What Are the Specific Challenges for SMES in Complying With ESG Reporting?

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As a part of a wider research, we proved that Hungarian SMEs (small and medium enterprises) are not just intrinsically motivated to be sustainable and report their sustainable activities and indices but are also compelled to do so by legislation. However, they face limitations such as a lack of resources and knowledge about sustainability. Partly, sustainability should be observed and reported as a part of accounting and corporate reporting. However, sustainability reporting mainly means a form of non-financial reporting that enables companies to communicate their progress in sustainability parameters. Sustainability reporting has only a few compulsory templates and both the EU and national ESG[1] regulations are constantly changing, which results in a considerable need for support from entrepreneurs. The first section of this paper provides an extended overview of the various non-financial reporting in historical order. While bigger companies have dedicated departments or employees who are responsible for ESG, the SMEs are looking for help, and require further support, information, training, and advice from outside. This research aims to study experts' interviews and explore how the experts in regulation, education and consultancy are thinking about the opportunities and challenges for SMEs regarding ESG reporting.

[1] ESG stands for environmental, social, and governance factors that companies measure when analyzing a company's sustainability efforts from a holistic view.

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1 Introduction

The roots of the international environmental movement go back to the second half of the 20th century when the first environmental movements began in Europe and North America. The term 'sustainability' or 'sustainable development' (SD) appeared in the international literature in the early 1980s (Brown, 1981, UN, 1987). Sustainable development is based on three interlocking dimensions: economic, social and environmental, and all three are interconnected, with their interactions and hierarchy - the environmental dimension is the basis, and only within it can the social dimension be understood, followed by the economic dimension as a subsystem of the system. By the beginning of the 2020s, the concept of sustainability had been mostly approached and translated into corporate practice by the term Environmental-Social-Governance, abbreviated ESG (UN, 2004, Hardyment, 2024).

Small and medium-sized enterprises (SMEs) are the cornerstone of many developing countries' economies - contributing significantly to economic growth, employment and innovation, and of course sustainability. According to Generali and SDA Bocconi's report (2023), 44% of their SME sample have adopted a more formalized approach to sustainability or are in the process of adopting one. Contrary, 37% of SMEs showed no interest in any ESG strategy. This can be explained through the fact they have limited access to tools to measure and monitor their sustainability. Additionally, the lack of institutional support and public incentives are severe barriers. Another serious obstacle is the lack of standardized methodology tailored to SMEs. As our previous research shows SMEs have limited human and financial resources to produce or provide non-financial reports, and lack the necessary expertise, which situation is even worse if they have to comply with more guidelines' expectations (Kolnhofer-Derecskei et al., 2024).

This paper provides an extended summary of the non-financial reporting format of sustainability interpreted in the ESG concept. In the empirical part, 6 experts were interviewed and asked about the opportunities and challenges for SMEs regarding legal obligations and non-financial reporting. Finally, practical implications are given to policymakers and ESG-focused institutions.

2 Theoretical Background / Literature review

2.1 Non-financial reporting – a historical overview

The history of CSR - Corporate Social Responsibility - has been closely linked to sustainability in the years of development of SD theory and practice. The concept of CSR has been widely recognised and used since the 1970s, first in the US and later as the need for accountability and transparency in business increased worldwide. As a result, from the 1990s onwards, more and more companies started to report on the impact of their activities on their stakeholders. The topics initially covered mainly by environmental and/or occupational health and safety reporting became more complex, and this was reflected in the naming of non-financial reports (Győri and Csillag, 2019). By the early 2020s, the most common names for reporting in line with ESG principles were non-financial reporting and sustainability reporting (Lippai-Makra and Kovács, 2023), which we use as synonyms in this paper.

There are four main theories in the literature about the factors that motivate companies to produce non-financial reports (Lippai-Makra and Rádóczi, 2021, Nada and Győri, 2023). The principal-agent theory suggests that this is how companies seek to reduce information asymmetry and its costs (Girella et al., 2019). According to the signalling theory, company insiders and managers provide data and information through various means, including non-financial reports, in order to show their excellence, and goodwill and avoid disputes (Mitchell, 2006). According to stakeholder theory, stakeholder engagement is key to the long-term success of the company and is, therefore, a business interest, but also a moral obligation, arising from the fact that stakeholders are involved in the creation of corporate value and are affected by the company's operations, and thus have a legitimate expectation of transparency (Grüning, 2011, Lippai-Makra and Kovács, 2021). Legitimacy theory emphasises the aspect that the company achieves legitimacy within the society in which it operates through the communication of information (Beck et al., 2017).

Corporate reporting is defined by Gibbins et al. (1990) to include the intentional disclosure of both financial and non-financial information. This disclosure may be mandatory or voluntary and may be made by formal or informal methods. Various forms of corporate communication may be used, such as analyst presentations, investor materials, interim reports, prospectuses, press releases and corporate websites, but the most complete information of all is contained in corporate reports, which may contain both financial and non-financial information. A whole range of existing academic research attests to the benefits that companies can experience from active interaction with stakeholders (Abeysekera, 2013, Shehata, 2014, Demartini and Trucco, 2017).

According to Buallay et al. (2020), the disclosure of non-financial information has gone through four main stages. Initially, companies focused on their social responsibility, but later, particularly in the wake of major pollution scandals, stakeholders started to pay more attention to the impact of companies on the environment, and this was the first topic to be reported. Subsequently, the concept of sustainability emerged, which as explained above, encompasses aspects of social, environmental and economic transparency and accountability, but usually in the form of separate financial and non-financial reporting. Finally, the concept of integrated disclosure emerged in the final phase, which means the disclosure of financial and non-financial information in a single report.

2.2 Regulation and practice of non-financial reporting

Whether or not non-financial reporting in general can contribute to transforming the economic rationale towards more sustainable management is still the subject of further research (Christensen et al., 2021, Gillian et al., 2021, Bini et al., 2023), however, corporate and auditing practice is increasingly adopting and incorporating a sustainability (Perrini, 2006) and more recently ESG (Hardyment, 2024) approach. A multi-directional and detailed analysis of current sustainability reporting practices is carried out annually by KPMG. In their survey published in autumn 2022 (KPMG, 2022), KPMG examined the sustainability reporting and websites of the G250 - i.e. the 250 largest companies in the world by revenue based on the 2021 Fortune 500 ranking - and the N100 companies in 58 countries - i.e. the 100 largest companies by revenue based on territorial and jurisdictional approaches in 58 countries, a total of 5,800 companies.

The survey found that 96% of companies in the G250 group report on sustainability issues, compared to 79% of N100 companies. This is an improvement from 18% and 12% respectively in 1993. In Asia and the Pacific, 89% of N100 companies report on sustainability. This is followed by Europe with 82%, the Americas with

74% and the Middle East and Africa with 56%. Within Europe, there is a disparity, with the Western European N100 reporting at 85% compared to 72% for Eastern European companies.

The above should be reassured, as the world's largest companies are concerned about sustainability and publish information about it. However, we also need to look at the extent to which companies are following the same practices and standards for sustainability reporting. As of Autumn 2024, the most well-known and dominant sustainability reporting standards that cover ESG aspects are:

Table 1: Best-known sustainability reporting standards and guidelines

CDP	Carbon Disclosure Project
CDSB	Climate Disclosure Standard Board Standards
ESRS	European Sustainability Reporting Standards
GGP	Greenhouse Gas Protocol
GRI	Global Reporting Initiative
IIRC IR	International Integrated Reporting Council Integrate Report
SASB	Sustainability Accounting Standards Board Standards
SDG	UN Sustainable Development Goals
TCFD	Taskforce on Climate-related Financial Disclosures
TNFD	Taskforce on Nature-related Financial Disclosures
WEF SCM	World Economic Forum Stakeholder Capitalism Metrics

Source: own elaboration

As shown in Table 1, there are many different reporting regulations and guidelines for sustainability reporting, which on the one hand make it difficult for companies to interpret and apply, and on the other hand limit comparability for stakeholders. Many large companies apply the standards and recommendations of several organisations, putting SMEs in their supply chains in an almost impossible situation.

3 Methodology

In 2025, January and February six expert interviews were carried out by two of the authors. The structured interview guide contained several questions regarding sustainability, ESG and non-financial reporting related to Hungarian SMEs. Table 2. provides an overview of our sample:

Table 2: Sample

Interviewee 1. Male	ESG expert and Head of ESG Related Activities by Supervisory Authority for Regulatory Affairs of Hungary
Interviewee 2. Male	Lawyer specified in professional ESG reporting
Interviewee 3. Male	Associate Professor and Senior Research Fellow in Sustainability
Interviewee 4. Male	Assistant Professor and Sustainability Office Leader
Interviewee 5. Male	Head of Sustainable Financial Analysis by Hungarian National Bank
Interviewee 6. Female	ESG expert and PhD student in sustainability studies

Source: own elaboration

The interviews were conducted by two researchers and clarified transcripts were confirmed by all interviewees. The transcripts are analyzed in a deductive way based on the before detailed grounded theories (Mitev, 2021). Meanwhile (in March), we have extended the sample of the experts and altogether 9 interviews were conducted and under evaluation. In this paper, only those five are partly evaluated that were available in February. The original guide included 5 main topics and topics were tailored to each expert's field. In this paper, one part was examined where ESG experts were asked "What are the specific challenges for SMEs in complying with the ESG reporting regulation? What do they think, how prepared the Hungarian SMEs are to meet the compliances?".

4 Results

All answerers agreed that SMEs are aware of non-financial reporting in ESG.

Most of them have to comply as suppliers for bigger companies. As one interviewee said, "supplier in the supply chain of the largest companies, they are already encountering daily how they receive the various questionnaires from the large company, which they have to fill in since the large company must also screen its suppliers for the ESG report for various reports, so on the one hand, even Hungarian SMEs are already encountering plenty of them." (interviewee 2.) Additionally, experts said that "The SME sector is working under a lot of pressure, the economy is inherently in favour of the big guys, and as an SME in Hungary it is very difficult to see any real success SME stories." (interviewee 3.) Meanwhile, as interviewee 4. highlighted government can also put extra pressure on SMEs and "the legal obligation (for SMEs) will also emerge sooner or later."

Industries and fields where an SME operates show differences, while suppliers e.g. agriculture can have more support from the vendors or distributors, but an SME which is the end service provider, will have to prepare these reports at its own pace.

In smaller companies where there is no capacity to do this, it is a serious extra workload on top of the day-to-day work. Although as interviewee 5. mentioned, "Obviously a large company has more resources to build this kind of system, but in return, a micro company has practically I don't know a quarter as many questions as a large company, and they are much easier to answer."

In sum, SMEs are way aware of non-financial reporting in ESG, many are required to comply as suppliers for larger companies. Legal obligations may emerge that can put additional pressure on SMEs. Since smaller companies have less capacity to prepare ESG and other types of non-financial reports regardless of the type of standards or guidelines.

5 Discussion

According to KPMG's 2022 analysis, GRI is the most dominant standard used worldwide, with 68% of N100 companies and 78% of G250 companies using it, and this spills over to smaller companies in the value chain. However, from 2025, the scope and proportion of the standard will change due to the entry into force of the European Union's ESG legislation, most notably the CSRD (Corporate Sustainability Reporting Directive, 2022/2464/EU, EP & EC, 2022). It is expected that the application of the GRI will be superseded, as the EU regulation has elaborated the European Sustainability Reporting Standards (ESRS, EFRAG 2022a, 2022b, 2024a, 2024b), which will be the mandatory basis for reporting under the CSRD, even if it may be complemented by other existing guidance in practical application.

Under the CSRD, from 2025 companies will have to share significantly more sustainability information, and ESRS indicators with stakeholders than before, and integrate it with financial data. In fact, in 2025 only the largest European companies will have to report on the year 2024, but a year later all large companies, and in 2027 all listed SMEs will have to publish their sustainability reports.

In Hungary, in addition to compliance with the CSRD, the requirements of the ESG Act[1] (Government of Hungary, 2023) also apply to sustainability issues, so companies will need to develop and operate a documented ESG risk management system, with a particular focus on the sustainability impacts of their supply chain. On the one hand, this is an additional burden - especially given the different logic of the ESG Act, for example, there is no materiality analysis but companies have to answer questions from a predefined ESG questionnaire - on the other hand, it contributes to improving the quality not only of ESG reporting but also of non-financial reporting, by setting higher standards for data collection and management through the whole value chain.

6 Conclusions and managerial implications

Due to these excessive regulations and bureaucracy, SMEs perceive these barriers more intensely. Clear regulations and reduction of bureaucracy, support, training, and partnerships with ESG-focused contributors are recommended. Firstly, initiatives and campaigns demonstrating the ESG benefits of sustainability are advocated. Non-financial reporting obligations should lay on clear and proportionate frameworks and templates for SMEs, SMEs can be reached through partnerships and collaboration with relevant stakeholders and the business community. An ESG framework that integrates environmental, social and governance considerations is becoming an increasingly vital factor for businesses in securing access to finance and maintaining their reputation and position in competition. Nevertheless, the question is given whether a small enterprise with limited resources really needs to provide an ESG report.

In Hungary, the Supervisory Authority for Regulatory Affairs of Hungary (SARA) was established to create stable and predictable operational and regulatory conditions for oversight of the corporate sustainability reporting system (ESG). One of our interviewees is representing this authority, as he said "If we are talking about reporting obligations, then I see that it is not the intention to include SMEs in this scope, neither in CS3D, nor in CSRD, nor the ESG Act, because we know that this can be a very strong extra obligation, which in turn can harm competitiveness if a

[1] As the ESG Act is not explicitly about non-financial reporting, but about building and operating an ESG-related risk management system and has a very different logic for measuring ESG performance, that is why we have not included it in the comparative frameworks of non-financial reporting.

company has to allocate too many resources to it. In addition, the ESG process starts from the very beginning, so that by the time they can produce real and high-quality material, it takes a lot of time, which is not necessarily the case if the report is to be brought to the SMEs in the European competitiveness context." (interviewee 1.).

7 Additional information

Meanwhile on 26 February 2025, the European Commission published the Omnibus legislative package, which not only dashes the foundations of EU sustainability regulation, but also proposes to redefine future corporate activities and their reporting obligations. It also has the declared aim of simplifying regulation, increasing the competitiveness of businesses and promoting more sustainable economic activity. It means that the changes to the legislative environment are further complicated by this "stop-the-clock" sustainability reporting recently suggested by the EU (European Commission, 2025). This decision temporarily suspends strict compliance deadlines, granting large companies with fewer than 500 employees and SMEs a two-year relaxation, meaning that SMEs will have to submit their first sustainability report in 2028 instead of 2026. The decision has been taken to reduce the administrative burdens faced by companies within the European Union, particularly in the context of the turbulent changes being experienced in the global economic environment. The Hungarian ESG law (Kavosz, 2025) underwent a rapid revision in the wake of the EU amendment, with the legal requirement for SMEs to disclose ESG information only becoming effective in 2028. This regulatory change will reduce the administrative burden in the short term but raises new questions. There is a question - highlighted by both the EU and the Hungarian government - that although ESG reporting is not mandatory for a few years, companies should use this delay to build up their data collection methods and systems.

Many companies that have been preparing for compliance for some time may decide to prepare voluntary ESG reports. This way, when they are required to do so, they will not feel that compliance is an overwhelming administrative burden. In addition, even if there is no legal obligation, institutional investors and banks alike prefer companies that have ESG reporting and sustainability reporting.

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