

Environmental Social Governance (ESG) Adoption among SMEs

Trends, Challenges and Insights from Cambodian Agro-Processing
SMEs

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Introduction: Defining ESG

- Environmental, social, governance (ESG) refers to a set of environmental, social, and governance issues considered by firms and investors when conducting their business and investment activities.

Environmental	<ul style="list-style-type: none">• Climate change, carbon & resource management, pollution.• Energy, water, waste management, biodiversity, sustainable innovations.
Social	<ul style="list-style-type: none">• Job creation, working conditions, equal opportunity, diversity, Health & Safety.• Community impact, human rights, child/forced labor, grievance mechanisms.• Social impact of products/services.
Governance	<ul style="list-style-type: none">• Board structure: Diversity, oversight, succession, executive pay.• Internal controls, risk governance, ethics & compliance.• Shareholder rights, stakeholder engagement, transparency.

Source: IFC, 2021

Growing Significance of ESG in Global Supply Chains

- **Global relevance:** critical component of the global business landscape/supply chains and a means to attain SDGs.
- **Emerging challenges for Cambodia's companies:** Transition towards mandatory ESG and necessary for global supply chain integration.
- **SMEs Sector:** a key component of Cambodia's economy and the need to adjust business model to align with ESG demands.
- **Research imperative:** knowledge gaps regarding SMEs' ESG adoption.
 - Flores (2023a) recommended conducting surveys to analyse firms' perspectives, practices, and trends of ESG adoption.
 - Ma'aji et al.,(2022) called for an in-depth investigation into factors influencing firms to adopt sustainability reporting.

Research Objectives and Questions

I. Research Objectives

1. To contribute to the literature on ESG adoption among SMEs in developing markets by examining trends, drivers, and challenges.
2. To generate empirical evidence that informs policy and programmatic interventions, supporting SMEs in adopting ESG practices and reporting within national contexts.

II. Research Questions

Primary Question	Secondary Questions
<ul style="list-style-type: none">• What challenges do Cambodia's SMEs face in adopting ESG practices and reporting?	<ol style="list-style-type: none">1. What are the drivers and benefits (including legal framework) to adopt? Do SMEs face consequences if they opt not to implement?2. What are the common frameworks or aspects of ESG adopted and materialized by SMEs?3. How have different stakeholders supported SMEs' transition towards ESG adoption?

Literature Review: ESG and Firms' Performance

- Impact of ESG on Firm Performance: Mixed Evidences
 - ESG performance linked to enhanced financial outcomes and innovation capacity (IFC, 2021; Pulino et al., 2022; Lian et al., 2023)
 - Governance aspects (e.g. compensation, board diversity) are positively associated with firms' financial performance. The environmental and social pillars negatively affect firms' financial performance (Shaikh 2022; Nareswari et al., 2023)
- ESG has been criticized for attempting to achieve too many objectives simultaneously; it should focus only on the **(E)** part (Economist 2022; Louche et al., 2023).

Framework and Standards

- Level of adoption

- 96% of the largest 250 companies & 79% of the 5800 leading companies reported their sustainability performance (KPMG, 2022)

- Framework

- Global Reporting Initiative (GRI)
- Sustainability Accounting Standards Board (SASB)
- Task Force on Climate-Related Financial Disclosures (TCFD)
- Sustainable Development Goals (SDGs)
- National Guidelines, e.g., Malaysia
- ESG Frameworks for SMEs

Wire Consultancy's ESG Framework



Why should SMEs embrace ESG?

- ESG strategies benefit not only large firms but also SMEs, improving market positioning and cash flow (Fenwick et al., 2022).
- Environmental and social impacts aren't limited by firm size; green investments should include SMEs, not just major corporations (Ferrazzi & Tieske, 2022).



With a HR & Compliance Manager, at finishing warehouse, SME4, Battambang province, December 2024

Drivers and Challenges Identified in Existing Literature

Key Drivers of ESG Adoption	Key Challenges to Implementation
<ul style="list-style-type: none">• Regulatory Frameworks: Growing emphasis on ESG compliance and sustainability regulations (Taylor & Painting, 2024; Bossut et al., 2021)• Supply Chain Pressure: Increasing expectations from buyers for responsible sourcing (E. Stek & Nungsair, 2023; ILO, 2022; Tomboles, 2023)• Access to Finance: ESG performance influencing investment and financing decisions (Uzsoki, 2020; Kuteesa et al., 2024; Drobet et al., 2024)• Business Benefits: Enhanced reputation, operational efficiency, and market competitiveness (Tomboles, 2023)	<ul style="list-style-type: none">• Limited Resources & Expertise: Many organizations lack the internal capacity to implement ESG initiatives• Inadequate Reporting Frameworks: Absence of standardized, sector-specific ESG reporting models for SMEs• Lack of Tools and Software: Difficulty in tracking, managing, and reporting ESG data effectively (Setyaningsih et al., 2024; Yasaswi et al., 2024; Markopoulos et al., 2023)

Research Design and Methodology

- **Explanatory mixed method:** an online self-administered survey on **Kobo toolbox** with SMEs, followed by in-depth interviews and field observations.
- **Convenience sampling from a population** of 44,628 enterprises in the MISTI's 2024 database 5,658 of which registered classified in manufacturing sector (MISTI 2024; NIS 2022).
 - Survey sent to more than 400 SMEs. 62 SMEs (44% female) participated, with respondents being primarily owners or founders (68%), CEO (18%), and staff (11 %).
 - 53% SMEs in Agro-processing sector and most operate longer than 3 years.
- **13 Key Informant Interviews** with SMEs, business associations, financial institutions, government ministries, NGOs, DPs, and employees of SMEs.
- **Two site visits** to agro-processing enterprises in Kampot and Battambang provinces. Both SMEs were exporting.

Results: Cambodia's Regulatory Framework on ESG

- ❖ No dedicated regulations/policies, but various legal frameworks and policies touch upon ESG matters.

Environment	Social	Governance
<ul style="list-style-type: none">- Art. 59 of the Constitution- Environmental Code (2023)- Sub-Decree on EIA- Cambodia Climate Change Strategic Plan 2014-2023- National Environment Strategy	<ul style="list-style-type: none">- 1997 Labour law- Law on Social Security Scheme, Pension, Health Care, Occupational Risk- Law on Consumer Protection- 2022 Law on Food Safety- 2019 Law on Construction	<ul style="list-style-type: none">- Commercial Enterprises Law (2005)- Law on Standards of Cambodia (2020)- Prakas on Corporate Governance for Public Listed Enterprises (2010)- Prakas on Management of Issuing Business Service and Trade Permits- Tax registrations

- ❖ SMEs are governed by various regulations depending on their sizes, specific requirements, and operating sectors.
- ❖ Pentagonal Strategy's intention to formulate and implement policy frameworks and incentive schemes to promote environmental and social responsibility among businesses (RGC, 2023, p. 32)

SMEs' Awareness and Perception towards ESG

- ESG is the most popular phrase among SMEs, followed by CSR, ethical & inclusive business with many SMEs became aware just recently.
- Despite different levels of understanding, SMEs believe ESG practices bring positive impacts to businesses, the environment, and society.

Table 4: SMEs' awareness on ESG and related terms

SMEs' Awareness on ESG and related terms		
Environment, Social, and Governance (ESG)	43	69%
Corporate Social Responsibility	39	63%
Sustainability Reporting	14	23%
Inclusive Business	26	42%
Responsible Business Conduct (RBC)	13	21%
Ethical Business	34	55%
Responsible Investment	18	29%
Initially became aware of ESG and related concepts		
Less than 1 year	25	40%
Between 1 - 3 years	24	39%
Between 3 - 6 years	10	16%
More than 6 years	3	5%

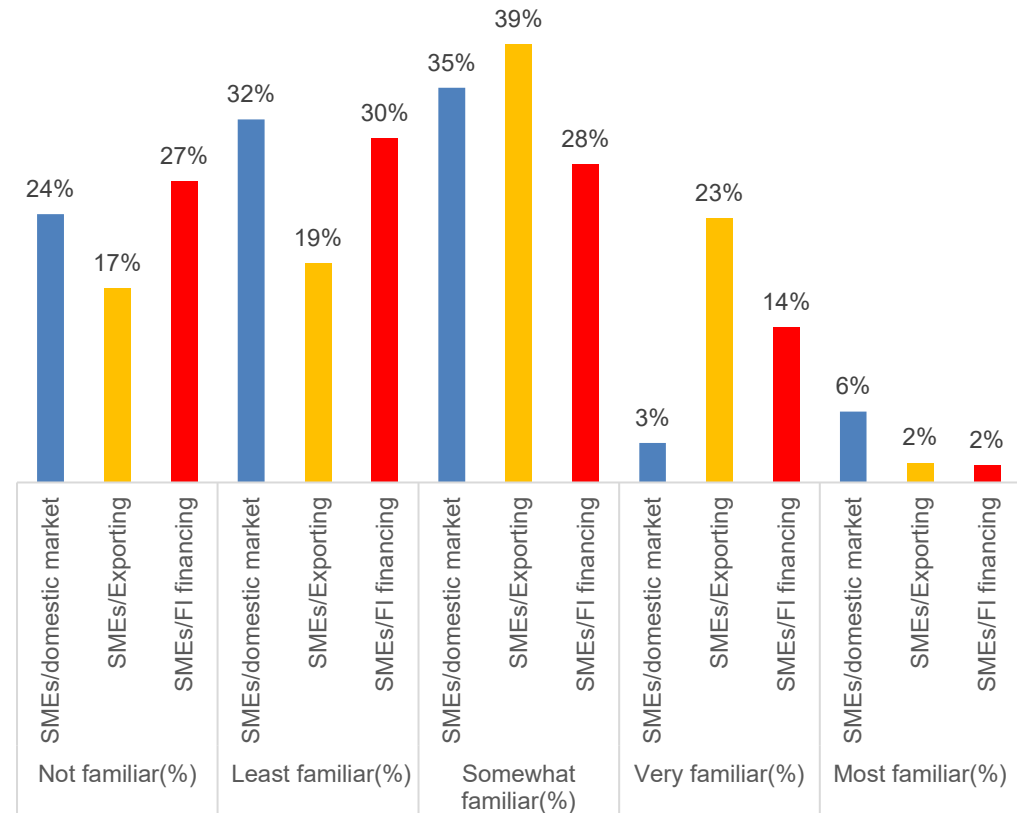
“I love ESG concepts, especially for SMEs. This is from my perspective. It also fits my environmental management background that I got from France. I also think that ESG is just a recent development framework that has been adopted” (SME4)

SMEs' Awareness and Perception towards ESG

- SMEs had limited understanding of the detailed elements of ESG.
- Exporting SMEs rated themselves highly.

“ESG will be important for our business. We are more or less in the startup stage. We have not grown much yet. However, ESG is essential as we are considering long-term plans and sustainability” (SME2)

SMEs' Familiarity with ESG



SMEs' Awareness and Perception towards ESG

Table 7: Perceived benefits from ESG adoption

Perceived benefits	N. of respondents	Percentage
Cost savings (e.g., energy efficiency)	37	60%
Improved access to finance	39	63%
Stronger customer relationships	39	63%
Increased employee engagement	31	50%
Reduced regulatory risks	39	63%
Others	3	5%

- SMEs were optimistic about ESG's benefits, citing that ESG practices lead to cost savings, access to finance, improved buyer relationships, promote employee engagement, and reduced regulatory risk

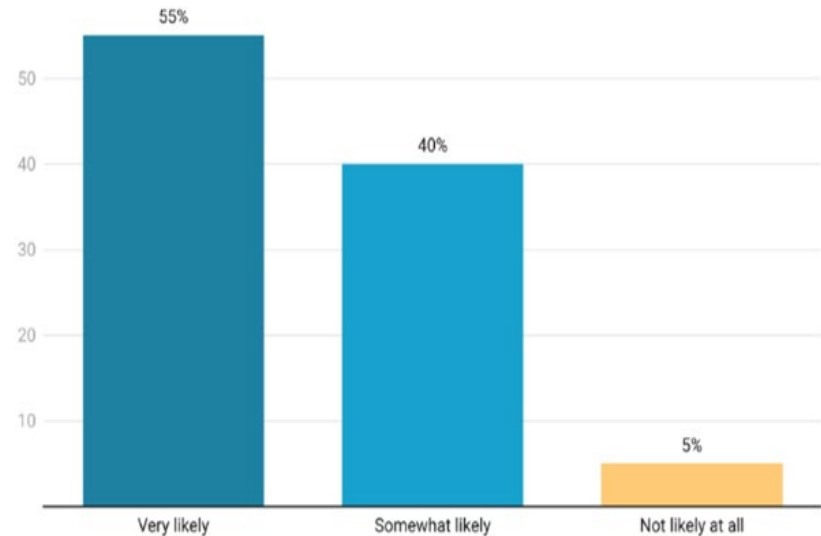


Salt flakes produced mainly for export to EU/US Markets

SMEs' Awareness and Perception towards ESG

- Most SMEs were likely to adopt ESG practices (55% very likely, 40% somewhat).
- However, some SMEs (5%) were unprepared for this shift.

Figure 5: How likely are SMEs to adopt ESG Practices



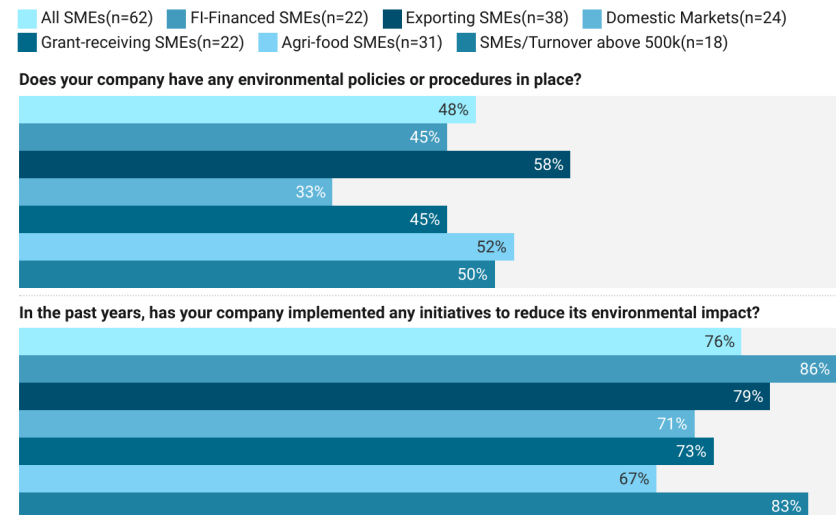
“The requirement of ESG is tough for SMEs to apply while balancing income generation and social and environmental responsibilities. SME4”

ESG Adoption: Trends and Approaches

Environment Pillar

- 48% of SMEs reported having environmental policies, with a higher rate among exporters (58%).
- 76% of SMEs implemented initiatives such as waste reduction, sustainable materials, energy efficiency, emission cuts, and staff environmental training

Figure 6: Current practices related to environmental pillar



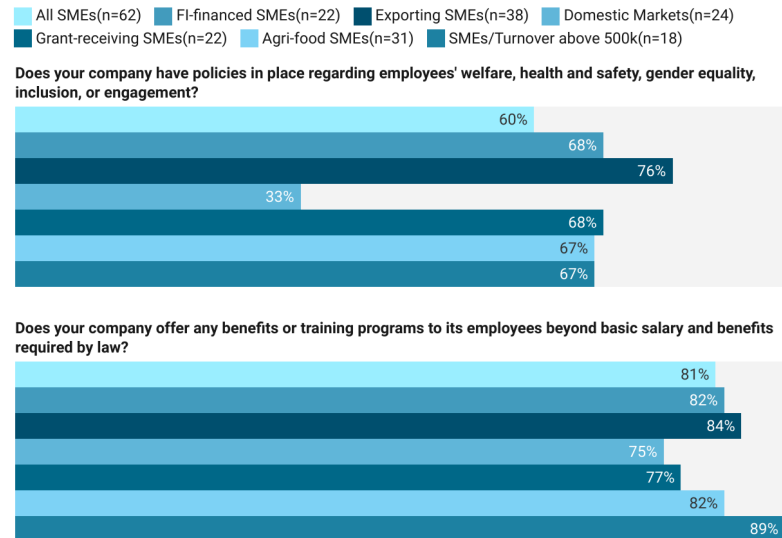
“In our company, we take care of our environmental performance by tracking energy usage, water usage, solar contribution to energy consumption, the level of energy emission in each facility, and conducting relevant audits...”

ESG Adoption: Trends and Approaches

Social Pillar

- 60% of SMEs established policies for HR, occupational safety and health (OSH), gender equality, and workplace inclusivity.
- SMEs widely adopted GFT's minimum wages
- Many cited compliance with labour laws, ISO, HACCP, and BSCI

Figure 7: Current practices related to social pillar



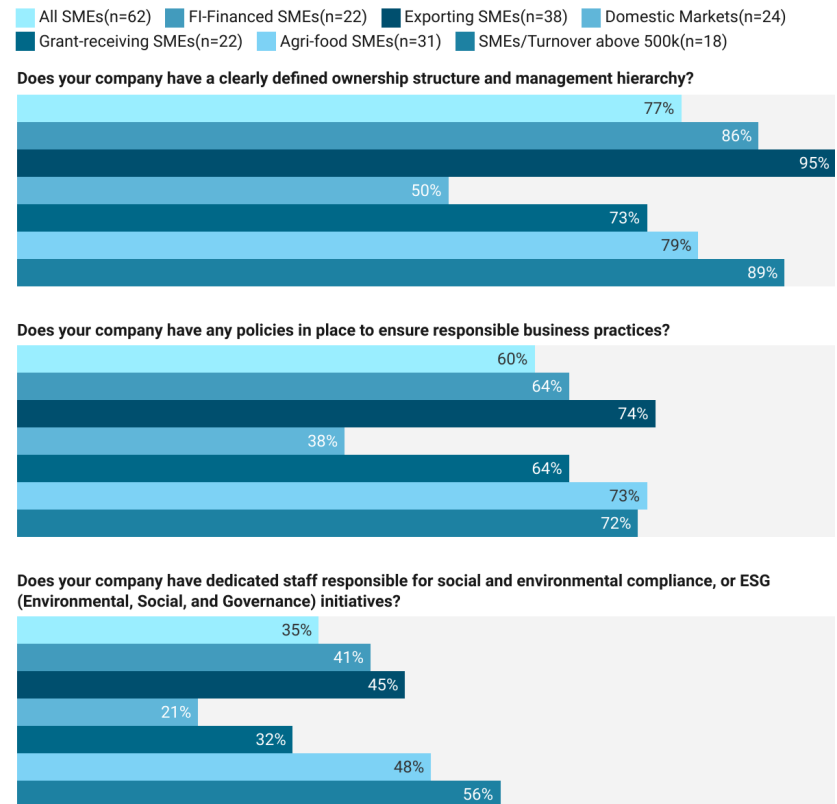
*“...we’re committed to be an inclusive business and perceived as a place where our farmer producer can go for support. We secured markets for **farmer producers**, worked on market linkages, provided technical support for sustainability in the production process” (SME 2)*

ESG Adoption: Trends and Approaches

Governance Pillar

- 77% of SMEs reported having clear ownership and management structures.
- Exporting SMEs (95%), larger SMEs (89%), and those financed by financial institutions (86%) showed stronger governance structures than domestic-focused SMEs (50%).
- 60% of SMEs had responsible business policies, but only 35% have dedicated staff for ESG compliance—larger SMEs are more likely to afford such roles.

Figure 8: Current practices related to governance pillar

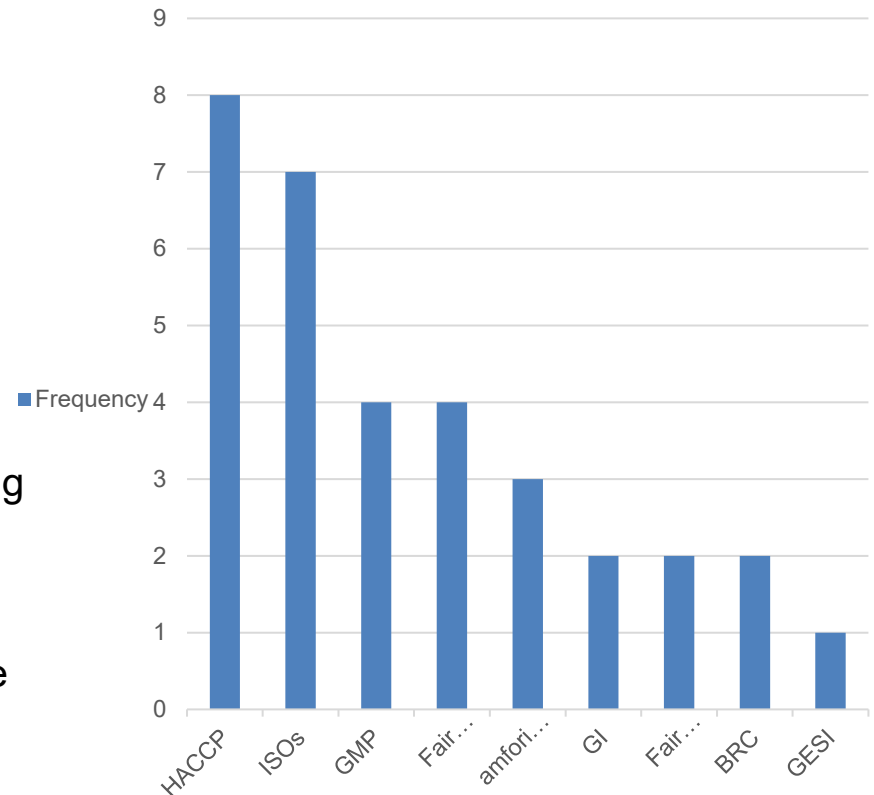


ESG Adoption: Trends and Approaches

Standards & Certifications as a Pathway

- ESG is a complex concept for SMEs. Many equates ESG adoption with obtaining certifications, helping them to enhance recognition, client trust, regulatory compliance, and market access.
- Commonly cited certifications include HACCP, ISOs, GMP, Fair Trade, reflecting the high concentration of agri-food processing SMEs in the study sample.
- SMEs noted that pursuing multiple certifications is resource-intensive, sometime overlapping requirements.

Figure 11: Certificates and Standards Considered Critical by SMEs

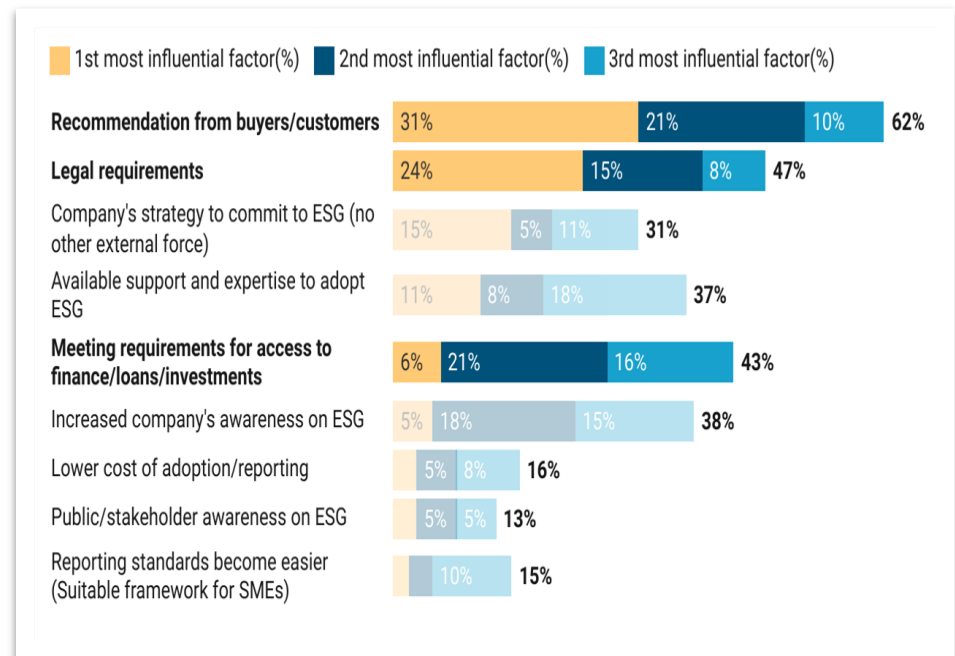


“...my company invested in people and management systems to obtain necessary certifications and standards such as BCSI, Fair Trade, Fair for Life, GMP, ISO 22000, HACCP” (SME 2).

Drivers for Adoption – Cambodia’s SMEs

- **Supply chain pressure/request** from buyers – exporting SMEs
- **Legal requirements/regulation** changes in major markets
- **Access to finance & investors’** requirements although the role of access to finance remains minimal.
- **Other factors** include company’s strategies, simplified standards, owners’ awareness & ethical commitment, reporting capabilities, and long-term sustainability.

Figure 12: Most influential factors influencing SMEs to adopt ESG practices

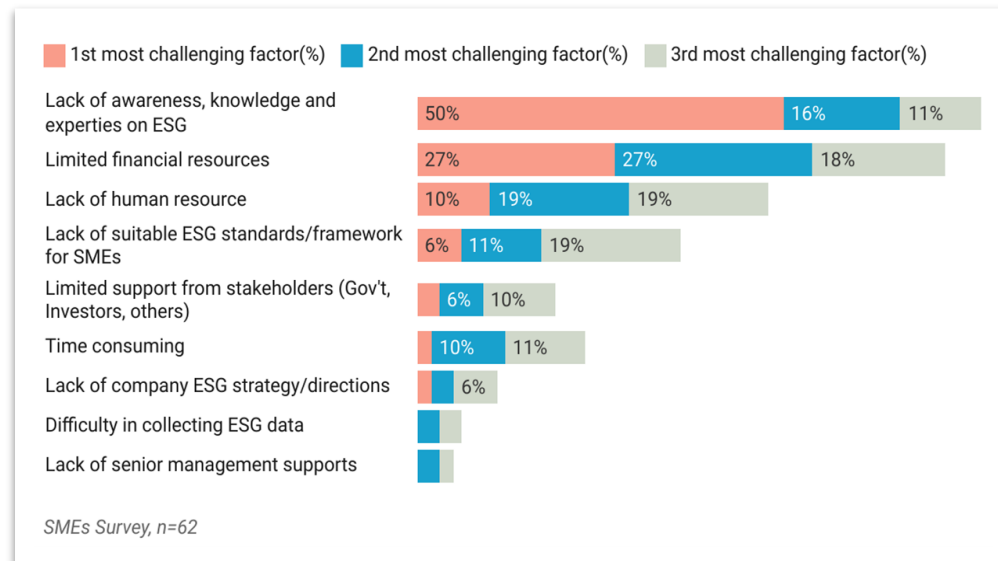


My clients often ask for their supplier's information. They want to know if the company has a history of child labor cases, if sufficient operational procedures are in place, the system for monitoring emissions levels, or if the company has established a traceability system” (SME 2)

Challenges to Implementation – Cambodia's SMEs

- **Limited awareness and expertise**, with difficulty accessing qualified ESG professionals.
- **Financial constraints** related to operations, audits, training, and certification costs.
- **Complex ESG standards** and reporting frameworks not tailored to SME capacities.
- **Lack tools** for monitoring and reporting ESG data and performance metrics.

Figure 12: Influencing factors for SMEs to adopt ESG practices



"We lack the right experts to support us in implementing all these ESG requirements" (SME2)

ESG Support Ecosystem

Figure 13: Whether SMEs know where to access support

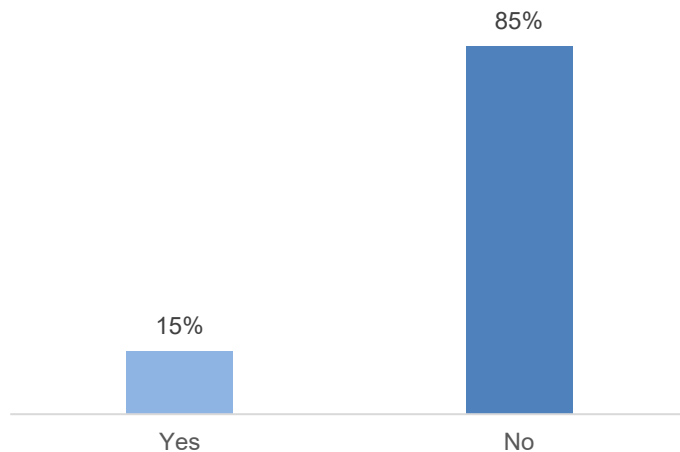
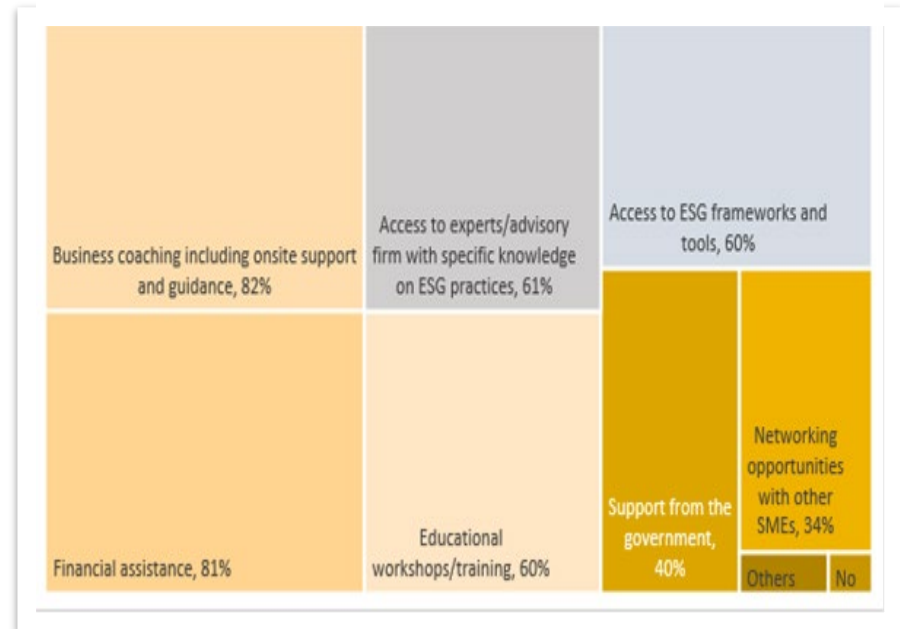


Figure 14: Types of supports needed by SMEs



- **Current support systems** (government, employer associations, CSOs, impact investors) have limited ESG/SME focus; **only 15% of SMEs** know where to find support.
- **Needed support includes:** Onsite coaching, expert access, ESG frameworks, financial aid, awareness campaigns, and support networks.

Discussion

- **ESG is gaining traction** among Cambodia's SMEs, driven by market access, GVC integration, and inclusive business goals.
- **SMEs' understanding is limited, and uneven** based on SME characteristics, yet has improved recently. SMEs' positive attitude towards ESG resulted in increased learning and adoption of ESG policies and initiatives, but the extent of adoption varies.
- **No specific ESG regulations exist**, but current laws cover many related aspects. With the growing importance of ESG, the regulation changes may be necessary.
- **Adoption is in early stages**, varies widely, and often differs from the literature & reporting standards. Practice appears to be happening at the firm level, which provides additional insight to Amalia-Elena's (2020) finding that Cambodia had little to no ESG policies.
- **International ESG frameworks** are largely absent with SMEs' primary focuses are on certifications and standard such as HACCP, ISO, GI, Fair Trade, and GMP

Discussion

- **The pursuit of ESG practices** is a response to both external pressures and a strategic choice of SME owners.
- **Access to finance** in driving ESG adoption somehow remains limited despite a few SMEs mentioning its existence.
- **SMEs face significant ESG adoption challenges** due to limited technical knowledge, financial and human resource constraints, complex frameworks, and the need to balance profitability with compliance—issues more easily managed by larger SMEs with dedicated ESG staff.
- **This study indicates a clear need** to scale up tailed supports for SMEs.

Concluding remarks

- **ESG is increasingly relevant** and potentially growing for SMEs in developing markets like Cambodia, presenting both opportunities and challenges.
- **SMEs need** tailored ESG frameworks, capacity building, harmonized regulations, shared support, and demonstrated business value to reduce resource burden.
- **Explore regulations and simplified national ESG frameworks** for SMEs (e.g., Malaysia's model), though more research is needed.
- **A multi-stakeholder approach** involving SMEs, government, investors, financial sectors, civil society organizations, and international partners including development financial institutions is crucial.

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