IMPACT OF ESG REGULATIONS ON SUSTAINABLE BUSINESS PRACTICES: EVIDENCE FROM INDONESIA SMES

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Abstract

This research project examines the correlation between ESG (Environmental, Social, and Governance) regulations and sustainable business practices among small and medium-sized enterprises (SMEs) in Indonesia. Through qualitative interviews and a review of relevant literature, this study seeks to identify the obstacles and advantages that Indonesian SME's encounter when attempting to incorporate ESG principles into their operations. Proactively promoting ESG-related policies to address environmental, social, and governance challenges has been the Indonesian government. However, little is known about the efficacy and implications of these regulations, specifically for SMEs with limited resources. By assessing the influence of ESG regulations on the behaviour of small and medium-sized enterprises (SMEs), this study aims to address this knowledge deficit by identifying barriers to adherence and viable approaches to promote sustainable entrepreneurship.

Keywords: *ESG Regulation, sustainable business practice, Indonesia SMEs*

INTRODUCTION

Global business investment and sustainability are receiving increasing attention in addressing sustainable development and green consumerism (Nosratabadi et al., 2019). In this context, regulatory frameworks play a pivotal role in shaping the behaviour and performance of businesses, particularly small and medium-sized enterprises (SMEs). This paper examines the intricate relationship between ESG regulations and sustainable business practices, with specific attention to the Indonesian SME sector. Through an analysis of existing literature, Interview the paper aims to elucidate the challenges and opportunities faced by Indonesian SMEs in integrating ESG principles into their operations. By understanding the dynamics of ESG regulations and their impact on SMEs can collaborate to foster a more sustainable business ecosystem in Indonesia.

Indonesia, with its growing economy and thriving SME sector, offers a fascinating case study to explore the influence of ESG regulations on sustainable business practices. Amidst the pressing issues of environmental degradation, social inequalities, and governance challenges, the Indonesian government has been actively promoting ESG-related policies and directives to encourage responsible and resilient business conduct. These regulations cover a wide range of issues, including environmental conservation, community engagement, corporate governance, and transparency (Law, 2023).

Nevertheless, there is still much to be discovered about the effectiveness and consequences of these regulatory interventions in real-world scenarios, especially when it comes to small and medium-sized enterprises (SMEs), which play a role in driving Indonesia's economy. Smaller businesses face distinct obstacles when it comes to meeting ESG regulations, as they often lack the level of resources, and additional funding (Law, 2023). It is important to grasp how these regulations impact small and medium-sized enterprises (SMEs) and shape their efforts towards sustaina**bi**lity. This understanding is vital for promoting fair and inclusive paths of development.

In addition, the Indonesian SME landscape is diverse, with businesses operating in different sectors, sizes, and geographical locations. Therefore, examining the varying effects of ESG regulations on different types of SMEs can offer valuable insights into the complexities and potential benefits of adopting sustainable business practices.

In light of this context, this study aims to address the lack of research by conducting an empirical investigation into the effects of ESG regulations on sustainable business practices within the Indonesian SME sector. This research utilizes a qualitative-methods approach, including qualitative interviews, to understand how ESG regulations impact SME behaviour. It also aims to identify obstacles to compliance and discover effective strategies for promoting sustainable entrepreneurship.

The culmination of this study to deliver insights that will benefit stakeholders including policymakers, industry players, and SMEs operating within the Indonesian landscape. By unravelling the intricate relationship between regulatory frameworks and sustainable business practices, this comprehension extends to industry stakeholders who will gain a deeper understanding of the nuances involved in ESG compliance and its impact on SME behaviour.

Moreover, SMEs themselves stand to gain immensely from the findings of this study. With a clearer understanding of the challenges and opportunities presented by ESG regulations, SMEs can adopt more strategic approaches to compliance, resource allocation, and market positioning. By leveraging this knowledge, SMEs can drive innovation, improve operational efficiency, and enhance competitiveness in both domestic and international markets. Additionally, insights gleaned from the study will empower SMEs to navigate regulatory complexities more effectively, fostering a culture of sustainable business practices that contribute to long-term resilience and inclusive economic growth.

In essence, the dissemination of findings from this study will catalyse a paradigm shift in the way policymakers, industry stakeholders, and SMEs perceive and approach sustainable entrepreneurship in Indonesia. By fostering a deeper understanding of the symbiotic relationship between regulatory frameworks and sustainable business practices, stakeholders can collaboratively work towards building a more inclusive, resilient, and environmentally conscious business ecosystem. Through informed decision-making, targeted interventions, and collective action, they can pave the way for a future where sustainable development is not just an aspiration but a tangible reality driving economic prosperity and social progress.

THEORETICAL FRAMEWORK

Institutional Theory

Institutional Theory is complementary to economic theory in general, and resource dependency theory in particular. Institutional theory provides another lens through which to view economic resource dependency incentives for accounting rule choice. Institutional theory views organisations as operating within a social framework of norms, values, and taken for granted assumptions about what constitutes appropriate or acceptable economic behaviour (oliver,1997)

Institutional theory provides insights into the interplay between ESG reporting, sustainability legislation, and small enterprises in Indonesia. ESG reporting is perceived as a response to external influences, including regulatory requirements, investor demands, and societal standards. The expectations to adhere to societal norms and standards have an impact on small firms in Indonesia, as they operate inside a distinct institutional framework shaped by cultural, legislative, and economic factors. Small and medium-sized enterprises (SMEs) can demonstrate their dedication to accountability and ethical business practices by engaging in Environmental, Social, and Governance (ESG) reporting. This not only enhances their credibility but also fosters transparency and receptiveness towards stakeholders. Organizations are increasingly recognizing the necessity of sustainability practices, such as environmental stewardship and social responsibility, in order to maintain their viability and credibility. SMEs in Indonesia may adhere to these procedures due to a combination of intrinsic motivation and external influences, such as regulatory agencies and peer pressure within their industry. In order to address the conflict between global sustainability norms and local circumstances, they adapt their approaches to suit the specific context of the institution while striving for consistency and legitimacy. That is the end! Institutional theory provides a comprehensive perspective on how the constraints exerted by institutions in the evolving landscape of Indonesian small and medium-sized enterprises influence the adoption of ESG reporting and sustainable practices.

RESEARCH METHODOLOGY

Sample

In the study, the researcher uses purposive sampling, a method where specific individuals are selected intentionally because they are experts in the field being studied. By gathering information from these knowledgeable participants through interviews or discussions, the researcher ensures that the data collected is accurate and credible. This approach strengthens the study by relying on the insights and expertise of well-informed individuals, leading to more reliable and trustworthy findings.

Data Analysis Method

In this research, the researcher collects primary data through interviews with representatives of small and medium-sized enterprises (SMEs). The goal is to understand how SMEs perform in relation to sustainability and the disclosure of Environmental, Social, and Governance (ESG) practices. The researcher first conducts a literature review to gain background knowledge and identify key questions. Then, they interview SME representatives to gather detailed insights, recording these interviews for analysis. This method helps the researcher understand the current state of SMEs, the impact of ESG practices, and potential ways to support their growth and sustainability. By combining existing knowledge with firsthand data, the researcher aims to address challenges and opportunities faced by SMEs.

FINDING

The research has identified the lack of specialized regulations designed to govern Small and Medium Enterprises (SMEs) in Indonesia. Although regulatory bodies like the Otoritas Jasa Keuangan (OJK) have conscientiously developed regulations regarding public companies and financial institutions, tailored ESG guidelines for the vast landscape of small and medium-sized enterprises (SMEs), which constitute the foundation of Indonesia's economy, are largely absent.

In the absence of specific regulatory guidance on environmental, social, and governance (ESG) practices, it may be difficult for small and medium-sized enterprises (SMEs) in Indonesia to effectively incorporate sustainability considerations into their business operations. In addition to jeopardizing their ability to contribute to Indonesia's sustainable development objectives, the gap exposes SMEs to dangers associated with environmental deterioration, social unrest, and governance deficiencies.

Moreover, the Ministry of Finance's publication of ESG manuals and frameworks is praiseworthy; however, their scope is limited to state-owned enterprises, which exacerbates the regulatory discrepancy for small and medium-sized enterprises (SMEs). Such a restricted focus neglects the plethora of small and medium-sized enterprises (SMEs) that operate in various sectors, each confronted with unique opportunities and challenges in relation to sustainability practices.

In order to promote a more sustainable and inclusive business climate, it is critical that Indonesia fills this regulatory vacuum through the development of ESG frameworks and guidelines that are tailored to the needs of small and medium-sized enterprises (SMEs). Legislation of this nature ought to take into account the distinct attributes, requirements, and capabilities of small and medium-sized enterprises (SMEs) while offering pragmatic direction on how to incorporate ESG principles into their operational frameworks. Indonesia can effectively leverage small and medium-sized enterprises (SMEs) to implement sustainable practices, thereby enabling them to operate as catalysts for economic expansion and catalysts for constructive transformation. This would substantially contribute to the nation's overarching development trajectory.

CONCLUSION

The research highlights the significant regulatory gap in Indonesia concerning specialized ESG guidelines for Small and Medium Enterprises (SMEs), despite the vital role these businesses play in the country's economy. While regulations for public companies and state-owned enterprises are well-established, SMEs lack tailored ESG frameworks, making it challenging for them to integrate sustainability practices effectively. This gap not only hinders their contribution to Indonesia's sustainable development goals but also exposes them to risks related to environmental, social, and governance issues. To foster a sustainable and inclusive business environment, it is essential for Indonesia to develop and implement ESG guidelines specifically designed for SMEs. Such frameworks should be practical and consider the unique characteristics and needs of SMEs, enabling them to become drivers of sustainable growth and positive change in the nation's development.

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