not report at all; 7 = we report intensively, i.e., CSR reporting is part of our company's non-financial reporting, either independently or within annual reports)

Fig. 5 Research question Q11 - results



	1	2	3	4	5	6	7	TOTAL
Choose one option only	13.64% 6	6.82% 3	11.36% 5	13.64% 6	15.91% 7	18.18% 8	20.45% 9	44

Source: own elaboration

For the evaluation of question number 11, a 7-point Likert scale was used. The sum of points 5, 6, and 7 reach 54,54%, with 20.45% of respondents indicating intensive reporting, i.e., CSR reporting is part of the company's non-financial reporting, either independently or within annual reports.

The authors of the dissertation are aware of certain limitations of this research, primarily rooted in the limited number of respondents in the category of large companies. The pandemic negatively impacted the data collection process, during which companies and individuals were dealing with serious, often existential, issues.

4.4 Research findings in the context of new EU directives

In the context of current demands in the area of ESG non-financial reporting for large companies, the research data obtained are not particularly encouraging. It is reasonable to suspect that many companies were not previously active in this area, as this type of non-financial reporting was voluntary for standard large firms. However, the new EU directive significantly alters the rules of the game, necessitating a much more positive and proactive approach from companies towards ESG non-financial reporting.

The above implies that the previously lax attitude towards ESG reporting will no longer be sustainable. As non-financial ESG reporting becomes mandatory rather than optional, businesses will be required to give it greater importance in their strategic planning and operations. The new EU Directive will shift corporate behaviour, requiring companies to adapt their business models, decision-making processes, and overall strategies. This transformation will likely have substantial implications for a company's financial performance, reputation, and social license to operate.

However, it is crucial to note that such a change will take time and effort. The transition to comprehensive ESG reporting will likely involve a significant learning curve, requiring companies to develop new capabilities, allocate resources effectively, and change their corporate culture. Nevertheless, increased transparency and stakeholder trust could foster more responsible corporate practices in the long run, contribute to sustainable development, and improve financial performance.

4.5 Potential challenges in implementing ESG

In order to report on something, a well-thought-out system of ESG activities must genuinely exist. The concept of "greenwashing" has emerged as a significant issue in this context.

Greenwashing refers to the practice where companies overstate or falsely advertise their environmental or socially responsible practices. This deceptive marketing strategy is employed to make an organization appear more committed to sustainable and ethical practices than it truly is. It is a way to mislead consumers, investors, and other stakeholders into believing a company is more environmentally friendly or socially responsible than it actually is.

As regulatory and societal pressure for companies to behave more sustainably grows, the temptation to engage in greenwashing can increase. However, with stricter ESG non-financial reporting guidelines in place, companies will have more difficulty maintaining such façades. Moreover, greenwashing can lead to severe reputational damage when uncovered in an era of growing transparency and stakeholder engagement.

Thus, companies should strive to develop an authentic and comprehensive system of ESG activities rather than resorting to greenwashing. It will fulfill reporting requirements and contribute to the broader objective of sustainable development and corporate responsibility. In the long run, such authentic commitment to ESG can lead to greater stakeholder trust, improved reputation, and better financial performance.

While numerous challenges may arise during the implementation of ESG, greenwashing is one that should be actively avoided. This deceptive practice not only undermines the credibility of a company's ESG efforts but can also lead to reputational damage, regulatory penalties, and loss of stakeholder trust when exposed. Hence, fostering authenticity and transparency in ESG initiatives is of paramount importance.

5 Conclusion

The objective of this article was to explore and shed light on the significance of ESG (Environmental, Social, Governance) factors in SMEs (Small and Medium Enterprises) and the role of large companies in promoting ESG adoption among their SME suppliers. The authors sought to identify the barriers to ESG implementation and evaluate its impact on the competitiveness and resilience of SMEs.

In conclusion, the authors highlight the idea that integrating ESG factors into business operations is not just necessary for large corporations but also for SMEs. These practices enable businesses to remain competitive, resilient, and attuned to stakeholders' changing demands in the current socio-economic environment. Large companies play a pivotal role in promoting ESG principles among their SME suppliers, fostering a more sustainable and accountable supply chain.

The study also identifies a range of barriers to ESG adoption. However, with a strategic approach, these obstacles can be overcome, enabling the benefits of ESG adoption to be realized. The research, although limited in scope due to the pandemic, underlines the importance of transparent and comprehensive reporting on CSR activities.

Furthermore, introducing the Corporate Sustainability Reporting Directive (CSRD) emphasizes the increasing significance of ESG factors in business operations and reporting. Adherence to this directive will be critical for companies moving forward.

Finally, the article underscores the need to avoid greenwashing, which threatens the credibility and authenticity of ESG efforts. It calls for companies to ensure that their commitment to ESG principles is genuine and that their reporting is accurate, which will enable sustainable growth and increased trust among all stakeholders.

In addition to the above insights, the authors wish to convey a genuine appeal for businesses, particularly SMEs, to embrace ESG principles with full responsibility. While the challenges in implementing ESG cannot be overlooked, its transformative potential for businesses, society, and our planet is remarkable. ESG is no longer a sideline practice or a mere compliance requirement but a central element in responsible business conduct that fosters sustainability, competitiveness, and resilience. It's an avenue for businesses to contribute positively to the world we inhabit while enhancing their own prospects. ESG isn't just about doing good; it's about long-term value creation in a rapidly evolving business landscape where sustainability is increasingly gaining ground. It's high time we realize that our futures, both as individual entities and collectively as a society, are intertwined with our environmental and social actions. As we move forward, let's ensure that ESG principles form the foundation of our business strategies, inspiring more ethical, transparent, and sustainable business ecosystems.

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