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Environmental, social, and governance evaluation for European small and medium enterprises: A multicriteria approach

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Executive summary

Assessing environmental, social, and governance (ESG) risks enables firms to identify opportunities for sustainable growth and manage social and environmental impacts. For European listed SMEs, this process is essential as they face increasing stakeholder pressure (Torelli et al., 2020) and expanding sustainability reporting requirements (Baumüller and Grbenic, 2021). This policy brief summarises the study *"Environmental, Social, and Governance Evaluation for European Small and Medium Enterprises: A Multicriteria Approach"* by D. Barro, M. Corazza, and G. Filograsso. The research applies a multi-criteria decision-aiding (MCDA) framework, using the MURAME model to develop a transparent and robust ESG scoring system for SMEs. Applied to a sample of European firms, the method evaluates ESG performance across key indicators while addressing missing data through a prudential imputation strategy (Sahin et al., 2022). The model provides a practical, data-driven tool to support inclusive and evidence-based ESG policymaking.

Context

Understanding the firm's exposure to various potential ESG risks involves evaluating its ESG performance, which can significantly impact the company's financial value creation. Previous analyses on SMEs have mainly investigated credit risk profiles (Angilella and Mazzù 2015, Corazza et al. 2015). In contrast, studies on the role of ESG sustainability performance in SMEs have mainly focused on the environmental perspective (see, for example, Deshpande et al. 2020).

The CSRD (European Commission 2023) expands mandatory sustainability reporting from approximately 11700 to more than 50000 EU companies, including many SMEs, and calls for a more comprehensive report on the impact of corporate activities on the environment and society, in line with the European Sustainability Reporting Standards (ESRS 2023), requiring assessment along each of the ESG dimensions. SMEs face cost and capability constraints, and ESG data are often sparse, inconsistent, or non-comparable across sectors, which undermines risk assessment and access to sustainable finance. In this context, a holistic assessment framework that embraces the problem of ESG performance for European SMEs from different perspectives is needed. A tractable, transparent SME-focused ESG rating can bridge this implementation gap.

Methodology

To address the lack of quantitative approaches for modelling the ESG profiles of small and medium-sized enterprises, this study adopts a Multi-Criteria Decision Analysis (MCDA) framework. This approach is particularly suitable for handling unstructured decision-making problems involving multiple, and often conflicting, criteria. Specifically, we employ the MURAME model (Goletsis et al., 2003), a parsimonious MCDA model that requires only a limited number of assumptions regarding the decision maker's (DM's) preferences and the underlying data. This feature makes it well-suited for contexts characterised by incomplete or uncertain information, which is common in ESG assessment for SMEs. Nonetheless, the quality and characteristics of the data—as well as the chosen imputation method for missing values—can significantly affect the results. The measurement of ESG ratings remains inherently ambiguous, as current definitions and frameworks often diverge and lack consensus on the true drivers of sustainability (Billio et al., 2021). These conceptual and data limitations, including the prevalence of missing firm-level information, represent a significant challenge in constructing reliable ESG scores. Improved data coverage and quality would enable the explicit inclusion of sectoral and country-specific effects in future iterations of the model. The proposed methodology yields a measure of a firm's ESG efforts (ESGness), applied here to a sample of European-listed SMEs. The analysis controls for sectoral effects to ensure comparability and robustness of the results. The model produces rankings of firms that remain relatively stable across different parameterisations, allowing the identification of ESG leaders and laggards.

Beyond its analytical value, the model provides actionable insights for firms, policymakers, and investors. It supports prudential scoring and helps assess the benefits of voluntary disclosure of sustainability information, thereby contributing to more transparent and evidence-based ESG evaluation practices. Main insights include:

- A compact indicator set (12 metrics) can capture SME sustainability performance, supporting the proportional implementation of the CSRD.
- Missing or inconsistent disclosures substantially influence ESG rankings; rewarding data quality and verification is therefore more impactful than mandating exhaustive reporting.

- The prudential approach to non-disclosure ensures conservative assessments but risks penalising small firms; coupling it with capacity-building and phased compliance would enhance fairness.
- Balanced achievements across E, S, and G pillars are more strongly associated with financial and operational resilience than single-pillar excellence.

Policy Takeaways and Analysis

1. **Proportional and transparent ESG disclosure frameworks for SMEs.** Small and medium-sized enterprises require a simplified but credible ESG reporting standard. The model proposed in the study uses a concise set of indicators, normalised by sector and scaled for firm size. Such proportional frameworks would support the CSRD's inclusivity objective while maintaining comparability across industries and countries.
2. **Incentivising data quality over disclosure volume.** The analysis shows that missing or inconsistent data strongly affect ESG rankings under prudential imputation. Policy design should therefore reward verifiable and complete disclosures, not merely extensive reporting. Linking verified ESG data to preferential access to sustainable finance, green guarantees, or reduced administrative burdens could align incentives and encourage truthful reporting.
3. **Managing the "prudence penalty" through capacity support.** Automatic downgrades for non-disclosure, though conservative, may unfairly penalise smaller firms with limited reporting capacity. Policymakers should accompany prudential rules with technical assistance, phased timelines, and guidance tools that help SMEs progressively fill data gaps. This approach sustains credibility while avoiding exclusionary effects in sustainable finance markets.

4. Promoting balanced E–S–G performance. The analysis confirms that balanced achievements across Environmental, Social, and Governance pillars are more strongly associated with overall resilience than single-pillar excellence. Policy instruments—such as ESG-linked funding schemes or rating criteria—should reflect this balance, encouraging firms to integrate social and governance progress alongside environmental action.

5. Strengthening SME capacities and digital tools for ESG management. Beyond compliance, ESG data can serve as a management tool for resource efficiency, innovation, and competitiveness. Targeted training programmes, open-source templates, and low-cost digital solutions would enable SMEs to automate data collection and track sustainability performance.

Recommendations

Building on the empirical results and policy analysis, the following recommendations support the operationalisation of inclusive ESG integration for SMEs:

1. Adopt proportional ESG disclosure frameworks. Introduce simplified yet credible ESG reporting standards using a concise set of 10–15 indicators, normalised by sector and scaled for firm size. This promotes comparability and supports CSRD's inclusivity objectives without imposing excessive reporting costs.

2. Incentivise data quality over disclosure volume. Encourage verifiable, complete, and high-quality data submissions. Linking verified ESG data to preferential financing, green guarantees, or reduced administrative requirements would reward accuracy and discourage superficial reporting.

3. Address the "prudence penalty" through capacity support. Avoid penalising SMEs for non-disclosure due to limited resources. Complement prudential scoring with technical assistance, phased timelines, and practical guidance tools to help firms progressively close data gaps.

4. Promote balanced E–S–G performance. Design funding schemes and rating criteria that reward balanced progress across all three ESG pillars—environmental, social, and governance—to strengthen systemic resilience.

5.Strengthen SME capacities through digitalization. Develop training programmes, open-source templates, and low-cost digital solutions enabling SMEs to automate data collection and integrate ESG management into core business processes.

Together, these recommendations advance the mission of fostering a resilient, inclusive, and sustainable European economy, bridging data asymmetries, and ensuring equitable access to sustainable finance across regions and sectors.

Conclusions

Credible ESG performance is essential for SMEs to ensure financial inclusion and contribute to systemic resilience. However, incomplete or inconsistent data hinder banks, investors, and policymakers from accurately assessing risks, limiting access to sustainable finance and slowing the transition. This study addresses these challenges by positioning SMEs within a composite risk framework that captures both external shocks and internal vulnerabilities. Through a proportionate and transparent ESG assessment, the proposed MCDA-based model offers a practical, evidence-driven tool for monitoring non-financial risks and supporting policy integration. The results highlight that well-calibrated ESG assessment tools can effectively integrate smaller firms into Europe's sustainable finance architecture. Moreover, digital tools and training can transform ESG compliance into a source of innovation, competitiveness, and inclusion—advancing a more resilient and sustainable European economy.

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