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ESG

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IT'S NOW OR NEVER

MSMEs CAN NO LONGER IGNORE ESG

The role of micro, small and medium-sized enterprises in the larger ESG mission is often neglected. But we have reached an inflection point where these companies will need to adopt ESG practices or lose out on business opportunities. **PG8**

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IT'S NOW OR NEVER: MSMEs CAN NO LONGER IGNORE ESG

BY VANESSA GOMES

A common perception is that multinational (MNCs) or public-listed companies are the only ones that need to integrate environmental, social and governance (ESG) practices into their operations. The call for micro, small and medium-sized enterprises (MSMEs) to embark on a sustainability journey tends to be ignored. However, the time has come when MSMEs can no longer ignore ESG.

According to the Malaysia Statistical Business Register (MSBR) published by the Department of Statistics Malaysia (DOSM), there were 1,226,494 MSMEs in 2021, which accounts for 97.4% of total establishments in the country.

The DOSM also stated that in 2020, SMEs contributed 38.2% to the country's gross domestic product (GDP) and employed 48% of the total workforce. Meanwhile, SME exports in 2020 stood at RM117.8 billion. Undeniably, SMEs are a significant contributor to the country's economy and can have an immense sustainability impact once they adopt ESG practices.

On top of that, Western countries have started demanding ESG compliance by companies that want to carry out business in their jurisdictions. This means that if MSMEs do not adapt now, they can potentially lose out on business opportunities in the near future.

Phang Oy Cheng, head of sustainability advisory services, KPMG Malaysia, tells *ESG* that the pandemic put corporations' and government's ESG risk management under close scrutiny.

Today, she says, more businesses have begun to recognise that ESG is no longer a choice.

"An example is the scrutiny of corporate behaviour in relation to management of their migrant labour workforce, leading

to significant economic and reputational damage among our corporations," she says.

Nevertheless, Phang says there are still misconceptions among MSME business owners. Firstly, the majority of business owners might not consider ESG as a business imperative and view these requirements as being onerous and costly.

"Other challenges arise from the lack of information, guidance and capabilities within the MSME community, as well as (the lack of) necessary subject matter experts to advise them accordingly. This has been recognised by SME Corp, which has worked with the United Nations Global Compact to develop the MAJU (Mission, Activity, Justify, Upgrade) framework aimed at enabling SMEs to adopt ESG," says Phang.

The MAJU framework is an easy step-by-step guide to help MSMEs approach sustainability in ways that are more accessible to them.

Chin Chee Seong, national secretary-general of the SME Association of Malaysia, says most MSMEs do not have a

comprehensive understanding of ESG. On top of that, their focus now is to make ends meet and revive their business as the world transitions to endemicity.

"In fact, a lot of them don't know where to start. We are trying to encourage them to head in this direction because there are several advantages to practising ESG," says Chin.

Margie Ong, CEO of Thoughts In Gear (TIG), a sustainability and social impact consulting firm, agrees with Chin. She adds that while MSMEs are very agile, they are still focused on profitability at the moment and are in survival mode. The implementation of ESG practices tends not to be prioritised and thus, misconstrued as ignorance.

"As far as we've seen, there's nothing (related to ESG) yet that has affected the business continuity of MSMEs, as compared to larger companies that have seen their business affected if they don't practise ESG," says Ong.

There are two ways companies can get on the ESG journey, says Ong. The first is in a defensive manner, where companies look at what they need

to do in order to be unaffected by market requirements and comply with the latest standards. The second is taking a proactive approach. Ong says this group typically consists of companies with foresight and see ESG practices as an opportunity instead of a threat.

"It's the MSMEs that have a little bit of foresight and want to future-proof themselves that have come on board because sustainability and ESG are not going away anytime soon."

Regardless, Ong says it is still a step in the right direction. "I always tell my team that it doesn't matter how they come to the table to discuss ESG and sustainability. The point is, they're coming to the table and we'll get them to see how ESG can actually work for their company."

ADAPT OR LOSE OUT

While MSMEs face many challenges over ESG, the biggest is the loss of potential business opportunities, says Ong. According to Standard Chartered Bank's 2021 Carbon Dated report, 78% of MNCs will consider switching suppliers if they do not meet their ESG goals.

MNCs are under immense pressure to report their ESG data, such as their carbon footprint. For this process, they have to include their suppliers' data, says Ong. If companies in the supply chain are not

ESG compliant, it will increase the MNC's carbon footprint.

"There are MNCs that are taking a gentler approach and are working with suppliers through supplier development programmes to help suppliers reduce their carbon footprint. But if that doesn't work, they'll just outright switch their suppliers," she says.

Victor Lee Meng Teck, CEO of group commercial banking at CIMB Group, is on the same page. MSMEs have to consider the risk of not adopting ESG practices, particularly from a financial standpoint. He adds that MSMEs are feeling the pressure to improve their ESG performance to remain attractive to business partners, such as MNCs and corporates, in the long run. This is especially the case for MSMEs that are looking to export their products and services and compete globally.

The European Union is in the process of formalising a Carbon Border Adjustment Mechanism (CBAM), also known as a carbon border tax. Under the proposed CBAM, EU member countries will impose a fee on imports from businesses in countries that do not comply with the EU's carbon pricing policies.

"When the CBAM is implemented in January 2023,

Malaysian MSMEs that export to the EU will be disproportionately affected, as EU importers may have to pay an extra border fee on the imports, thus eliminating (the advantage of) the lower cost of operating in Malaysia. As this may impact the attractiveness of exporters from countries such as Malaysia, it is critical for MSMEs to reduce their carbon emissions intensity through ESG adoption," Lee says.

"In order to remain competitive and not lose out on opportunities, MSMEs can no longer take a business-as-usual approach. It is imperative for them to invest in their business now to implement ESG practices and maintain the long-term viability of their business."

CLARITY AND AWARENESS NEEDED

For MSMEs, the link between health, safety and environment (HSE) regulations and ESG requirements is not clear, as they are still compartmentalising ESG and HSE compliance issues, say the interviewees.

For example, Phang points out that waste regulations, which apply to hazardous and non-hazardous



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waste, focus primarily on the proper management of waste within the MSME's compound and its disposal requirements. However, waste generation and disposal also have implications on greenhouse gas emissions.

"The connection between these requirements and how they interact has yet to be clearly drawn up for MSMEs," she explains.

Many MSMEs conduct energy efficiency programmes, says Phang. It is primarily a cost reduction exercise, but on the upside, energy use is also tied to an organisation's carbon footprint.

"If the organisation embarks on energy efficiency programmes without first quantifying its carbon footprint, the demonstration of carbon management or mitigation activities is then lost," she explains.

Meanwhile, from a social perspective, Phang says many MSMEs employ foreign labour. However, the lack of regulations or awareness of prevailing international requirements means that many of them are unable to apply best practices relating to foreign labour management.

"This leads to risks along the supply chain for their customers, which might result in sanctions applied to their clients or products," she says.

"While some of these international requirements may not pertain to the Malaysian legal system, the risk to product sales and reputation is high if these requirements are not acknowledged or acted on," she adds.

Ong also points out that more often than not, MSMEs do not realise they are practising some form of sustainable activity, such as saving energy or reusing water. What needs to happen now, she stresses, is for them to realise that they are already being sustainable and take the extra effort to understand ESG a little deeper.

"There are low barriers to entry for sustainability initiatives, such as energy efficiency, water efficiency and resource efficiency, all of which have a positive impact on the environment, society and the bottom line."

Nevertheless, some ESG efforts will require capital investment. Ong says companies that want to comply with the Task Force on Climate-Related Financial Disclosures (TCFD) and Global Reporting Initiatives (GRI) may incur some costs associated with ESG



reporting and assurance. But efforts such as installing solar panels and introducing new business offerings that cater to ESG have clear returns on investment.

WHAT MORE SHOULD BE DONE?

KPMG's Phang says if MSMEs can see the benefits of adopting ESG, it would be more attractive to them. "When the adoption of ISO14001 started in Malaysia, the government was able to provide grants for implementation. Unfortunately, this is not always the case," she adds.

"At the moment, it is left to market forces to encourage SMEs to demonstrate appropriate ESG management. It would be good if incentives in the form of grants or tax deductions can be provided for MSMEs."

CIMB's Lee says MSMEs should measure their carbon footprint so they have a starting point to measure their ESG impact. This will allow them to begin identifying opportunities and areas for improvement.

"They can also expand their knowledge in the field by signing up for ESG awareness programmes offered by accredited and credible bodies, such as Climate Governance Malaysia and other institutions."

Capital Markets Malaysia, with the Ministry of Environment and Water, launched a series of capacity building initiatives earlier this year that are targeted at MSMEs. Banks have come on board with MSME support programmes too, says Ong. However, more needs to be done. Given that the bulk of businesses are MSMEs, there needs to be a different approach than what has been offered to bigger companies.

"Banks and regulators can help in the form of incentives, financial support and grants, which can go a long way for an MSME," Ong says.

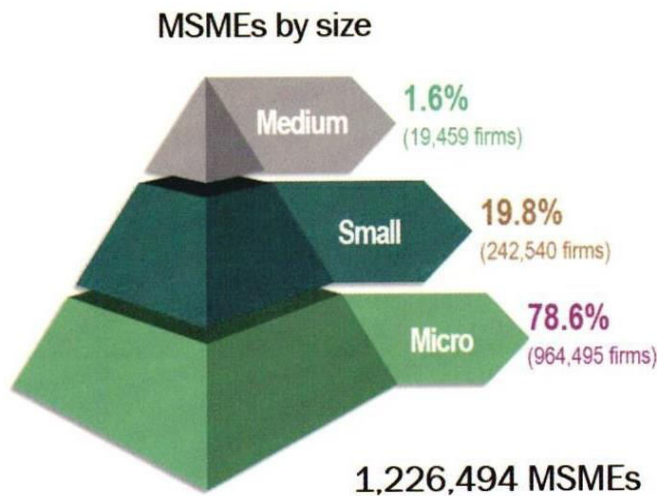
"(It would be great) If we have financing packages that could actually support MSMEs on the adoption journey instead of judging them on ESG performance. This means banks need to find concrete examples of how MSMEs can go on this journey (and) potentially have a very well-documented ROI."

SME Association's Chin believes the government should step in and enforce the adoption of ESG practices among MSMEs, as there are currently no strict requirements for them to do so.

In order to remain competitive and not lose out on opportunities, MSMEs can no longer take a business-as-usual approach. It is imperative for them to invest in their business now to implement ESG practices and maintain the long-term viability of their business.

Lee

MSMEs ARE THE BACKBONE OF THE MALAYSIAN ECONOMY, REPRESENTING 97.4% OF OVERALL BUSINESS ESTABLISHMENTS IN 2021



Source: Malaysia Statistical Business Register, Department of Statistics, Malaysia
Note: Data as of 28 February 2022

MSMEs by Sector:



BANKS ARE SPURRING ESG ADOPTION AMONG MSMEs

Banks have been engaging with MSMEs and prompting them to start on their ESG journey, but this comes with a set of challenges. Aaron Sum, group chief strategy, marketing and business development officer at Alliance Bank Malaysia Bhd (ABMB), says that an increasing number of MSMEs want to adopt ESG practices but do not know where to start.

At the same time, some companies may have already begun practising ESG but are unsure if they are on the right track. Given the breadth of ESG, Sum says many business owners are seeking a practical framework for embedding sustainability into their business road map.

Lack of funding to kick-start their sustainability journey is a major hurdle. To address this, Sum says ABMB offers financing to MSMEs to lower the barriers to entry.

"For example, we provide solar panel financing at affordable rates to SMEs that want to install solar panels at their business premises, as we are one of the participants in Bank Negara Malaysia's Low Carbon Transition Facility (LCTF)," he says.

"We also understand that MSMEs face unique challenges like limited access to operational resources and talent recruitment. To address this, our BizSmart Solution portal enables business owners to access sustainable solutions. MSMEs will have access to over 300 companies that provide ESG solutions."

Victor Lee Meng Teck, CEO of group commercial banking at CIMB Group, says that the bank has a sustainability programme called CIMB GreenBizReady that provides MSMEs with the knowledge, tools and support needed to incorporate ESG practices into their businesses.

One example of CIMB's green financing facilities for MSMEs is CIMB Renewable Energy Financing, a solution for the purchase and installation of solar photovoltaic systems with zero collateral and no upfront cost. Lee says this facility provides MSMEs with the option



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Sum

of a zero per cent-interest easy payment plan for 36 months. MSMEs can obtain a discount of up to 5% with selected solar service providers.

CIMB has also committed RM100 million in financing through the LCTF. Lee explains that the facility enables businesses to access capital expenditure or working capital financing to facilitate the adoption of sustainable and low-carbon solutions.

This includes the installation of solar power systems, adoption of recycled or biodegradable materials, improving process efficiency to reduce waste or obtaining sustainability certifications.

"Through CIMB's LCTF, businesses will benefit from collateral-free financing of up to RM10 million with an affordable repayment period of up to 10 years, at a low interest rate of up to 5% per annum. This will support their efforts to transform their businesses towards low-carbon and sustainable operations, increase resource efficiency and reduce (their) environmental impact."