

The direction of ESG for SMEs: from bureaucracy to innovation

Environmental, social and governance (ESG) principles were initially conceived as a transformative framework to promote sustainability, accountability and more ethical business practices. Over time, however, the focus of ESG has shifted and several unexpected and inadvertent consequences have begun to materialize. For small and medium-sized enterprises (SMEs), what was intended as a guiding light often became a burdensome labyrinth of bureaucratic compliance (Passerini *et al.*, 2024). Instead of empowering these enterprises to drive innovation and develop localized solutions to social issues, current ESG frameworks and subsequent regulations often stifle the very entrepreneurial spirit and activities that SMEs thrive on (McCloskey and Mingardi, 2020).

Bureaucracy and bureaucratic regulation seem to be at the core of the issue. ESG principles were devised to promote the goals of enhancing an SME's sustainability practices and boosting its market appeal. Yet, the evolving complexities of appropriate ESG compliance often impose an unexpected strain on operations. SMEs can face costly audits and numerous, stringent reporting standards that divert limited, valuable resources away from innovation projects. In fact, administrative burdens may not only slow innovation but also require additional staff, or even a dedicated team, solely devoted to compliance efforts. As a result, procedural adherence can receive priority over the pioneering initiatives that drive SMEs' growth and competitiveness. It may even deter entry into certain business areas due to anticipated compliance difficulties—a complaint we have heard from firms working in allied healthcare areas such as caregiving and rehabilitation.

In this regard, we urge scholars to examine these potential misalignments critically and to promote scholarly conversations and research on innovative solutions. Research on the barriers SMEs face when engaging with ESG frameworks, such as increased administrative burdens and overload, is urgently needed (Cortes and Lee, 2021; Parkinson, 1957). Addressing these barriers and solutions is essential if we are to reclaim ESG's potential as a driver of meaningful change.

Bureaucratic overreach and the cost to SMEs

At the heart of the problem lies a disconnect between ESG's intentions and its implementation. Institutions advocating ESG have established compliance-heavy systems, often demanding SMEs adhere to rigid reporting standards designed more for large corporations with readily available administrative resources. And this demand, at least at first glance, makes sense. It seems reasonable to establish a universal standard of accountability and transparency across businesses of all sizes. It also seems ideal to have a level playing field in which every firm contributes to sustainable development under a common framework, thereby reassuring investors and all relevant stakeholders that ethical behavior and environmental stewardship are safeguarded.

However, this "one-size-fits-all" approach demonstrates a fundamental misapprehension of SMEs' unique challenges (Gunningham, 2002). Unlike larger firms, SMEs operate on



limited resources while relying on agility, creativity and deep community connections. Yet, with numerous (and often somewhat sudden) ESG regulations being promulgated, they are now expected to create entire departments or hire consultants to navigate convoluted ESG reporting processes and make sense of a regulatory maze disproportionate to their operational scale and capabilities.

This bureaucratic imposition can exact a heavy toll on SMEs, not just financially but also in terms of opportunity cost (Gunningham, 2002). Instead of fostering innovation, current ESG systems often divert attention and, at times, drain entrepreneurs' energy, effectively alienating them from sustainability efforts. As a result, the framework intended to encourage ethical and sustainable practices becomes more of a barrier to participation.

Misaligned priorities and their consequences

This may also lead to an additional, quite concerning trend. That is, as ESG advocacy can become more focused on maintaining institutional relevance, it can lose its ability to enable impactful change with respect to its original mission. Overly prescriptive ESG standards prioritize bureaucratic work over social impact and SME competitiveness. This shift from fostering meaningful sustainability to enforcing rigid compliance highlights a critical misalignment in priorities. The entrepreneurial agility of SMEs, which could be a powerful driver of localized and innovative ESG solutions, can be throttled by unnecessary administrative burdens.

Reimagining ESG for entrepreneurship and innovation

To restore ESG to its original purpose, particularly with respect to SMEs, researchers and policymakers must seek a centering of its frameworks more on entrepreneurship and innovation (Ahlstrom, 2010; Bruton *et al.*, 2025). Research is needed to explore how simplified, flexible ESG guidelines can empower SMEs rather than constrain them. For instance, scholars could investigate how outcome-oriented approaches, rather than process-heavy reporting, can lead to more impactful and scalable sustainability initiatives. A case in point is examining the success of SMEs in countries with less prescriptive ESG frameworks and more adaptive approaches to local contexts. ESG challenges can differ dramatically by region: SMEs in emerging economies face higher opportunity costs and weaker institutional support. Understanding these differences is essential for designing inclusive and effective ESG strategies.

Empowering SMEs through entrepreneurship-focused ESG also requires a shift in institutional mindset. Institutions must transition from dictating compliance to facilitating innovation, enabling SMEs to design sustainability solutions tailored to their specific circumstances. Scholars can contribute by identifying best practices, evaluating scalable models of ESG implementation and highlighting the role of digital tools in simplifying ESG reporting for smaller businesses.

The role of academia in the ESG-SME dialogue

Academic research plays a key role in addressing the gaps and challenges SMEs face under current ESG frameworks. For example, scholars could explore the psychological toll of bureaucratic compliance on small business owners or examine the financial strain of ESG implementation on different types of SMEs. Comparative studies across industries or regions could shed light on why some SMEs succeed in engaging with ESG frameworks while others struggle.

Moreover, there is a pressing need for interdisciplinary collaboration to integrate insights from behavioral economics, organizational psychology and sustainability studies. By

leveraging diverse perspectives, researchers can propose actionable solutions that balance accountability with innovation.

A future agenda for ESG research

As such, we encourage scholars to lead the way in reclaiming ESG as a framework for progress rather than a barrier to firm (and economic) growth. Key research questions include:

- (1) What specific aspect or aspects of ESG compliance create the most significant barrier for SMEs and how can these be minimized?
- (2) How can ESG frameworks be redesigned to align with the innovative strengths of SMEs, such as creativity and adaptability?
- (3) What role can technology play in reducing the reporting burden for smaller businesses while maintaining transparency and accountability?
- (4) How do different cultural and institutional contexts influence SMEs' engagement with ESG principles?

We believe these research questions have immense practical relevance, as addressing them will yield actionable insights for policymakers, institutions and entrepreneurs alike, ensuring that ESG fulfills its promise of fostering sustainability and equity.

Conclusion

The original spirit of ESG—encouraging sustainable, ethical and community-focused business practices that also enable growth and development—must be reclaimed. This requires moving away from rigid, compliance-driven protocols that alienate SMEs and returning to frameworks that inspire and empower entrepreneurial innovation. By embracing the innovative strengths of SMEs and addressing the misaligned priorities within ESG advocacy, a future can be created where ESG becomes a tool for genuine progress. If ESG began as an ethical compass, let us return it to that role, guiding not by paperwork, but by purpose.

As editors of entrepreneurship journals, we encourage contributions that analyze and advance this agenda. Together, we can drive scholarly discourse that ensures ESG evolves into a framework that not only supports SMEs in their growth and development but also delivers meaningful, sustainable impact in the area of valuable products and services, as well as increased employment opportunities, for society as a whole.

Ayman El Tarabishy

George Washington University, USA

Younggeun Lee

State University of New York, Korea

Andres Felipe Cortes

Sacred Heart University, USA, and

David Ahlstrom

Hong Kong Metropolitan University, China

References

- Ahlstrom, D. (2010), "Innovation and growth: how business contributes to society", *Academy of Management Perspectives*, Vol. 24 No. 3, pp. 11-24, doi: [10.5465/amp.24.3.11](https://doi.org/10.5465/amp.24.3.11).

- Bruton, G.D., Mejía-Morelos, J.H. and Ahlstrom, D. (2025), "Multinational corporations and inclusive supply chains: how conflicting social and market logics can coexist", *Journal of World Business*, Vol. 60 No. 6, 101663, doi: [10.1016/j.jwb.2025.101663](https://doi.org/10.1016/j.jwb.2025.101663).
- Cortes, A.F. and Lee, Y. (2021), "Social entrepreneurship in SMEs: a note on three essential questions", *New England Journal of Entrepreneurship*, Vol. 24 No. 2, pp. 62-78, doi: [10.1108/nej-03-2021-0014](https://doi.org/10.1108/nej-03-2021-0014).
- Gunningham, N. (2002), "Regulating small and medium sized enterprises", *Journal of Environmental Law*, Vol. 14 No. 1, pp. 5-32, doi: [10.1093/jel/14.1.3](https://doi.org/10.1093/jel/14.1.3).
- McCloskey, D.N. and Mingardi, A. (2020), *The Myth of the Entrepreneurial State*, American Institute for Economic Research.
- Parkinson, C.N. (1957), *Parkinson's Law, and Other Studies in Administration*, Houghton Mifflin Company.
- Passerini, K., El Tarabishy, A. and Pagan, A. (2024), "Measuring environmental, social, and governance (ESG) firm performance: a new story resembling an old one", *Journal of the International Council for Small Business*, Vol. 6 No. 4, pp. 1-13, doi: [10.1080/26437015.2024.2418335](https://doi.org/10.1080/26437015.2024.2418335).