

ANALYSING STRATEGIES FOR OVERCOMING CHALLENGES IN ESG PRACTICES: A COMPARATIVE CONCEPTUAL PAPER ON MALAYSIA AND INDONESIA

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Abstract: *This study critically examines sustainability awareness among Small and Medium Enterprises (SMEs) in Malaysia and Indonesia. With a primary focus on discerning influential factors and challenges, the research addresses the exclusion of SMEs from mandatory Environmental, Social, and Governance (ESG) compliance, prevalent in Malaysia's and Indonesia current regulatory landscape. As ESG becomes integral for financial assessments and global trade, the oversight raises fairness concerns. SMEs, vital contributors to both nations' GDPs, face potential challenges. Employing a mixed-methods approach, the study utilizes a detailed questionnaire and Focus Group Discussion (FGD) validation, aiming for a comprehensive model. Anticipated outcomes include identifying critical issues and presenting a holistic model to guide sustainable SME development. This model, valuable for policymakers, fills the gap in SME ESG implementation, ensuring equitable inclusion for economic resilience in Malaysia and Indonesia.*

Keywords: *Sustainability, Environmental, Social, and Governance (ESG), SME, Challenge*

Introduction

The Sustainable Development Goals (SDGs), a universal agenda established by the United Nations in 2015, provide a crucial framework for promoting global sustainability. In Malaysia, the emphasis on environmental, social, and governance (ESG) issues is an integral part of the sustainability agenda. Initiatives like Bursa Malaysia's Strategic Roadmap 2021–2023 demonstrate a commitment to sustainability by mandating publicly listed companies to report their sustainability activities in annual reports (Hassan et al., 2023; Wahab et al., 2022). Despite these commendable efforts, there is a concerning lack of awareness regarding the sustainability agenda among Small and Medium Enterprises (SMEs) in Malaysia.

Datuk Seri Mustapa Mohamed, a former Minister in the Prime Minister's Department, highlighted a staggering statistic – approximately 1.2 million SMEs in Malaysia remain unaware of the national sustainability agenda (Bernama, 2022). This lack of awareness is often compounded by a perception among SMEs that sustainability practices are financially burdensome. Tan Sri Abdul Wahid Omar, Non-Executive Chairman of Bursa Malaysia, underscored the hindrance faced by SMEs due to inadequate ESG enforcement, restricting their participation in the global supply chain for sustainable products and, consequently, impeding their growth prospects (Hassan et al., 2023). Moreover, governance concerns, such as the mismanagement of foreign workers and non-compliance with employment standards, further exacerbate the challenges faced by SMEs in Malaysia. Employment discrimination issues, as highlighted by Lee & Choong (2019), add another layer of complexity, encompassing aspects like job quality, employment opportunities, and wages.

In Indonesia, a parallel narrative unfolds as SMEs grapple with ESG-related challenges. While the adoption and awareness of SDGs are deemed crucial, many Indonesian SMEs lack a comprehensive understanding and engagement with these global sustainability goals (Narotama et al., 2023). Governance issues in Indonesia mirror those in Malaysia, impacting the country's overall image. Problems like poor labor management, non-compliance with housing standards, and employment discrimination contribute to the complexity of the ESG landscape for Indonesian SMEs. Bridging the awareness gap and addressing governance concerns are pivotal steps that must be taken to facilitate the active participation of SMEs in the sustainable development trajectory. These measures are essential for fostering resilience and growth in both Malaysia and Indonesia, aligning their SMEs with global sustainability imperatives.

Research Objective:

- i. To assess and analyze the internal factors influencing the successful implementation of (ESG) practices among (SMEs) in Malaysia and Indonesia, with a specific focus on organizational culture, leadership support, and awareness.
- ii. To examine the impact of external factors, including market pressure and regulatory requirements, on the adoption of ESG practices among SMEs in the Malaysian and Indonesia.
- iii. To compare the determinant of ESG practice among SMEs in Malaysia and Indonesia.
- iv. To propose sustainability framework in enhancing sustainability practice among SMEs in Malaysia and Indonesia

Significance of the Study

This study addresses the critical gap in awareness of sustainability practices among Small and Medium Enterprises (SMEs) in Malaysia and Indonesia. By understanding the challenges faced by SMEs in adopting Environmental, Social, and Governance (ESG) practices, the research contributes to creating a more informed business landscape. The study aligns with the global agenda of Sustainable Development Goals (SDGs) by investigating the impediments faced by SMEs in incorporating sustainable practices. Identifying these challenges is pivotal for aligning SME practices with the broader sustainable development objectives. Findings from this research can inform policymakers and regulatory bodies in Malaysia and Indonesia. By highlighting the hurdles faced by SMEs in adhering to ESG practices, the study contributes to the formulation of more effective and inclusive policies that promote sustainability.

SMEs play a crucial role in the economic development of both Malaysia and Indonesia. This study aims to empower SMEs by providing insights into sustainable business practices, potentially enhancing their contributions to national GDPs and fostering economic resilience. The comprehensive model developed through this study offers a roadmap for SMEs to navigate the complexities of ESG implementation. Industry stakeholders, including practitioners, finance institutions, and academicians, can use these insights to guide SMEs in adopting sustainable practices. The significance of this study lies in its potential to drive positive change by addressing the awareness gap, informing policies, supporting SDG implementation, and empowering SMEs in Malaysia and Indonesia to embrace sustainable practices for long-term growth and resilience.

Literature Review

SMEs play a vital role in economic growth and development. Sustainable practices are essential for their growth and success. However, the adoption of sustainable practices by SMEs is more challenging and still limited. Therefore, this literature review explores the previous studies on ESG sustainability among SMEs, focusing on three scopes, namely, awareness, challenges, and factors towards sustainability integration among business entrepreneurs.

Theoretical Discussion

This study is situated within the theoretical framework of sustainability, corporate social responsibility (CSR), and Environmental, Social, and Governance (ESG) principles. The overarching aim is to critically examine sustainability awareness among Small and Medium Enterprises (SMEs) in Malaysia and Indonesia, considering the influential factors and challenges that arise from the exclusion of SMEs from mandatory ESG compliance in the current regulatory landscapes of both countries.

Stakeholder Theory, proposed by R. Edward Freeman, suggests that organizations should consider the interests of all stakeholders, not just shareholders, in decision-making processes. In the context of SMEs in Malaysia and Indonesia, this theory is relevant as it emphasizes the importance of addressing the concerns of various stakeholders, including SMEs, in the implementation of Environmental, Social, and Governance (ESG) practices (Freeman, 1984). The study will explore how sustainability awareness, as influenced by ESG practices, can align with the interests of SMEs and other stakeholders.

Applying Stakeholder Theory, the study positions SMEs as key stakeholders in the broader ESG framework. By recognizing SMEs as entities with interests and contributions to economic development, the study seeks to highlight the importance of integrating their concerns and perspectives into sustainability initiatives. This aligns with the notion that sustainable business practices should consider the diverse needs and impacts on all stakeholders involved (Freeman, 1984). Based on this discussion the study construct the research framework as follows:

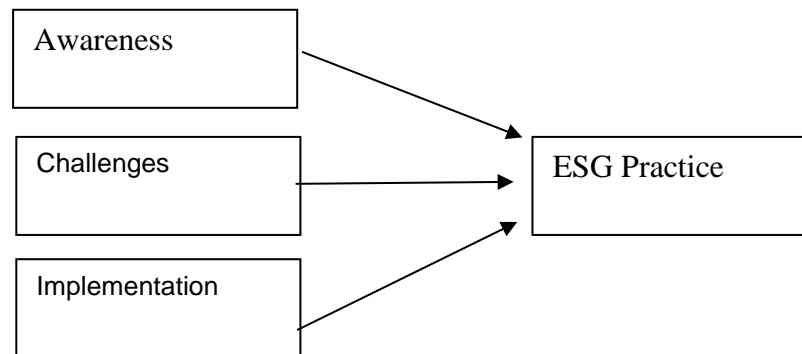


Figure 1: Conceptual Framework

Hypothesis Development

Awareness of sustainability among Small and Medium Enterprises

Recognizing the significance of ESG issues is paramount for small and medium-sized enterprises (SMEs) to embrace sustainable practices. A study by Baharudin (2021) uncovered that, in Malaysia, SMEs exhibited limited awareness of ESG sustainability practices, with a predominant focus on financial performance rather than sustainable considerations. Similarly, Fung et al. (2021) observed a lack of awareness and knowledge among Malaysian SMEs, particularly concerning energy efficiency and waste reduction. The importance of ESG sustainability awareness among SMEs has been emphasized as a key driver for implementing sustainable practices (Prasanna et al., 2019). Numerous studies, including Moorthy et al. (2012) in Malaysia, identified a pervasive low level of awareness among SMEs, attributing it to a shortage of resources and knowledge in sustainable practices. Fadli's study (2022) on Malaysian SMEs echoed these findings, indicating a lack of awareness regarding ESG practices and their potential benefits.

Contrastingly, studies like that of Hahn et al. (2015) on German SMEs reported a higher level of ESG awareness, indicating a good understanding and motivation to implement sustainable practices. Efforts to enhance awareness among SMEs have been implemented through initiatives like government policies, awareness campaigns, and training programs (Sulaiman et al., 2023). The Malaysian government, for instance, has taken steps to promote sustainability, incorporating Sustainable Development Goals (SDGs), introducing financing schemes, and offering incentives for sustainable businesses (Mohammed et al., 2023). In Indonesia, Prasetyo and Suwignyo's research (2019) underscores a rising awareness of sustainability among SMEs, with businesses increasingly recognizing the importance of sustainable practices to address environmental and social concerns. Setiawan et al.'s study (2020) in Indonesia reinforces the shift towards environmental sustainability, indicating that

SMEs are integrating eco-friendly practices into their operations, driven by internal motivations and external pressures.

Despite progress, challenges endure. Limited resources, awareness gaps, and regulatory complexities hinder widespread sustainability adoption among SMEs (Hadiwijaya & Budihardjo, 2021). Overcoming these barriers necessitates targeted interventions and supportive policies, with government initiatives, including tax incentives and capacity-building programs, playing a pivotal role in encouraging SMEs to embrace sustainable practices (Santoso & Hartantyo, 2017).

Hypothesis 1: A lack of resources and knowledge regarding sustainable practices is a contributing factor to a limited awareness of ESG sustainability among SMEs in Malaysia and Indonesia.

Hypothesis 2: The implementation of government initiatives, awareness campaigns, and training programs has a significant positive impact on enhancing the awareness of ESG sustainability among SMEs in Malaysia and Indonesia.

Challenges faced by Small and Medium Enterprises in implementing sustainability.

The adoption of ESG sustainability practices among SMEs is influenced by various factors. A primary challenge encountered by SMEs in incorporating sustainability is the scarcity of financial resources (Alhadhrami & Nobanee, 2019; Hassan & Yahya, 2020; Reddy et al., 2018). Alhadhrami and Nobanee (2019) highlighted that SMEs often grapple with limited budgets and face competition from larger enterprises, hindering their ability to invest in sustainable practices. Moreover, this financial constraint may lead SMEs to perceive sustainability investments as a potential burden rather than an opportunity for business growth.

Another obstacle is the deficiency in expertise and knowledge concerning sustainability issues (Gamage et al., 2020; Løkke & Madsen, 2022). Gamage et al. (2020) pointed out that SMEs may lack the necessary know-how to implement sustainable practices, often due to the absence of dedicated sustainability departments or access to external consultants. Parrish and Tilley (2016) similarly noted that SMEs may have limited awareness of sustainability issues and may not fully grasp the potential benefits associated with sustainable practices.

The absence of stakeholder support presents another hurdle for SMEs in their sustainability endeavors (Bruce-iri, 2022; Jayasundara et al., 2019; Zutshi et al., 2021). De Marchi et al. (2017) indicated that SMEs might encounter resistance from stakeholders, such as employees or customers, who may be reluctant to alter their habits or practices to align with sustainable initiatives. Additionally, Jayasundara et al. (2019) found that SMEs may perceive a lack of demand for sustainable products or services from customers, potentially discouraging them from investing in sustainable practices.

Regulatory barriers further complicate the implementation of sustainability practices for SMEs (Peng et al., 2016; Jayasundara et al., 2019). According to Peng et al. (2018), SMEs may encounter challenges in complying with sustainability regulations, including reporting requirements and environmental standards. Alhadhrami and Nobanee (2019) also noted that SMEs may view sustainability regulations as burdensome and may lack the necessary resources for compliance.

Additionally, studies by Ali et al. (2021) and Mohammad et al. (2022) underscore the significant influence of factors such as corporate social responsibility (CSR), environmental concerns, organizational culture, top management support, employee awareness, and green innovation on ESG implementation among SMEs in Malaysia. Addressing these multifaceted factors is imperative for the successful implementation of ESG sustainability practices by SMEs.

Hypothesis 3: Scarce financial resources pose a significant hindrance to the adoption of sustainability practices among SMEs.

Hypothesis 4: SMEs view sustainability investments as a financial burden rather than recognizing them as opportunities for business growth.

Hypothesis 5: The absence of expertise and knowledge on sustainability issues constitutes a major obstacle for SMEs in the effective implementation of sustainable practices.

Factors of Sustainability implementation among Small and Medium Enterprises

The factors influencing the implementation of ESG practices within SMEs exhibit a diverse and intricate nature. Various studies have pinpointed distinct elements that could impact ESG implementation, encompassing both internal factors such as organizational culture, leadership, and resources, and external factors including market pressure, regulatory requirements, and stakeholder pressure. In the context of Malaysia, Mat Yusoh et al. (2021) discovered that the most pivotal factors affecting ESG adoption among SMEs were internal, notably awareness, leadership support, and organizational culture. External factors like regulatory requirements and market pressure were identified as having a moderate impact on ESG adoption among SMEs.

In Germany, Hahn, Kühnen, and Blome's study (2015) highlighted that SMEs are more inclined to adopt ESG practices when they perceive tangible benefits, such as enhanced reputation and access to new markets. The study also emphasized the significant role of stakeholder pressure, particularly from customers and suppliers, in motivating SMEs to implement ESG practices. Moreover, Salehi et al. (2022) established a positive correlation between the level of ESG implementation among SMEs and the level of social capital within the organization. Their findings also underscored the positive influence of external stakeholders, such as customers, suppliers, and regulators, on ESG implementation within SMEs.

Hypothesis 6: External factors, including market pressure and regulatory requirements, exert a moderate impact on the adoption of ESG practices among SMEs.

Hypothesis 7: The perception of benefits, such as enhanced reputation and access to new markets, positively influences SMEs in adopting ESG practices.

Hypothesis 8: Stakeholder pressure, especially from customers and suppliers, significantly motivates SMEs to implement ESG practices.

Methodology

This study employs a mixed-methods approach, integrating both qualitative and quantitative research methods. This allows for a comprehensive exploration of the factors influencing the implementation of Environmental, Social, and Governance (ESG) practices among Small and Medium Enterprises (SMEs) operating in Malaysia and Indonesia. The target population consists of SMEs operating in Malaysia and Indonesia. The sample will be selected through a stratified random sampling technique to ensure representation from various industries and

sectors. The sample size will be determined based on statistical considerations to ensure the reliability and generalizability of the findings.

Data Collection:

Quantitative Data Collection:

A structured questionnaire will be designed based on the research objectives and questions. The questionnaire will include items related to internal factors (organizational culture, leadership support, awareness), external factors (market pressure, regulatory requirements), perceived benefits, stakeholder pressure, and the level of ESG implementation. The questionnaire will be distributed electronically to the identified SMEs in Malaysia and Indonesia. The quantitative data will be analyzed using statistical tools, primarily SPSS (Statistical Package for the Social Sciences). Descriptive statistics, inferential statistics, and regression analysis will be applied to interpret the quantitative findings.

Qualitative Data Collection:

Focus Group Discussions (FGDs) will be conducted to gather qualitative insights from practitioners, representatives from financial institutions, and academicians. A semi-structured interview guide will be developed to facilitate the discussions. FGD participants will be purposefully selected to ensure diverse perspectives. Practitioners from SMEs, representatives from finance institutions, and academicians with expertise in sustainability and finance will be invited. FGDs will be organized separately for each participant group, exploring their perceptions, experiences, and suggestions related to ESG implementation among SMEs. Thematic analysis will be employed to identify patterns, themes, and insights from the qualitative data gathered through FGDs. The findings will be validated through member checking and triangulation.

Results Validation:

To bolster the study's credibility and reliability, a triangulation process will be employed to validate the results derived from both the quantitative questionnaire and the qualitative Focus Group Discussions (FGDs). This entails inviting practitioners, representatives from financial institutions, and academicians to participate in a validation session. The primary objective of this session is to solicit their feedback, insights, and expert opinions on the study findings, ensuring a more robust interpretation of the results. The study's outcomes will be documented in a comprehensive research paper, delineating the quantitative results, insights from thematic analysis, and validation feedback from practitioners, finance institutions, and academicians. This report will contribute to both academic knowledge and offer practical implications for government policymakers seeking to enhance sustainability practices among SMEs in Malaysia and Indonesia.

Quantitative Data Analysis:

Utilize statistical tools such as descriptive statistics, correlation analysis, and regression analysis for the analysis of quantitative data. This analytical approach can yield insights into the relationships between variables and the factors influencing sustainability awareness (Creswell, 2009). For a comprehensive exploration of sustainability awareness among Small and Medium Enterprises (SMEs) in Indonesia, a mixed-methods research approach involving both quantitative and qualitative instruments is essential. Begin by creating a structured survey questionnaire to collect quantitative data on SMEs' awareness of sustainability. The questionnaire should incorporate closed-ended questions with Likert scale responses,

measuring the level of awareness, adoption of sustainable practices, and perceptions of challenges. Include questions related to environmental, social, and economic dimensions of sustainability. This instrument allows for numerical analysis and statistical comparisons (Allen Bryman et al., 2003).

To ensure a representative sample of SMEs in Indonesia, employ a stratified random sampling technique. This method involves categorizing the population into distinct strata based on relevant characteristics such as industries and geographic regions (A. Bryman, 2008). Each stratum is then randomly sampled to ensure proportional representation, enabling an accurate reflection of the diverse SME landscape in Indonesia (Creswell, 2009). Determine the sample size for the survey questionnaire with the aim of achieving statistical robustness and enhancing the generalizability of findings. Targeting responses from 400 SMEs in Indonesia strikes a balance between feasibility and the need for a sufficiently large sample size (Creswell, 2009). This sample size is considered adequate for drawing meaningful conclusions about sustainability awareness among SMEs in the Indonesian context.

Data Analysis Tool:

Leverage the Statistical Package for the Social Sciences (SPSS) as the primary tool for data analysis in this research. SPSS, renowned for its user-friendly interface and extensive capabilities in diverse statistical procedures, will be instrumental in executing descriptive statistics, correlation analysis, and regression analysis efficiently. This ensures the accuracy and reliability of the statistical analyses, thereby enhancing the credibility of the study's findings (Saunders et al., 2008).

For qualitative data, organize focus group discussions with SME representatives to facilitate group interactions and gather insights into sustainability awareness. These discussions can unveil shared experiences, opinions, and attitudes that may not be apparent in individual interviews (Saunders et al., 2008). Apply content analysis to interpret qualitative data obtained from interviews and focus group discussions. This involves systematically coding and categorizing responses to identify recurring themes, challenges, and opportunities related to sustainability awareness among SMEs (A. Bryman, 2008).

Combine findings from both quantitative and qualitative methodologies to provide a comprehensive understanding of sustainability awareness among SMEs. Triangulation of data from different sources enhances the reliability and validity of the study (Sekaran, 2003).

Conclusion

In conclusion, this study embarked on a critical examination of sustainability awareness among Small and Medium Enterprises (SMEs) in Malaysia and Indonesia, with a primary focus on identifying influential factors and challenges hindering their participation in mandatory Environmental, Social, and Governance (ESG) compliance. The study, employing a mixed-methods approach, aimed to fill the existing gap in SME ESG implementation, offering insights valuable for policymakers and industry stakeholders. The Sustainable Development Goals (SDGs), serving as a global framework, emphasize the importance of environmental, social, and governance issues. Despite initiatives such as Bursa Malaysia's Strategic Roadmap and SDG adoption in Indonesia, both countries face challenges related to SMEs' limited awareness of sustainability practices. In Malaysia, issues such as cost perceptions and governance concerns, including those related to foreign workers, present

hurdles for SMEs. Similarly, in Indonesia, challenges include a lack of comprehensive understanding of SDGs and governance issues, impacting the country's image.

The research objectives focused on assessing internal factors like organizational culture, leadership support, and awareness, as well as analyzing the impact of external factors such as market pressure and regulatory requirements on ESG practices among SMEs. Comparative analyses between Malaysia and Indonesia aimed to uncover determinants influencing ESG practices. Additionally, the study proposed a sustainability framework to enhance sustainable practices among SMEs in both countries. The significance of this study lies in its contribution to closing the awareness gap among SMEs and addressing challenges hindering their adoption of ESG practices. By aligning with the global SDGs agenda, the research provides valuable insights for policymakers and regulatory bodies. The comprehensive model developed offers a roadmap for SMEs to navigate ESG complexities, empowering them to contribute more substantially to national GDPs and fostering economic resilience. Industry stakeholders can utilize these insights to guide SMEs in adopting sustainable practices, thereby driving positive change and supporting long-term growth and resilience in Malaysia and Indonesia.

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