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# Status Quo of Voluntary Sustainability Reporting by German SMEs in 2021

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**Abstract:** *New regulations related to Environment, Social and Governance (ESG), such as the Non-Financial Reporting Directive (NFRD) or the upcoming Taxonomy Regulation of the European Union (EU), will have a significant impact on various market participants. To gain insight, a study was conducted comparing sustainability reporting patterns of the top ten voluntary small and medium-sized enterprises (SMEs) sustainability reports. The results showed that these companies do not follow a uniform approach to sustainability reporting. Though the evaluated topics were the same, their contents and level of detail differed. It was also observed that some of the examined companies selected key performance indicators (KPIs) according to their preference and explained them in detail. Moreover, the companies issued different types of sustainability reports, such as separate PDF reports, online versions, or a combination of both. The companies provided extensive information on environmental issues, especially on GHG emissions, concrete measures, and targets for reducing emissions and energy consumption. Many presented this information in detail with status and KPIs linked to their sustainability program based on their previously identified material issues. However, the topics of pollution, water and marine resources, biodiversity, and ecosystems were only marginally addressed in the examined sustainability reports. Regarding social information, the investigated companies disclosed a broad spectrum of information on their own workforce, especially on working conditions, equal treatment, and opportunities. On the other hand, the reporting of the examined companies varied widely for governance. Many firms reported on mandatory topics such as corruption, bribery, and political engagement. These findings are useful for policymakers, other companies including banks and suppliers, and individuals interested in assessing sustainability status and progress.*

## 1. INTRODUCTION

Climate change and environmental degradation pose significant threats to Europe and the world. To address these challenges, Europe has launched the European Green Deal, which aims to transition to a modern, sustainable, and resource-efficient economy and become the first continent to achieve climate neutrality by 2050. Similarly, the German government recognizes the importance of steering financial flows towards a more sustainable economy. It views this as a crucial lever to support the sustainability transformation of the country. In line with this, the German Sustainable Finance Strategy states that companies will be held more accountable in the future, as they represent a significant part of the German economy. Sustainability aspects, therefore, have to be considered in financing decisions.

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The purpose of this paper is to analyze the sustainability reporting patterns of small and medium-sized enterprises (SMEs), including their key performance indicators (KPIs). To achieve this aim, we used the ten best sustainability reports from German SMEs according to the Institute for Ecological Economy Research and the business network Future, as a basis for our analysis. The Corporate Sustainability Reporting Directive (CSRD) came into effect in January 2023. This directive requires comprehensive, mandatory, and externally audited sustainability reporting from almost 50,000 European companies, instead of around 11,700 firms previously. As a result, companies are facing immense challenges, as they need to provide insights about their non-financial performance. This is particularly difficult for SMEs, given their limited resources and the lack of SME-specific guidelines on sustainability reporting. According to a study by the German Federal Statistical Office, around 99.4 percent of all companies in Germany were classified as SMEs in 2020. This highlights the enormous relevance of SMEs for the German economy and explains why they are often called the backbone of the German economy. However, SMEs face significant external pressure regarding the disclosure of sustainability-related data, as financing partners and customers in the supply chain demand information on sustainable indicators. This demand is set to increase significantly in the future, given that the CSRD will subject nearly five times as many entities to reporting requirements. Therefore, this study analyzes the current status of voluntary sustainability reporting by German SMEs and highlights the challenges they face in meeting the new reporting requirements set out in the CSRD.

In the following, section 2 provides the background on sustainability reporting regulations, while the next section 3 describes the data and methodology. The discussion of the empirical results follows in section 4, while section 5 concludes the paper.

## 2. REGULATORY BACKGROUND AND LITERATURE REVIEW

There is currently no universally accepted definition of sustainability reporting in the scientific literature (Dilling, 2010). Nonetheless, one of the most influential definitions of sustainability reporting comes from Steinhöfel et al. (2019), who describe it as a practice in which companies disclose their most significant economic, environmental, and social impacts resulting from their corporate actions. This allows companies to be held accountable for these impacts and to take responsibility for managing them. Sustainability reporting is often seen as an extension of financial reporting and covers topics such as the company's development and future viability (Auer et al., 2022).

To obtain the necessary data and information, a company must have a sustainability management plan in place. The materiality principle, which is central to financial reporting, also applies to sustainability reporting (Harrison, 2018). This principle requires that all facts relevant to stakeholders' decisions be included in the sustainability report. Therefore, companies often conduct a materiality analysis to identify and prioritize the sustainability issues that are most relevant to their stakeholders. The creation of a set of sustainability-related KPIs can help organizations and stakeholders measure and evaluate a company's sustainability success. This information can then be used to develop appropriate measures for the company's sustainability management (Auer et al., 2022). This approach is a valuable tool for internal decision-making processes and can significantly enhance non-financial corporate communications with stakeholders (Meutia et al., 2021; Oprean-Stan et al., 2020).

Starting from January 2023, certain European companies are required to comply with the CSRD, which is a set of European standards for sustainability reporting. The goal of the CSRD is to ensure transparent and truthful disclosure of information about sustainability opportunities and risks. A task force of the European Financial Reporting Advisory Group (PTS-EFRAG) is currently developing mandatory cross-industry ESRS (European Single Reporting Standard), which will ensure uniform data and standardization of sustainability reports, making the data comparable and promoting the transition to a more sustainable economy. By October 31, 2023, sector-specific standards and separate reporting standards for SMEs will be published, taking into account the capacities and characteristics of SMEs.

Under the CSRD, almost 50,000 companies are required to report on sustainability, instead of around 11,700 companies previously following the NFRD. Furthermore, all non-European Union (EU) companies with substantial activity in the EU, with a turnover over 150 million euros in the EU, that have at least one subsidiary (large or listed) or branch (net turnover of more than 40 million euros) in the EU will be affected by the CSRD. Only listed SMEs are obliged to report on sustainability from January 2026 onwards according to the CSRD. However, non-listed SMEs can voluntarily publish sustainability reports, although they may be required to do so by various stakeholders.

The ESRS are EU standards for sustainability reporting, which are binding under the CSRD. The European Commission is currently consulting with EU bodies and member states on the final draft of the cross-sector reporting standards submitted by EFRAG, which is responsible for developing the ESRS. In June 2023, the final standards will be adopted as delegated acts, first by the European Commission and then by the European Parliament and the European Council. The first set of ESRS, based on the requirements of the CSRD, comprises twelve standards shown in **Figure 1** (EFRAG, 2022). The following **Figure 1** provides an overview of the topics covered in the first draft of the ESRS.

| **Cross-cutting Standards** | | |
|---|---|---|
| ESRS 1 *General requirements* | | |
| ESRS 2 *General disclosures* | | |
| **Topical Standards** | | |
| **Environment** | **Social** | **Governance** |
| ESRS E1<br>*Climate change* | ESRS S1<br>*Own workforce* | ESRS G1<br>*Business conduct* |
| ESRS E2<br>*Pollution* | ESRS S2<br>*Workers in the value chain* | |
| ESRS E3<br>*Water and marine resources* | ESRS S3<br>*Affected communities* | |
| ESRS E4<br>*Biodiversity and ecosystems* | ESRS S4<br>*Customers and end-users* | |
| ESRS E5<br>*Resources and circular economy* | | |

**Figure 1.** Overview of the Content Elements of the First Set of ESRS Drafts

**Source:** Own illustration based on EFRAG, 2022

The ESRS 1 General Requirements outlines the fundamental principles that must be followed when reporting, without specifying any concrete disclosure requirements. On the other hand, the ESRS 2 General Disclosures mandates the essential information that should be disclosed, regardless of the sustainability matter under consideration. The topical standards are then classified based on the ESG classification (EFRAG, 2022). The ESRS's content requirements emphasize that the application of double materiality is an integral part of the ESRS, and it is compulsory for all affected companies. This means that the company's positive and negative impacts on the people and the environment (impact materiality) and the impacts of the people and the environment on the company's economic situation (financial materiality) must be reported (EFRAG, 2022).

As per the new CSRD (Directive [EU] 2022/2464, 2023) and ESRS regulations, companies will now be required to include a separate sustainability statement in their management report. This section will contain crucial sustainability-related information. Additionally, all companies must have their sustainability information audited by an external organization. Initially, the audit will be carried out with limited assurance and will be extended to reasonable assurance over time.

## 3. DATA AND METHODOLOGY

The literature review allows us to identify the current sustainability reporting requirements for SMEs, while the empirical content analysis (Mayring, 2022) helps to examine common reporting patterns of SMEs. For the latter, the ten best sustainable reports from German SMEs according to the study of the Institute for Ecological Economy research and the business network future were taken for an in-depth analysis (**Figure 2**).

| Rank | Company | Industry |
|---|---|---|
| 1 | Assmann Büromöbel GmbH & Co. KG | Office furniture |
| 2 | Pure Taste Group GmbH & Co. KG | Food |
| 3 | Neumarkter Lammsbräu Gebr. Ehrnsperger KG | Food |
| 4 | memo AG | Trade |
| 5 | GLS Gemeinschaftsbank eG | Service provider |
| 6 | Bohlsener Mühle GmbH & Co. KG | Food |
| 7 | Entega AG | Energy and water supply |
| 8 | alstria office REIT-AG | Real estate |
| 9 | elobau GmbH & Co. KG | Electronics |
| 10 | Stadtreinigung Hamburg | Public utilities |

**Figure 2.** List of the 10 best sustainable reports from German SMEs

**Source:** Own illustration based on Institute for Ecological Economy Research, & future e.V., 2021

## 4. RESULTS

The study findings reveal that there is no standard approach to sustainability reporting among the companies investigated. The examined sustainability reports focus on different themes, which is positive due to the prior materiality analysis conducted in all the reports. The results can be explained by the concept of double materiality, which is a mandatory element of the ESRS for all affected companies. According to theoretical findings, the materiality analysis is a vital strategic tool for prioritizing sustainability topics that are crucial for a company and its stakeholders. However, despite companies identifying the same topics as material, their contents, as well as the level of detail, differ. For instance, firms use different KPIs to measure their targets, and some select KPIs based on their preference and explain them in detail. This approach allows companies to influence their reputation positively, even with negative figures. Therefore, readers should engage in critical thinking while reading sustainability reports since greenwashing can be conducted through non-financial reporting. This raises questions about the purpose of sustainability reporting in achieving the EU's climate targets if companies can choose which data to disclose. Disclosing only positive topics and excluding risks or metrics that still need improvement can lead to reputational damage. Additionally, the opportunities of sustainability reporting cannot be fully exploited.

The empirical findings of this study reveal the existence of different types of sustainability reports. The companies examined present their sustainability topics in separate PDF reports, as online versions, or as a combination of both. However, none of these reporting types will be permissible under the CSRD (Corporate Sustainability Reporting Directive) since this EU directive mandates that affected companies must present their sustainability data in a separate section of the company's management report, the so-called sustainability statement. One reason for the inconsistent quality of the examined sustainability reports is the fact that SMEs are not yet legally required to publish non-financial information, and therefore, their reports are not externally audited, which means that the completeness of the content is not proven. Another reason for the different design of the sustainability reports is that 90 percent of the studied sustainability reports are based on the GRI (Global Reporting Initiative) standards. However, the GRI standards are merely guidelines for the structure and content of sustainability reports and have no binding legal character. Nevertheless, the transition to reporting based on the ESRS (European Single Reporting Standard) might pose a future challenge for the affected SMEs. The lack of uniformity in non-financial reporting will change in the future, as the CSRD, adopted on 5 January 2023, aims for standardized sustainability reporting that includes more companies and stricter requirements for mandatory non-financial reporting. As explained in the theoretical part of this study, SME-specific standards will be published by October 2023. Listed SMEs will then be required to report on sustainability from 1 January 2026.

The analysis conducted for the company reveals that not all of the investigated firms can be classified as SMEs according to the definition set by the European Commission. This could be due to the fact that the authors had to broaden the definition of SMEs to collect enough sustainability reports to make a comparison. This observation is in line with the findings in the literature which suggests that only a few SMEs have started reporting on sustainability so far. However, the research shows that the range of disclosures varies greatly. For instance, Entega AG, which has significantly more employees and generates more revenue than memo AG, provides far less detailed sustainability reports. In contrast, alstria AG presents a comprehensive representation of their office building emissions over the lifecycle in the context of sustainability due diligence. It is worth noting that carrying out such detailed descriptions, calculations, and explanations is often difficult for SMEs due to their limited financial and human resources.

**Environmental Information.** The findings reveal that companies provide ample information on climate change in their reports. Specifically, they present their greenhouse gas emissions, measures taken, and targets for reducing emissions and energy consumption in great detail. Most of the companies also link their sustainability program's status and key performance indicators (KPIs) to their previously identified material issues.

The examined sustainability reports only touch on topics related to pollution, water and marine resources, biodiversity and ecosystems in a limited way. This could be because the firms did not consider these topics to be important in their materiality analysis. Bohlsener Mühle, for instance, explains in their sustainability report that they only partially report on water and marine resources for this reason. It is important to note that different industries have different relevant topics and KPIs. For instance, biodiversity and ecosystems are much more important for food manufacturers than for retailers of electrical appliances. Conducting a materiality analysis can help identify relevant topics, but it is even more helpful that EFRAG plans to release sector-specific reporting standards.

**Social Information.** The companies under investigation have disclosed a wide range of information about their own workforce, particularly regarding working conditions, equal treatment, and opportunities. This is likely because this information is readily available through the human resources department or the time-recording system. Collecting data about their own workforce provides an opportunity for companies to plan their workforce better. For example, Entega AG provides essential figures about the number of employees who will retire in the next five to ten years, which enables them to plan employee replacements and helps with human resources planning.

Based on the empirical results, it can be inferred that companies do not provide significant information about workers in their value chain. Furthermore, they only give minimal details about the affected communities in their reports, with a focus on local communities rather than those living farther away. This could be due to the resource-intensive and costly nature of gathering such information, especially when dealing with globally dispersed suppliers. Alternatively, companies may choose not to disclose this information due to its negative impact on their reputation. As for the disclosure of information about consumers and end-users, the analyzed firms do not provide much detail, seemingly only sharing the information they have collected anyway.

**Governance Information.** In relation to how companies are run, the way that information is reported varies greatly. Many companies report on mandatory topics such as corruption, bribery, and political involvement. It’s worth noting that small and medium-sized businesses may have fewer resources for compliance and anti-corruption measures compared to larger organizations. The findings show that the management of relationships with suppliers is reported in greater detail. This may be because most companies already have set standards for suppliers such as a code of conduct, so they only need to provide these policies and their approach to supply chain management without having to gather new data.

It is important to highlight that a company’s sustainability statement can serve as a comprehensive source of information for various stakeholders. Prospective employees, for instance, can access detailed information about working conditions in different organizations and use this information to compare employers. Similarly, companies can benefit by attracting and retaining top talent if they provide accurate and helpful sustainability statements.

## 5. CONCLUSION

This study has investigated the sustainability reporting practices of SMEs in Germany. The research has revealed that there is no standardized approach to non-financial reporting among SMEs. The analysis of the data has shown that the content and extent of disclosures in the sustainability reports of these SMEs vary considerably. As the literature suggests, this issue will be addressed by the CSRD, which mandates listed SMEs to disclose sustainability information.

Starting in 2026, listed SMEs will have to report using the standardized ESRS framework, and their reports will need to be audited with limited assurance. However, these strict legal requirements pose a significant challenge for SMEs, given their limited resources.

In the coming years, both listed and unlisted SMEs are likely to face increasing pressure from stakeholders such as banks, suppliers, and consumers to demonstrate their sustainability performance and progress. As a result, sustainability reporting will remain a major concern for SMEs. The extent to which the SME-specific ESRS will be both comprehensive and practical remains to be seen. However, for the time being, SMEs that report on their sustainability can gain a competitive edge. Further research could explore and validate the voluntary compliance of SMEs with regulatory standards.

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