# An introductory guide to ESG for SMEs

Many of us will have heard of the acronym ESG, but what does it really mean in practice? In this guide, we'll talk about what ESG is, its origins, why it's important for SMEs and some ideas on what to measure.

We know that for a lot of SMEs (small and medium sized businesses), 'ESG' sounds daunting. We're here to reassure you that at the core of ESG is helping businesses do the right thing as well as manage risks and opportunities that could impact a business's ability to operate successfully. You're probably already doing ESG related work, so this resource might help you measure some of that great work.

# What is ESG?

ESG stands for Environmental, Social and Governance. It's a collective term that helps organisations to understand their sustainability and social impact, and how they're accountable to their stakeholders. When looking at ESG, businesses will often consider the internal and external conditions most relevant for their sector, geography and stakeholders.

# Origins

ESG grew from the financial world. In the 1960s, investors started becoming more cautious about which companies they invested in and began making their choices on more than just financial reasons. This movement was called ‘socially responsible investment’ and was the reason why some industries were not as heavily invested in such as tobacco and guns, and why some investors refused to invest in companies linked to the South African apartheid regime. Decisions were being made not just on whether there was a profit or not, but whether it was socially responsible to do so.

In 2005, the UN Secretary-General Kofi Annan worked with the world’s largest institutional investors to develop the ‘Principles for Responsible Investment’ (PRI). These principles argued that ESG factors were an important part of any financial analysis and decision.

Although the origins of ESG are from the financial industry, it’s become increasingly important for all sectors. No matter what industry you’re in, having a proactive approach to ESG could help your business to succeed and grow.

# What does ESG mean in practice?

ESG is a way of assessing what you're doing and showing your consumers, investors and wider society that your business is working in a sustainable and ethical way.

ESG separates the environmental, social and governance factors into three areas – but remember that they're really all connected. Doing something good for the environment can cause positive, and sometimes negative, impacts to society. So it's helpful to think about ESG topics holistically.

At Heart of the City, we encourage our SMEs to become responsible businesses by embedding activities which support people, environment and community into the way they operate. It's most effective when responsible business becomes a core part of your business as you grow. So, by having a strong ESG focus, a business that is sustainable for people and planet, you can help future proof your business.

On the next pages, we've explained a bit more as to what the environmental, social and governance words really mean – as well as given some examples of what influences them and how you can demonstrate them.

| ENVIRONMENTAL |
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| **What is it?** |
| How your business' products, services, supply chain and operations all impact the planet, and how the planet and its resources can impact your business.<br>How a company guards and conserves nature and how it minimises its negative impact on the environment. |
| **Examples of environmental factors you could assess as an organisation** |
| • Your impact on climate change and the impacts of a changing climate on your ability to operate and maintain a supply chain<br>• How much waste and pollution you create<br>• Your impact on water pollution, water use and air pollution<br>• Your impact on deforestation and biodiversity<br>• How you manage and conserve your land<br>• How you treat animals<br>• Your contribution to greenhouse gas emissions<br>• Current or emerging regulation which could impact your products/services or your operations (e.g. energy efficiency requirements within your office) |
| **Examples of environmental business practices** |
| • Reducing your energy consumption and using renewable energy sources<br>• Developing greener products and services<br>• Reducing waste, for example reducing food waste, using recyclable packaging and not using single-use plastics<br>• No animal testing, no mistreatment of animals<br>• Calculating your carbon emissions, reducing your carbon footprint and aiming for net zero emissions<br>• Considering how 'nature' will be impacted in all business decisions<br>• Financially investing in green initiatives |

| SOCIAL |
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| **What is it?** |
| How your company impacts wider society and how you look after your people. Equity and fairness are at the heart of the 'social' element. |
| **Examples of social factors you could assess as an organisation** |
| • How diverse and inclusive you are<br>• Working conditions within your supply chain and ensuring no slavery and child labour<br>• Whether you're operating in regions of conflict<br>• Whether you support and engage with local communities, particularly indigenous communities<br>• Levels of customer success and satisfaction |
| **Examples of social business practices** |
| • Ensuring the safety and wellbeing of all your employees, both physically and mentally<br>• Promoting equity in your business by having diversity and inclusion policies and improvement plans<br>• Committing to prevent modern slavery in your supply chain<br>• Paying a fair/living wage and working with partners who do the same<br>• Supporting local communities through financial giving or volunteering to promote a better society |

| GOVERNANCE |
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| **What is it?** |
| How decisions are made in your organisation.<br>How you report and how transparent you are. Who are your leaders and what skills and experience do they bring? |
| **Examples of governance factors you could assess as an organisation** |
| • The diversity and structure of your board and leadership<br>• How you manage risk and report it internally and externally<br>• Transparency and reporting requirements<br>• Pay breakdowns<br>• Tax strategy<br>• Management of customer, or employee, personal data |
| **Examples of governance business practices** |
| • Accurate, timely reporting to stakeholders<br>• Anti-corruption and bribery policies<br>• Diversity in the leadership team as well as governing boards<br>• Publishing gender and ethnicity pay gaps<br>• Regular audits<br>• Ensuring your data is secure and handled responsibly |

# Reporting and disclosures

Do you have to do it? If you work in the financial services industry, then yes, you do. But if you're a non-financial service UK business and you have less than 500 employees, or have less than £500m annual turnover, then there are no reporting requirements currently. [UK's Companies Act, correct as of March 2023]. However, as governments, customers and wider society continue to place importance on good ESG practices, it is very possible that reporting requirements will expand to include SMEs in the future. And, if you are in the supply or value chain of a larger company, they are increasingly likely to ask you about your ESG practices, as part of their own ESG reporting requirements and general corporate reputation management.

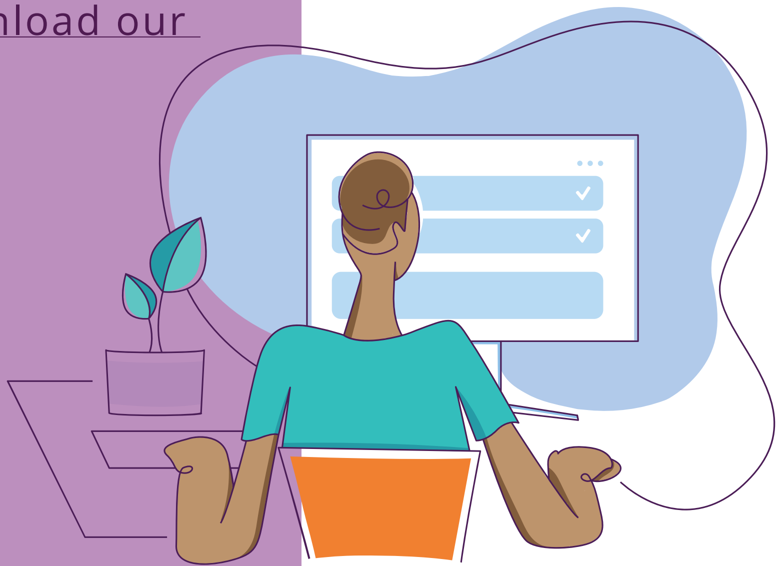
In the UK, over 1,300 of the largest companies and financial institutions are now required to complete mandatory reporting against the Task Force for Climate Related Financial Disclosures.

Even though you may not have to, many companies are voluntarily reporting or disclosing. That's because more and more people are taking ESG factors into account when investing or working with a company.

# Environmental reporting

Disclosing on the 'E' of ESG is more common than the Social or Governance elements, as it's often quantitative data rather than qualitative. Our climate action toolkit explains the regulatory landscape for SMEs.

Some of the businesses you work with may be using reporting platforms such as ecovadis or CDP (Carbon disclosure projects). They're tools that help you report your data, and by making the data transparent, your supply chain and clients can incorporate your business data into their reporting where necessary. There are many tools out there, but it does mean that if you're a supplier to lots of different businesses then you may have to submit your data across multiple tools. To find out more about the regulatory and reporting landscape, as well as commonly used reporting tools, download our climate action toolkit.



# A few final thoughts

If you're feeling daunted after reading this resource, please don't! You're probably doing a lot of this work already, so see it as an opportunity to talk about and report on areas that you want to shout about.

Think about whether there are any material areas of your organisation that you want to talk about in a way that many in the ESG space would understand. If you're an SME, it's likely that you don't have to formally report, so you're not limited by set reporting requirements.

Outside of the financial sector, ESG is often used interchangeably with 'sustainability', 'corporate social responsibility', 'responsible business', 'social value' and 'social and environmental impact'. They're different terms to essentially describe the same thing – how your business is impacting its people, community and environment, and how these could impact your business.

So, it's best to see ESG as an opportunity to better measure and demonstrate your work and progress, as well as help build your business as being fit for the future We're here to talk more if you want!

# Other useful resources

British Business Bank - how to measure ESG

Plan A policy centre

PwC climate change and TCFD reporting guide

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