EFRAG Voluntary Sustainability Reporting Standard for non-listed SMEs (VSME)

- EFRAG's Cover Letter on the cost-benefit analysis for the Voluntary Sustainability Reporting Standard for non-listed SMEs (VSME)

- Cost-benefit analysis for the Voluntary Sustainability Reporting Standard for non-listed SMEs (VSME) prepared by Syntesia Prometeia

EFRAG's Cover Letter on the cost-benefit analysis for the Voluntary Standard for non-listed SMEs (VSME)

The European Commission requires that EFRAG's Technical Advice is 'accompanied by cost-benefit analyses that include analyses of the impacts of the technical advice on sustainability matters.' Even though the Voluntary SME European Sustainability Reporting Standard (VSME) is outside the scope of the CSRD and will not be adopted by the European Commission as a delegated act, EFRAG has fulfilled the same obligation as the for the rest of the ESRS.

The objective of this cover letter is to explain how EFRAG has discharged this obligation for VSME.

EFRAG's Due Process Procedures (paragraph 2.22) states that « the purpose of Cost-Benefit Analyses is to understand the impacts of proposed ESRS and amendments to ESRS from various stakeholders' perspectives on a systematic basis to enable informed judgements about how to balance the needs of competing interests, including costs and benefits but also wider impacts on sustainability matters ».

EFRAG has commissioned Syntesia Prometeia (hereafter 'the contractors') to conduct an assessment of the costs and benefits of the VSME. The report is submitted to the EC and published together with the VSME and this cover letter.

In selecting the contractors, through a public tender process, EFRAG has in particular considered the experience of the contractors in conducting similar work and in particular the contractors' contribution to the Cost/benefit analysis on SME disclosure on taxonomy alignment conducted by the Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs.

Contractors' report on the Cost-benefit analysis of the VSME

The contractors' report accompanying this cover letter assesses the possible costs and benefits of the VSME and presents the methodology, evidence and data collected in the context of the costs and benefits analysis to arrive at estimates. The study presents an assessment of the impact of the VSME across different stakeholder groups, these are mainly EU micro, small and medium sized undertakings as preparers; banks, investors and large undertakings as business counterparts of SMEs in the value chain as users. The survey design and the contractors' cost calculations followed the EU Standard Cost Model. In particular, the administrative costs were estimated by Syntesia Prometeia by retrieving data from the targeted consultation of preparers and service providers, as well as from the estimates provided in other related studies, the SME survey and the field test conducted by EFRAG. Quantifiable financial benefits have been estimated using existing economic literature and where possible previous studies.

The information and views set out in the contractors' report are those of the authors and do not necessarily reflect the views or opinion of EFRAG. The EFRAG Sustainability Reporting Board (EFRAG SRB) and the EFRAG Sustainability Reporting TEG (EFRAG SR TEG) have been informed of the work and progresses done by the contractors in the following meetings:

In June 2024, the EFRAG SR TEG and the EFRAG SRB were presented with an initial cost-benefit analysis of the VSME exposure draft published in January 2024. The contractors then provided a detailed report to the EFRAG SR TEG and the EFRAG SRB.

In a joint EFRAG SR TEG and EFRAG SRB meeting on 30 October 2024, the contractors updated the EFRAG SR TEG and EFRAG SRB members with the revised cost-benefit analysis conducted following the changes made to the VSME Standard after the public consultation.

On 20 November 2024, the contractors provided the EFRAG SR TEG and EFRAG SRB with their final report.

EFRAG has shared with the contractors the feedback received from the public consultation on the Exposure Drafts of the VSME. Specific questions in relation to the costs and benefit of the proposals were included in the consultation.

EFRAG acknowledges the information in the report and its conclusions. It also observes that the costs for individual companies depending on their circumstances may differ widely. Moreover, it should be underlined that the benefits, given their nature, can hardly be quantified and in the report the benefits are assessed mainly in qualitative terms.

EFRAG's consideration of costs and benefits in finalising its Technical Advice to the European Commission

In finalising its Technical Advice to the EC, EFRAG has considered the draft and final reports prepared by the contractors including the acknowledged limitations and uncertainties inherent to the ex-ante assessment of the costs and benefits of the VSME Standard.

EFRAG has also considered the extensive insight that it gained into the likely impacts and benefits of the draft VSME Standard through the public exposure of its proposals, which included several detailed questions at the level of each Disclosure Requirements on the cost/benefit profile, and through consultation, and outreaches with stakeholders, including the questionnaire and workshops with the preparers and users that participated to the Field Tests in May 2024. This feedback has led EFRAG to significantly review and streamline the proposals in the Exposure Draft of the VSME Standard. In particular:

- The Narrative-PAT module has been deleted. The content has been reallocated in a simplified semi-narrative format between the Basic and Comprehensive. modules. The practices, policies and future initiatives for transitions towards a more sustainable economy are to be reported only if the undertaking has them in place.
- The former Business Partners module has now been renamed **Comprehensive module.** The change of name was requested in the public consultation to flag that business partners may request more comprehensive information beyond what is covered via the Basic module.
- **Materiality** has been removed entirely. No materiality analysis is now asked to be performed by SMEs. The simplification was tested with both SMEs and banks representative and received strong support as it is expected to remove a large burden for reporting SMEs and also provide standardised disclosures for users' business partners.
- Additionally, a clear request that stemmed out from the public consultation has been the development of an **online tool** to serve as a simplified and guided process for SMEs to use when disclosing their information. While EFRAG can partially work on certain elements of guidance and stimulate the availability of such online tools, it will not develop them. In particular, the development of online platforms and tools (i.e., GHG calculators, geolocation tools) is considered by stakeholders as an essential element to facilitate the reporting as well as the comparability of information.

On this basis, in the revised CBA a majority of the identified savings are attributed to structural modifications, the costs of which were previously established through stakeholder consultations. Hence, there are no elements that would lead EFRAG to believe that the overall cost/benefit profile of the VSME is incompatible with the policy objectives of the Commission's SME Relief Package. In fact, the sensitivity analysis on analytical parameters suggests that net impacts are neutral to positive following the first year of implementation. In the central scenario, net impacts become positive from 2027, and increase in 2028. The positive results are driven by the lower recurring reporting costs, as well as the increasing benefits. This happens despite the CBA sensitivity analysis having been conducted with the assumption that the entirety of the two modules would be always reported on, which may not be the case for micro undertakings, which are expected to report only on the Basic Module.

EFRAG notes the following important conditions for the benefits expected to derive from the use of VSME: (i) the availability of online platforms that work at the same time as template and data repository, making the reported information available to multiple existing and potential business partners; and (ii) the availability at affordable costs of online tools supporting the preparation of the disclosure (e.g., GHG calculator).

In conclusion, EFRAG considers that in conjunction with the materialisation of the conditions identified in the consultation, the cost of VSME is likely to be largely off-set in due time by the corresponding benefits including those to the society and environment.

Yours sincerely,

Patrick de Cambourg (Chair of the EFRAG SRB)

Chiara Del Prete (Chair of the EFRAG SR TEG)

17 December 2024

EFRAG

Cost-Benefit Analysis of the VSME

Submitted by:

Syntesia
Prometeia

20 November 2024

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ABSTRACT

This report presents the Cost-Benefit Analysis (CBA) of the Draft Voluntary European Sustainability Reporting Standard (VSME) prepared by EFRAG. The VSME is a reporting standard for non-listed micro, Small and Medium Enterprises (SMEs) which do not fall within the mandatory reporting requirements of the Corporate Sustainability Reporting Directive (CSRD). The VSME aims to harmonise and eventually replace ESG used by banks and large companies to collect data from SMEs.

The study quantifies the costs and benefits of VSME for preparers and includes qualitative considerations on other aspects. Scenario analyses were carried out to account for uncertainties in estimates. The key findings show that the net impacts from VSME are negative in the first year, because of implementation costs. They then turn positive from 2027 onwards, and grow to EUR 2,600 million by 2028, driven by lower recurring reporting costs and increasing benefits. More radical scenarios, e.g. in case provision of ESG information becomes *de facto* mandatory for accessing bank credit, would result in much higher positive impacts.

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ABBREVIATIONS AND ACRONYMS

BP	Business Partner
BTAR	Banking Book Taxonomy Alignment Ratio
CBA	Cost-Benefit Analysis
CDP	Carbon Disclosure Project
CRR	Capital Requirement Regulation
CSRD	Corporate Sustainability Reporting Directive
DMA	Double Materiality Assessment
EBA	European Banking Authority
ECB	European Central Bank
ECIROA	European Captive Insurance and Reinsurance Owners' Association
ED	Exposure Draft
EEA	European Economic Area
EMAS	Eco-Management and Audit Scheme
ESAP	European Single Access Point
ESG	Environmental, Social, and Governance
ESRS	European Sustainability Reporting Standards
GHG	Greenhouse Gas
GRI	Global Reporting Initiative
IIRC	International Integrated Reporting Council
IO	Information Obligation
LSME	Listed SMEs
NACE	Nomenclature des Activités Économiques dans la Communauté Européenne
NFRD	Non-Financial Reporting Directive
NGOs	Non-Governmental Organization
PAI	Principal Adverse Impact
PAT	Policies, Actions, Targets
PRI	Principles for Responsible Investment
PTF	Project Task Force
ROI	Return-On-Investment
SASB	Sustainability Accounting Standards Board
SBS	Structural Business Statistics
SCM	Standard Cost Model
SFRD	Sustainable Finance Disclosure Regulation
SMEs	Small and Medium Enterprises
SR TEG	Sustainability Reporting Technical Expert Group
SRB	Sustainability Reporting Board
TCFD	Task Force on Climate-related Financial Disclosures
UN SDGs	United Nations Sustainable Development Goals
VSME	Simplified Voluntary Reporting Standard for SMEs

1 INTRODUCTION

This Report was prepared for the assignment 'Developing a cost benefit analysis for (i) the Listed SMEs, small non-complex credit institutions and captive insurance/re-insurances Draft European Sustainability Reporting Standard for listed SMEs (LSME); and (ii) the voluntary standard for non-listed SMEs (VSME)'. This report is submitted to EFRAG by Syntesia Policy and Economics in partnership with Prometeia.

The purpose of the Report is to present the results the **Cost-Benefit Analysis (CBA) of the VSME.** It is structured as follows:

- Section 2 describes the **legal background** and context of the VSME and the main features of the standard as they have been developed following the public consultation;
- Section 3 provides a summary of the **data collection** processes deployed;
- Section 4 presents the description of the **population** of SMEs;
- Section 5 describes the **methodology** followed for the assessment of the costs and benefits;
- Section 6 illustrates the **costs and benefits** of the final version of the VSME;
- Section 7 concludes, by presenting the **CBA of the VSME** and complementing it with qualitative findings and considerations.

The first results of the analysis related to the VSME ED were presented to the EFRAG Sustainability Reporting Board (SRB) and Sustainability Reporting Technical Expert Group (TEG) on 12 June 2024. The comments received have been incorporated in this analysis. As a result of the public consultation and the findings of the first CBA the text of the VSME has undergone a revision process. A provisional version of the CBA based on the text available as of 16 October 2024 were presented to both the SRB and TEG on 30 October 2024 and related comments have also been incorporated here.

1.1 Purpose and scope of the study

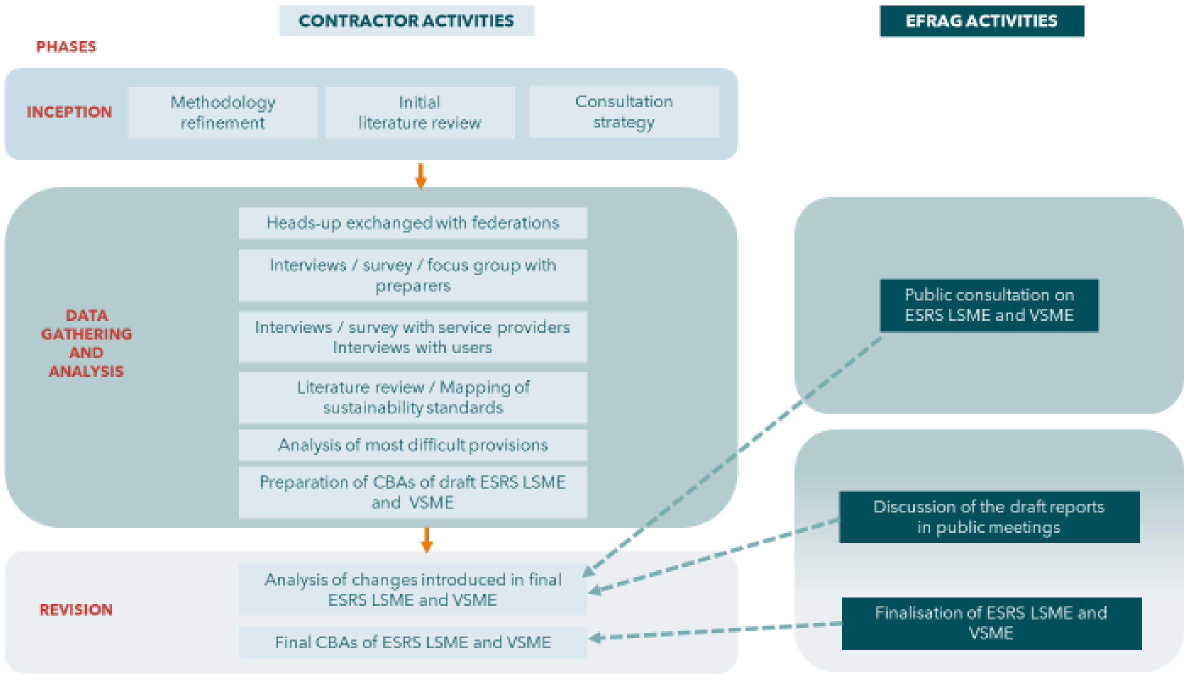
The overall purpose of the study is to provide **a CBA of the VSME, with its different target populations, and the VSME**.

The scope of the analysis includes an assessment of the **costs for the reporting SMEs and the benefits for** a broad set of stakeholders including **financial and management benefits, benefits from value chain participation, savings from harmonisation, impacts on competitiveness, as well as on increased transparency and accountability.** Not all these aspects did equally lend themselves to quantification, so a quali-quantitative approach was followed.

1.2 Activities undertaken

The assignment was envisaged to be carried out throughout three main phases: (i) inception, (ii) data gathering and analysis, and (iii) revision, summarized in Figure 1 and further detailed overfleaf. As the activities carried out by the study team and EFRAG were strictly interconnected, both are reported in the description of the assignment.

Figure 1. Overall approach of the assignment



The work on the assignment started on 23 November 2023; a start-up meeting was held online on December 4th between EFRAG and the study team, in which the structured outline report was presented. This was followed up by another technical follow-up between EFRAG and the study team on December 6th, and regular catch-up meetings starting from December 20th.

The **inception phase** was concluded by the end of January with the presentation of the inception report, including the refined methodology, an initial literature review, initial information on the populations affected by the standards, and the consultation strategy. The inception report was presented to the EFRAG SRB and EFRAG SR TEG on January 10th and was discussed on January 25th. The revised version of the inception report integrated the comments and reviews received by the SRB and SR TEG.

The **data gathering and analysis phase** was carried out from the end of January until May 2024. Throughout this phase a total of 75 interviews were carried out, including heads-up exchanges with European federations, and targeted interviews with national association, SMEs (listed and not), service providers, users and SMEs' business partners (lenders, large corporates, investors).

The first results of the CBA were presented to the EFRAG Sustainability Reporting Board (SRB) and Sustainability Reporting Technical Expert Group (TEG) on 12 June 2024 and discussed with all participants. This final report reflects some of the comments and insights provided by the SRB and TEG. The VSME was then revised also in the light of the results from the field tests and public consultation carried out by EFRAG. The study team has remained in contact with EFRAG during its work on revising the standards and attended as observers a number of SRB and TEG meetings, as well as the Bank Workshop on VSME held on 16 September 2024. Once the standard was closer to finalisation, a provisional CBA of results was carried out and presented to SRB and TEG on 30 October 2024.

The revision phase was concluded with the presentation of the **final CBA** on the approved texts in this report by end November 2024.

2 LEGAL BACKGROUND AND CONTEXT

The idea of having the VSME standard does not come from a legal requirement included in the Corporate Sustainability Reporting Directive (CSRD) The need for a voluntary ESG reporting standard for non-listed SMEs has been recently reaffirmed by the Commission in its **SME Relief Package**[1], and namely in action 14, which calls for the rapid adoption of such standard. The rationale behind its development was to prioritize the **identification of a proportionate set of indicators as a credible harmonised replacement** for the different Environmental, Social and Governance (ESG) questionnaires currently received by SMEs. This approach aimed to provide a framework that would allow SMEs to report on their ESG impacts with the same document in a manner that is manageable and relevant to their scale and capabilities. Therefore, **the focus was on providing tool for reporting the impacts relevant to the SME counterparts, in particular large customers and financial institutions, in a proportionate manner,** rather than a complete picture to inform all possible stakeholders.

The need to develop voluntary reporting standards for SMEs was first mentioned in the EU Commission Impact Assessment accompanying the CSRD in 2021[2] and then reiterated by several stakeholders during the work of EFRAG. The principles for a European Sustainability Reporting Standard (ESRS) Setting Process developed by EFRAG in the same year[3] further elaborated on the subject. After reaffirming the need to develop an SME-dedicated standard focused on the expectations of value chain counterparts and financial institutions, and coherent with related ESRS reporting requirements, the document made several key statements informing the subsequent VSME drafting process, and namely:

- The ESG information is relevant (i) for the reporting entity itself, (ii) for its value chain and (iii) for financial institutions was largely converging;[4] this would allow designing 'core SME' disclosures, limited in number and fit for purpose.
- SME sustainability reporting requirements should not merely be a simplified version of those for large reporting entities. These would likely not be fit for purpose and prove difficult and costly to produce. Instead, SME-specific sustainability reporting standards should be designed for SMEs on a stand-alone basis ('think small first') while ensuring that sustainability information provided by SMEs using such standards remains relevant for larger stakeholders.
- The new standard should address the lack of a dedicated ESG standard for SMEs and the fact that prevailing ones are considered as a potential administrative burden for them.[5]
- Size does not necessarily best reflect an SME's sustainability footprint and profile either, and so the business activity/sector and its associated risk profile should also be a primary driver for determining sustainability reporting requirements. Therefore, the report suggested considering a sector-specific approach towards sustainability reporting requirements for SMEs, which would lead

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[1] Communication from the Commission, SME Relief Package, COM/2023/535 final.

[2] "Consistent with the "think small first" approach, the standard-setter would develop a simplified standard for voluntary use by SMEs who are not under the scope of the NFRD. The simplified nature of this standard would reflect the fact that SMEs often do not have the technical expertise nor resources necessary to prepare reports in accordance with state-of-the-art, sophisticated standards." Commission Staff Working Document Impact Assessment Accompanying the Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting.

[3] https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520PTF-NFRS_MAIN_REPORT.pdf

[4] The Corporate Reporting Dialogue, an initiative bringing together the major standard-setters and framework providers globally, had released a report on September 2019, showing high levels of alignment between the existing climate reporting frameworks on the basis of the TCFD recommendations. As part of the Dialogue's Better Alignment Project, CDP, CDSB, GRI, IIRC and SASB collaborated intensively to assess alignment on the TCFD's disclosure principles, recommended disclosures and illustrative example metrics. Corporate Reporting Dialogue (September 2019) Driving Alignment in Climate-related Reporting.

[5] Already a decade before, the first figures officially mentioned in the EU policymaking debate pointed to an estimated cost of EUR 15-25,000 for an SME to develop a Global Reporting Initiative (GRI) report, which was deemed as out of scale.

to sector-agnostic disclosures[6] applicable to all SMEs, and sector-specific disclosures for those operating in most high-impact sectors[7].

The development of the VSME involved a series of discussions and decisions by EFRAG's Technical Expert Group (SR TEG) and EFRAG's Sustainability Reporting Board (SRB). The process began with the first discussion of a VSME by the SR TEG on 17 November 2022[8]. Subsequently, the EFRAG SRB decided on 27 January 2023 to follow a building block approach[9]. This approach included discussions on whether to develop a single standard for all SMEs or to create two separate standards: one for listed SMEs and another for non-listed SMEs, identified as VSME. Since SME standards are primarily articulated based on the sector, and not on the size, the concept of modularity was designed to overcome, at least in part, the complexity of dealing with a broad and diversified class of undertakings, ranging from less than 10 to up to 249 employees. This modular approach was intended to allow for flexibility and scalability in sustainability reporting for SMEs. This decision-making process laid the groundwork for the development of the VSME standard.

Largely developed within EFRAG, the VSME initiative has then been gradually referenced and increasingly endorsed also in Commission policy documents. It was first mentioned in the Q&A related to the ESRS adoption[10] as a tool being developed by EFRAG to enable non-listed SMEs to *"respond to requests for sustainability information in an efficient and proportionate manner"*. In addition, the recently released SME Relief Package[11] refers to the VSME as a tool to support SMEs *"in accessing sustainable financing"*. Action 14, in particular, states that the Commission will "*ensure that SMEs have a simple and standardised framework to report on ESG issues*" and "*the rapid delivery of* ***voluntary standards for non-listed SMEs***". The VSME has also been increasingly referenced as a possible tool for banks to gather information to fulfil their Pillar 3 reporting requirements and to comply with the data needs of the upcoming EBA guidelines on the management of ESG risks. Furthermore, there have been requests to the Commission from a number of Member States and SME envoys to exert "moral suasion" on all the stakeholders involved to limit in practice their ESG requests to SMEs for the purposes of CRSD reporting to the contents of the VSME irrespective of the fact that it is the LSME representing the "value chain" cap legally speaking.

2.1 Outline of the main VSME Features

The VSME is articulated into two[12] different modules:

1. the **Basic Module,** which provides the 'target' reporting standard for micro undertakings, and
2. the **Comprehensive Module,** summarising the likely requests from business partners within the value chain and the sustainable finance datapoints for lenders and investors.

[6] As regards the reporting structure it was noted that not all SMEs are required to prepare a management report. Finally, the ESS may also encourage the implementation of easy to communicate reporting means, e.g. through certifications evidenced by seals and logos (subject to appropriate verification processes), that indicate compliance with certain sustainability requirements and criteria. Moreover, the use of existing data and certifications to automatise the reporting process and decrease the administrative efforts required should be explored.

[7] The sector-specific sustainability reporting requirements for highly critical sectors should be based on EU policy priorities and legislative definitions (e.g. EU Taxonomy).

[8] The document discussed in November 2022 was part of the initial stages in the development of the VSME standard. It was identified as an Issue Paper by the former EFRAG Project Task Force ESRS (PTF-ESRS), specifically within cluster 8. This document served as a preliminary draft prepared by the EFRAG Secretariat and was presented during the SR TEG meeting on 17 November 2022. It marked the first discussion of VSME by SR TEG, setting the stage for the subsequent development and refinement of the VSME Exposure Draft through a series of versions and consultations, leading to the creation of a more structured and detailed Exposure Draft for further evaluation and feedback

[9] The building block approach, as discussed in the development of the VSME standard, is a methodological element designed to maintain consistency between the VSME standard and the European Sustainability Reporting Standards (ESRS).

[10] European Commission (2023), Questions and Answers on the Adoption of European Sustainability Reporting Standards, Brussels, 31 July 2023.

[11] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions SME Relief Package, COM/2023/535 final.

[12] An Additional Taxonomy Module acting as a residual placeholder for a link to taxonomy eligibility and alignment disclosure once an SME-dedicated version of the EU Taxonomy currently under preparation with the Platform on Sustainable Finance has been eventually approved by the Commission that has retained the right to act on it or not was eventually dismissed in latest versions of the VSME.

SMEs can choose between preparing the Basic Module only or complementing it with the other module, depending on their sustainability practices and the information requests received. However, the undertaking that wants to provide more comprehensive information may also integrate the metrics required in the Basic Module with selected disclosures from the Comprehensive Module.

2.1.1 Basic Module

The **Basic Module** is a kind of minimum reporting, envisaged primarily for micro-SMEs and ideally intended not to require support from an external consultant. It includes eleven disclosures, of which nine require quantitative datapoints:

- One introductory disclosure on the preparer;
- One cross-cutting disclosure on practices, policies and future initiatives;
- Five environmental disclosures;
- Three social disclosures;
- One business-conduct disclosure.

The disclosure requirements can be of a different nature as reported in Table 1 below:

1. **'Shall' mandatory disclosure requirements,** applicable to all companies;
2. **'If applicable' disclosure requirements**, referring to information that must be reported only when a company is concerned by the relevant metric or requirement (e.g. B2 on the company's practices for transitioning towards a more sustainable economy);
3. **'May' optional or voluntary disclosure requirements,** e.g. on type of land use in B5 on biodiversity or the gender pay gap in B8 workforce characteristics.
4. **"To be reported when above the threshold"** are applicable only to undertakings whose employment exceeds a given threshold.

As can be seen, there can be disclosure where different types of disclosures are mentioned in different paragraphs.

Table 1. Classification of VSME Basic Module Disclosures by Nature

Disclosure Requirements	Mandatory	If applicable	May Disclosure	Only if above Threshold
B 1 - Basis for preparation	✓	✓		
B 2 - Practices, policies and future initiatives for transitioning towards a more sustainable economy		✓		
B 3 - Energy and greenhouse gas emissions	✓[13]			
B 4 - Pollution of air, water and soil		✓		
B 5 - Biodiversity		✓	✓	
B 6 - Water	✓	✓		
B 7 - Resource use, circular economy and waste management	✓	✓		

[13] Breakdown only if available

B 8 - Workforce - General characteristics	✓		✓	✓
B 9 - Workforce - Health and safety	✓			
B 10 - Workforce - Remuneration, collective bargaining and training	✓			✓
B 11 - Convictions and fines for corruption and bribery		✓		

Source: VSME

The specific contents and datapoints for each disclosure are the following:

1. **Basis for preparation (Disclosure B1 - Introductory).** This disclosure includes the basis of the sustainability report preparation, including whether the report is consolidated or individual, and the list of subsidiaries covered and basic information on the company size and activities undertaken (including the legal form, the number of employees, the NACE code(s), the turnover, the size of the balance sheet). The geolocation of the company sites must be indicated together with details about any ESG rating eventually obtained.

2. **Practices, policies and future initiatives for transitioning towards a more sustainable economy (Disclosure B2 - Cross-cutting).** Undertakings should report practices[14], policies and future initiatives to transition towards sustainability and related targets Reporting is in a checklist format and may avail itself of a simplified template with binary questions and lending itself to be transposed in a dropdown menu.

3. **Energy and greenhouse gas (GHG) emissions (Disclosure B3 - Environmental).** This disclosure involves reporting total energy consumption and GHG emissions. Energy consumption should be in MWh, with a breakdown between renewable and non-renewable fossil fuels and electricity, if available The Basic Module requires reporting on Scope 1 and 2[15] GHG emissions while Scope 3 emissions are foreseen just as an entity-specific disclosure[16] due to its complexity and the lack of free available tools for SMEs. The undertaking is also required to disclose emission intensity: i.e. total GHG scope 1 and 2 emissions by total turnover.[17]

4. **Pollution of air, water and soil (Disclosure B4 - Environmental).** Undertakings must report on an if applicable basis, their pollution impact, including emissions, effluents and waste affecting air, water and soil quality. Information must be provided when the law requires to report to competent authorities (e.g. under the Industrial Emissions Directive and the European Pollutant Release and Transfer Register) or SMEs already report according to an Environmental Management System, such as the Eco-Management and Audit Scheme (EMAS)[18].

5. **Biodiversity (Disclosure B5 - Environmental).** This disclosure requires information on the undertaking's impacts on biodiversity on an "if applicable" basis, i.e. depending on whether the company is located near a biodiversity relevant area. The number and area (in hectares) of sites in use

[14] Examples include initiatives to improve working conditions and equal treatment in the workplace, sustainability training for the undertaking's workforce, collaboration with universities related to sustainability projects, efforts to reduce the undertaking's water and electricity consumption or to prevent pollution, and initiatives to improve product safety.

[15] The VSME requires location-based Scope 2 Emissions. This approach calculates emissions based on the average emissions intensity of the electricity generated within the geographic location where the electricity is consumed. It takes into account the emissions associated with the average electricity mix in the area where the energy is consumed and allows for straightforward reporting. It differs from market-based scope 2 in that the latter account for the specific environmental attributes of the electricity they purchase and reflects the environmental benefits of purchasing renewable energy and incentivizes companies to invest in clean energy sources.

[16] Application requirements simply note that SMEs active in manufacturing, construction and packaging are likely to have significant scope 3 emissions.

[17] GHG intensity is envisaged to be calculated automatically, in a future online tool version of VSME.

[18] This is, actually, one of the few remaining instances of a synergy with the original idea of exploiting SME ESG certification schemes as one of the bases for VSME reporting.

in or near biodiversity sensitive areas must be reported. In addition, broader details can be reported on the total use of land, indicating the part in sealed areas[19] and in total nature-oriented areas on-site (roofs, façades, etc.) and off-site.

6. **Water (Disclosure B6 – Environmental).** It typically consists of water withdrawal (separately indicated for high-stress areas) and eventually water consumption. Whenever an undertaking withdraws water from the public water network and discharges it into the sewer, water consumption is close to zero and can therefore be omitted. Reporting on water consumption is required only if applicable. It can be argued this is particularly important for undertakings that have a significant water withdrawal and consumption, beyond the simple use from the public network, including those that draw water from other sources such as groundwater, rivers or lakes, which raises the issue of availability of water meters.
7. **Resource use, circular economy and waste management (Disclosure B7 – Environmental).** The disclosure concerns all companies, which are to report the total annual generation of waste in units of weight (preferably) or volume, broken down by type (non-hazardous and hazardous). Also, they must report the total annual waste diverted to recycling or reuse, expressed in units of weight (e.g., kg or tonnes). For undertakings operating manufacturing, construction and/or packaging processes the annual mass-flow[20] of relevant materials used as drawn from the EMAS methodology must also be reported.
8. **Workforce – General characteristics (Disclosure B8 – Social).** This disclosure requires information on the breakdown of workforce by type of employment contract, gender and, for the preparers operating in more than one country, country of employment. The companies with 50 employees or more are also required to disclose their employment turnover rate.
9. **Workforce – Health and safety (Disclosure B9 – Social).** The disclosure includes health and safety metrics, such as work-related accidents and fatalities.
10. **Workforce – Remuneration, collective bargaining and training (Disclosure B10 – Social).** This disclosure includes reporting on employee remuneration policies (including the gender gap beyond a certain threshold), the extent of collective bargaining coverage and training initiatives, highlighting the undertaking's commitment to fair labour practices and employee development.
11. **Convictions and fines for corruption and bribery (Disclosure B11 – Business Conduct).** In case of convictions and fines in the reporting period, the undertaking shall disclose the number of convictions, and the total amount of fines incurred for the violation of anti-corruption and anti-bribery laws.

2.1.2 Comprehensive Module

The **Comprehensive Module** provides for nine additional disclosures, of environmental (2), social (3), governance (2) and cross-cutting (2) nature. They also include the metrics that are required by financial market participants (based on their SFRD Principal Adverse Impact – PAI, Pillar 3 and the Benchmark regulation) and that may be relevant to other corporate clients. SMEs are expected to use this module when they receive ESG requests to assess their sustainability risks from business partners, such as customers or financial institutions. The key assumption is that **the Comprehensive Module, on top of the Basic module, can satisfy the data needs of both banks and corporate customers**, as SFDR PAI are considered proxies to manage the sustainability profile of SMEs clients (banks/investors) and customers (corporates). Most metrics in this module should be reported, for simplification purposes, under the "if applicable" principle.

[19] A sealed area means any area where the original soil has been covered (such as roads) making it impermeable. This non-permeability can create environmental impacts. The definition is not used for ESRS reporting purposes and is specific to the VSME only.

[20] The annual mass-flow is a measurement that helps companies understand how much material they use, which ties into rules for being efficient. Companies must share information about the materials they use, whether they buy them from suppliers or generate them internally. To determine the annual mass-flow, businesses should first figure out which materials are essential for their work (like how efficiently they're using wood). If a company uses different types of materials, it needs to keep track of each one separately, showing how much of each material it uses (like how many tons of wood it buys). This tracking includes all kinds of materials they use in their production, like raw materials and partially finished products, but it doesn't include energy sources or water. This information should be expressed in common measurement units such as weight (like kilograms or tons) or volume (like cubic meters), so it is easy to understand and compare.

The type of disclosure requirements is reported in Table 2 below according to the same criteria used for Table 1.

Table 2. Classification of VSME Comprehensive Module Disclosures by Nature

Disclosure Requirements	Mandatory	If applicable	May Disclosure	Only if above Threshold
C 1 -Strategy: Business Model and Sustainability-related initiatives	✓	✓		
C 2 - Practices, policies and future initiatives for transitioning towards a more sustainable economy		✓		
C 3 - GHG Reduction Targets and Climate Transition		✓		
C 4 - Climate Risks		✓	✓	
C 5 - Workforce Additional General Characteristics		✓		
C 6 - Human Right Policies and Processes	✓	✓		
C 7 - Severe Human Rights Incidents	✓	✓		
C 8 - Revenue from Certain Sectors and Exclusion from EU Reference Frameworks	✓	✓		
C 9 - Gender Diversity Ration in Governance Body		✓		

The specific contents and datapoints for each disclosure are the following:

1. **Strategy: Business Model and Sustainability – Related Initiatives (Disclosure C1 – Cross-cutting).** The undertaking shall describe the key elements of its business model and strategy, including: significant groups of products and/or services offered (such as B2B, wholesale, retail, countries); main business relationships (such as key suppliers, customers distribution channels and consumers); and if its strategy has key elements that relate to or affect sustainability issues, a brief description of those key elements

2. **Description of practices, policies and future initiatives for transitioning towards a more sustainable economy (Disclosure C2 – Cross-cutting)** If the undertaking has put in place specific practices, policies or future initiatives for transitioning towards a more sustainable economy, which it has already reported under disclosure B2 in the Basic Module, it shall briefly describe them. It may additionally indicate, if any, the most senior level of the undertaking accountable for implementing them.

3. **GHG emissions reduction target and climate transition (Disclosure C3 – Environmental).** Under this requirement, the company must report its targets for GHG emissions reductions, if adopted. Scope 3 emissions must be reported if the targets concern them as well. Undertakings operating in high climate impact sectors and adopting a transition plan may provide information about the plan, including an explanation of how it contributes to reduce GHG emissions. If it does not have one, it shall indicate whether and when this will be adopted.

4. **Climate risks (Disclosure C4 – Environmental).** If climate-related hazards or climate-related transition events have been identified the undertaking shall report them, disclose related exposure and sensitivity of assets, activities and value chain including their time-horizon and the climate adaptation actions undertaken. On a voluntary basis this can be complemented by a disclosure about effects on financial performance or business operations in the short, medium or long term and whether this risk is considered as high, medium or low.
5. **Workforce additional characteristics (Disclosure C5 – Social).** Small and medium companies above 50 employees may disclose the female to male ratio in management positions, as well as the number of self-employed working exclusively for the undertaking and temporary workers provided by companies specialised in such services.
6. **Human Rights Policies and Processes (Disclosure C6 – Social).** The undertaking shall answer in a binary yes or no format to questions on whether it has a code of conduct or human rights policy for its own workforce and whether this concerns: i) child labour, ii) forced labour; iii) human trafficking; iv) discrimination; v) accident prevention; vi) or other matters.
7. **Severe Negative Human Rights Incidents. (Disclosure C7 – Social).** The SME must answer in a binary yes or no format on whether it has had confirmed incidents related to i) child labour; ii) forced labour; iii) human trafficking; iv) discrimination or v) other related matters. It may disclose on a voluntary basis the actions undertaking to address them. Finally, the SME is to answer whether they are aware of any such confirmed incidents in their supply chain, affected communities, consumers and end-users and eventually explain them.
8. **Revenues from certain sectors (exclusion from EU reference benchmarks) (Disclosure C8 – Governance).** This disclosure focuses on the revenues generated from sectors that are considered sensitive or significant from a sustainability perspective, providing insight into the company's sectoral exposure. Additionally, the undertaking is to disclose whether it is excluded from the EU reference benchmarks that are aligned with the Paris Agreement[21].
9. **Gender diversity ratio in governance body (Disclosure C9 – Governance).** The disclosure asks for the gender diversity ratio in the governance body, if in place.

To validate the comprehensive module, EFRAG held a meeting with banks and other financial institutions under the assumption that these were more likely to use the standard as such, while corporate clients would complement it with more sector-specific requests. This supplemented and updated, also in the light of banks' own regulatory requirements,[22] the review that EFRAG had carried out of twelve real-life examples of ESG questionnaires from various sources[23] that was used as a foundation of the original VSME ED.

2.2 Main changes relevant to the Cost-Benefit Analysis

This section describes **the main changes between the VSME ED and its final version that are relevant to the CBA**, including their impact on preparers' reporting costs. The following list is not comprehensive of all the changes introduced. The impacts on reporting costs have been estimated based on data and parameters collected during the ED consultation activities, as well as the workshops and meetings organized by the EFRAG during the revision process, and independent analysis.

The VSME ED was greatly simplified in structure and disclosure types, driven by feedback from users and preparers during public consultation.[24] The modifications to the VSME ED can be categorized into two primary areas: structural changes and changes in the number and type of disclosures.

[21] These are defined in articles 12.1 and 12.2 of the Commission Delegated Regulation 2020/1818.
[22] In particular the likely consequences in terms of data requests of the upcoming EBA Guidelines on the Management of ESG Risks were considered. This was done based on the developments following the April 2024 consultation See https://www.eba.europa.eu/activities/single-rulebook/sustainable-finance/guidelines-management-esg-risks
[23] These included (i) two from national central banks; (ii) four from national federations; (iii) one from a national credit information provider; (iv) one from a national bank; (v) one from a rating agency; and (vi) three from banks and supply chain (international initiatives) actors.
[24] For instance, banks insisted on having data on the geolocation of company sites to be able to carry out their own analysis on climate risk exposure and commented on the limited usefulness of any materiality analysis in influencing the scope and size of their requests.

- **Structural Changes**

- The VSME's structure has been streamlined by removing the Narrative PAT Module and replacing it with closed questions in the Basic Module. This change was influenced by feedback from banks during public consultations, to facilitate the processing of vast amounts of information.
- In the ED, the VSME included three modules: the Basic Module, and two optional ones: (i) Business Partners and (ii) Policies, Actions and Targets both requiring a materiality assessment. In the final version of the VSME, there are two modules: the Basic Module and the Comprehensive Module without the need for a materiality assessment.

- **Changes in the Number and Type of Disclosures**

- The total number of disclosures has been reduced from 26 (12 in the Basic Module, 5 in the Narrative PAT module, and 9 in the BP Module) to 20 (11 in the Basic Module and 9 in the Comprehensive Module).
- Three disclosures from the Policies, Actions, and Targets modules have been added to the Basic Module: (i) N1 Strategy: business model and sustainability-related initiatives; (ii) N3 and N5 on the management and governance of sustainability matters (N3 applies only to companies with PATs in place – likely a minority of VSME preparers, while N5 is voluntary) in a very simplified checklist format suitable for a dropdown menu. The remaining two narrative disclosures were dropped.
- The scope of some of the disclosures in the basic module (e.g. B1 and B8) has been slightly expanded. Cumbersome calculation of content of recycled material for SMEs active in manufacturing, construction and processing has been replaced by mass-flows considerations.
- The voluntary disclosure on workers in the value chain and stakeholders (B11) from the ED Basic Module, considered one of the most burdensome to understand and comply with, has been removed.
- Former disclosures BP3 and BP4 on GHG emissions and transition plans have been merged.
- Three DRs have been deleted from the Comprehensive Module (BP on Hazardous and Radioactive Waste, BP10 on work-life balance and BP11 on apprenticeship) because deemed hardly relevant.
- Former BP7, BP8 and BP9 containing complex and cumbersome references to other international legislation and reliance on ILO, UN and OECD instruments designed for multinationals, have been replaced by much simpler binary questions. The new reference to the exemption from EU benchmarks in Paris Alignment in C8, that could sound obscure to the non-specialist reader, has been spelled out in the text of the standard.
- Former disclosure BP5 on physical risks from climate change, considered out of reach for many SME preparers, has been simplified, making the most cumbersome and costly parts optional (e.g., the disclosure of financial effects of physical climate risks).

- **Impact on Costs**

- The reorganization of disclosures, the elimination of reference to international standards, the wider use of closed or yes/no questions has led to an estimated reduction of 10-30% in the internal personnel time required for preparing sustainability statements.
- The propensity to use platforms or other automated means for preparing sustainability statements is estimated to increase by 15-35% for smaller preparers and by 5-25% for larger ones.
- The elimination of the materiality assessment will save preparers the associated costs, previously estimated between EUR 6,000 and 20,000.
- The Comprehensive Module, which includes elements required by banks and financial institutions, is likely to be requested from 50% of micro and small enterprises with less than 20 employees) applying for bank loans and 100% of medium and small enterprises with 20 employees or more. This means that the estimated population using the comprehensive module is going to be larger compared to the share of preparers that were estimated to use the business partner module.

The expected impacts on costs are summarised in Table 3 overleaf.

Table 3. Expected impacts on VSME revisions on costs

Change	Impact on reporting costs	
Streamlining, removing of narrative disclosures, elimination of references to international guidelines	Reduction of preparers' internal costs by 10-30% More likely use of platforms and automated means because of simpler, YES/NO or closed questions: 15-35 pp. for smaller preparers, 5-25 pp. for larger preparers	↓
Removal of materiality assessment	Reduction of preparers costs (not for basic module): 6,000 – 20,000 €	↓
DRs in the Basic Module	Largely comparable scope, no changes to costs associated (±10% sensitivity analysis)	=
DRs in the Comprehensive Module	Largely comparable to those included in the BP module	=
Nature of requests from financial institutions	Feedback from financial institutions suggest that in many cases the comprehensive module will be requested. Uncertainty whether all banks will request it for all types of loans - 50% of micro enterprises and small enterprises with less than 20 employees will be requested the comprehensive module by banks (sensitivity: 25-75%) - All small enterprises with 20 employees or more and medium enterprises will be requested the comprehensive module by banks (low scenario at 80%)	↑

3 DATA COLLECTION

The analysis used both primary and secondary sources, including:

- **Interview programme**. The study team conducted an interview programme involving preparers, service and IT providers, and users to collect primary data from stakeholders directly involved in the adoption of the standards. The interview programme was divided into heads-up exchanges and targeted consultations aimed at gathering various forms of evidence from stakeholders, including data and parameters to quantify costs and benefits, market acceptance of the standards, information on populations covered by the disclosure requirements, as well as feedback on the most challenging or costly aspects. The interview programme was shared with the analysis of the LSME; some stakeholders were asked questions on only one draft standard, some questions (e.g small banks, consultants) were asked questions on both draft standards.

- **Public consultation and field test on LSME and VSME Exposure Drafts**. EFRAG carried out a public consultation and field test exercise on the LSME and VSME Exposure Drafts. The field test involved SMEs and users evaluating the Exposure Drafts, providing information on their feasibility, costs, challenges, benefits, and usefulness. This report incorporates the analysis of the field test results, as well as the findings from the public consultation.

- **Participation into EFRAG VSME Consultation Activities after Public Consultation and Field Test.** To better follow developments and related cost assessment considerations the study team attended several EFRAG SRB and SR TEG online meetings in July, September and October. The team also specifically attended the VSME Bank Workshop on September 16th, which specifically reviewed DR relevance and usefulness from a user's perspective.

- **SME survey.** In a recent study for the European Commission, the Study Team conducted a survey on SMEs regarding their ESG reporting practices, covering 13 Member States and more than 4,400 companies. The survey includes estimates relevant to the analysis of current ESG costs and practices.

- **Literature review.** Several studies have estimated costs and benefits related to the scope of this study and have been used to validate the estimates or fill data gaps.

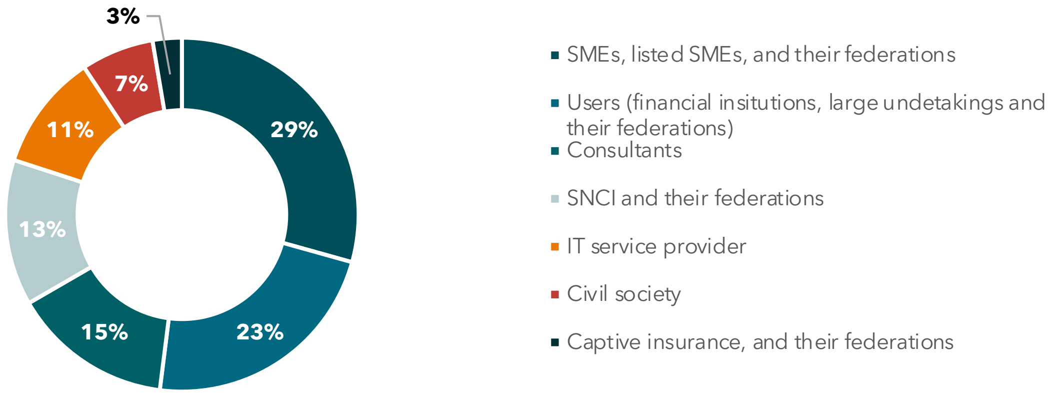
In the following sections, all the data collection processes will be described in greater detail.

3.1 Interview programme

The interview programme constituted one of the main sources of data for this assignment and was necessary given the complexity of the topic and the need to obtain sufficient data on future benefits and the likely adoption scenarios for the ED standards. The interview programme was divided in two phases: (i) an initial round of heads-up interviews and (ii) a targeted consultation.

Overall, **a total of 75 interviews were carried out during the whole interview programme**, of which 14 during the heads-up interviews and 61 during the targeted consultation. As shown by Figure 2Figure 2, SMEs and their federations represented 29% of the participants, making them the largest group in the interview programme. The second group consisted of users (23%), which included financial institutions and large undertakings and their federations.

Figure 2. Overview of the interview programme



3.1.1 *Heads-up interviews*

The **heads-up interviews** were aimed at collecting initial information and insights by the federations of the stakeholders directly concerned by these standards. During these interviews, business federations were also requested to elicit the participation from their members to the following consultation activities. The heads-up interviews were scheduled with the most relevant EU federations representing the stakeholders' directly involved by the standards, and namely:

- **Generalist business federations** i.e., SME United and Eurochambres.
- **EU business federations of smaller banks**, and namely the European Association of Co-operative Banks and the European Savings and Retail Banking Group.
- **EU business federation of users**, namely the European Banking Federation and Business Europe.

The interviews were based on an open-ended questionnaire, which focused on the interviewees' assessment of the standard an on understating the relevant population. Initial questions were also targeted at understanding the current costs of sustainability reporting and the foreseen benefits.

3.1.2 *Targeted consultation*

The targeted consultation consisted of different strands targeted at the different categories, including directly involved stakeholders, following up on the approach adopted during the heads-up interviews. More specifically, during the targeted consultations, direct contact was established with individual SMEs through their association, which in most cases allowed the organisation of focus groups or acted as a liaison to gather the views of several members. Interviews were also conducted with financial institutions, as users.

On top of these entities, interviews with IT platforms and service providers offering sustainability reporting services were also carried out. In fact, as the quantification exercise concerns an obligation (i.e., its standard) which is not yet in force, cost and benefit data could not be retrieved (only) from likely affected entities.

Interviews were carried out based on a semi-structured questionnaire, including both closed questions for the collection of comparable data, and open questions to discuss broader qualitative issues. Questionnaires were tailored to the various stakeholder segments. Seven questionnaires have been prepared for the various categories, addressing different topics, as summarized in Table 4 below.

Table 4. Topics of the questionnaire

Stakeholder	Topics				
Non-listed SMEs	Current reporting practices	VSME Relevance	Cost of VSME	Other costs and benefits	
Listed SMEs	Current reporting practices	Cost of LSME	Other costs and benefits	User perspective and relevance of VSME	VSME Relevance and LSME value chain cap

Financial institutions	Current reporting practices	Cost of LSME	Other costs and benefits	Sustainability information request	VSME Relevance and LSME value chain cap	VSME other costs and benefits
Corporate users	Current reporting practices	Sustainability information request	VSME Relevance and LSME value chain cap	Other costs and benefits		
Service providers (both questionnaires)	ESG reporting by SMEs	VSME	Costs of VSME reporting	Other costs and benefits	LSME	

3.2 EFRAG public consultation

In parallel to the targeted consultation, EFRAG also consulted all relevant stakeholder affected by the adoption of these standards. More in detail both for the VSME and LSME, a field test and a public consultation were carried out starting from January to May.

The public consultation aimed at gathering feedback from stakeholders on (i) (i) the relevance of the proposed disclosures; (ii) the simplifications achieved; and (iii) the market acceptance of the VSME ED, (iv) the proposed architecture; and (v) the implementation of CSRD requirements, particularly the role of the LSME ED in defining the value chain cap for information to be reported by large undertakings.

In addition, the field tests[25] were run in parallel to the public consultations to provide additional fact-based evidence. The main purpose was indeed to gather facts and indication on the challenges and benefits of the ED's content from stakeholders who will prepare actual disclosures.

The Field Test for VSME focused on the following key elements:

- The costs and challenges associated with each of the disclosures;
- The understandability of the guidance provided in the ED and its ability to support the implementation of the disclosure requirements; and
- The expected benefits of the disclosures

Once the consultation phase was closed, EFRAG organised a series of workshops, for the participants to the VSME field test. These were also attended by the study team, to complement and validate the information collected through the other primary and secondary sources as described in this Section.

The participation to EFRAG's consultation package was as follows: 164 respondents to the VSME Field Test Respondents, 311 VSME public consultation responses and 22 comment letters.

The study team could also evaluate the results of the EFRAG own public consultation as presented to both SRB and SR TEG in July (EFRAG VSME documents 05-04, 05-05, 05-06).[26]

3.3 Participation into EFRAG VSME consultation activities after public consultation and field test

The study team followed post-consultation standard revision and development activities by attending the related SRB and SR TEG online meetings from July to November. On top of that the study team participated to the EFRAG VSME Bank Workshop on September 16th.

[25] Questionnaire of the field test are available here: https://www.efrag.org/News/Public-479/EFRAGs-

[26] The results of the public consultation are available at the following link: https://www.efrag.org/en/news-and-calendar/meetings-calendar/efrag-srb-meeting-10-july-2024

3.4 SME survey

In a recent study for the European Commission,[27] the study team carried out a survey on SMEs about their ESG reporting practices, covering 13 Member States and more than 4,400 respondents. The survey took place in July 2023. The survey includes estimates which are relevant to the current analysis, such as the share of SMEs that already engage in sustainability disclosures, the costs thereof, the amount of duplicated requests from buyers and financial institutions. Most of the information is available per size segment, i.e. for micro, small and medium enterprises, as well differentiated between listed and non-listed SMEs. This information has been particularly useful to estimate baseline costs and the current uptake of ESG standards, which served as a basis for determining future adoption, cost and benefits scenarios.

The SME survey covered 13 Member States: the four largest (France, Germany, Italy and Spain), three five north-western EU countries (Denmark, Finland, Belgium, the Netherlands and Sweden), three Central and Eastern European countries (Hungary, Poland and Romania), and one Southern country (Greece). The Survey attracted between 250 and 500 SMEs in each of the EU Member States covered. After the removal of noisy data, outliers and incomplete or inconsistent answers, a total of 4 404 completed questionnaires have been analysed.

In terms of enterprise size, the majority (74%) of respondents were micro enterprises, 16% were small enterprises and 10% were medium-sized enterprises. As far as the sector of activity is concerned, a granular classification was adopted, comprising most manufacturing and service sectors, with the exclusion of agriculture and forestry. To reduce the bias produced by non-responses and underrepresented groups, results have been extrapolated to the EU level based on the EU SME population. Weights for the various size class (micro, small, and medium) and industries (1-digit NACE code) were extracted from Eurostat Structural Business Statistics (SBS)[28].

3.5 Literature review

The assignment included a desk review of relevant policies and existing studies and estimates, concerning the CSRD specifically, as well as other disclosure requirements (e.g. SFRD, taxonomy) and ESG frameworks and standards (e.g. GRI, SASB, IIRC, TCFD, CDP, GHG protocol, UN SDGs, etc).

The review encompassed, first and foremost, studies and analysis of CSRD, the ESRS standards[29] and related EU policies, including impact assessment documents and implementation reports,[30] as well as EFRAG preparatory works.[31]

Other data sources include thematic publications (e.g., from the Principles for Responsible Investment (PRI), an UN-supported network of investors), academic studies, 'grey' literature, such as industry reports. The grey and academic literature analysing the linkages between sustainability reporting related costs and

[27] Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, Giannotti, E., Bolognini, A., Pal, T., (2024) SME disclosure on taxonomy alignment – Cost/benefit analysis – Final report. Volume 1, Publications Office of the European Union, https://data.europa.eu/doi/10.2873/48775

[28] Eurostat SBS describe the detailed structure, economic activity, and performance of businesses over time, database available here: https://ec.europa.eu/eurostat/web/structural-business-statistics/database

[29] All EFRAG Draft ESRS for LSME and VSME *cfr,* EFRAG SR TEG 13 July 2023, Agenda paper 03-02, Agenda paper 03-03, Agenda paper, 03-04, Agenda paper, 03-05, Agenda paper, 03-06; and EFRAG draft VSME ESRS Paper 04-02. Also Input Papers, i.e., EFRAG Secretariat (2023), Input Paper basis for conclusions LSME ESRS, EFRAG SR TEG meeting, 19 June 2023, Paper 03-02, and EFRAG Secretariat (2023), Input Paper basis for conclusions VSME ESRS, EFRAG SR TEG meeting, 13 July 2023, Paper 04-04; and EFRAG Secretariat (2023), Building blocks LSME and VSME (revised version) – after SR TEG meeting 19 June and SRB 26 June 2023 Issues Paper, 13 July 2023 Paper 04-05

[30] Commission Staff Working Document-Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, 21 April 2021

[31] All EFRAG Draft ESRS for LSME and VSME *cfr,* EFRAG SR TEG 13 July 2023, Agenda paper 03-02, Agenda paper 03-03, Agenda paper, 03-04, Agenda paper, 03-05, Agenda paper, 03-06; and EFRAG draft VSME ESRS Paper 04-02. Also Input Papers, i.e., EFRAG Secretariat (2023), Input Paper basis for conclusions LSME ESRS, EFRAG SR TEG meeting, 19 June 2023, Paper 03-02, and EFRAG Secretariat (2023), Input Paper basis for conclusions VSME ESRS, EFRAG SR TEG meeting, 13 July 2023, Paper 04-04; and EFRAG Secretariat (2023), Building blocks LSME and VSME (revised version) – after SR TEG meeting 19 June and SRB 26 June 2023 Issues Paper, 13 July 2023 Paper 04-05

societal benefits is still under-developed[32] because the mandatory reporting requirements are recent, and most indirect benefits are not yet visible to society.

[32] The starting point for a review of this subject is by Christensen, H. B., Hail, L. and Leuz, C. (2021), 'Mandatory CSR and sustainability reporting: economic analysis and literature review', Review of Accounting Studies, 26(3), pp. 1176–1248. A EU-centered perspective can be found in La Torre, M., Sabelfeld, S., Blomkvist, M. and Dumay, J. (2020), 'Rebuilding trust: sustainability and non-financial reporting and the European Union regulation', Meditari Accountancy Research, 28, pp. 701–725, doi:10.1108/medar-06-2020-0914

4 POPULATION - THE ENTITIES CONCERNED

4.1 EU SME population

The VSME concerns all SMEs falling outside the scope of the CSRD, i.e. whose securities (including stocks, bonds) are not traded on a regulated market. This means that **the VSME can be applied by the vast majority of the about 32 million EU SMEs**[33] operating in the industry and service sectors.[34] A description of the SME population, as updated by the most recent Eurostat figures is presented in Box 1 below. This is a proxy of the criteria integrated to the Accounting Directive[35].

Box 1. SME definition

More in detail, according to Eurostat,[36] nearly 32 million SMEs operate in the industry and services sector in the EU, which is more than 99% of the total number of companies. As shown in Table 5, the vast majority (94%) consist of micro companies with less than 9 employees; small businesses with 10 to 49 employees represent 5% of SMEs, with medium companies with more than 49 employees account for about 1%. Companies with less than 20 employees – defined 'smaller preparers' for the quantification of costs – represents 97% of the total population. Limited liability companies, which are typically required to publish their accounts under the Accounting Directive, amount to about 13.7 million, the other being non-limited (e.g. personal) companies.[37]

Table 5. EU SME population

	Number ('000)	%
Micro	30,119	94%
Small	1,579	5%
Of which: => 20 employees	*1,039*	*3%*
Of which: < 20 employees	*540*	*2%*
Medium	247	1%
Total	**31,945**	

Source: Eurostat SBS

In terms of sectoral distribution, the largest number of SMEs operate in the wholesale and retail trade (18%), professional activities (16%), and construction (12%). Manufacturing accounts for about 7% of the total number of SMEs; this sector is more prominent among small and medium enterprises.

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[33] In theory, a VSME could also be applied by non-EU SMEs (e.g. for own business decisions, to apply for a subsidy or a loan in the EU). While this is possible the geographical scope of this analysis and of the subsequent CBA is on EU companies.

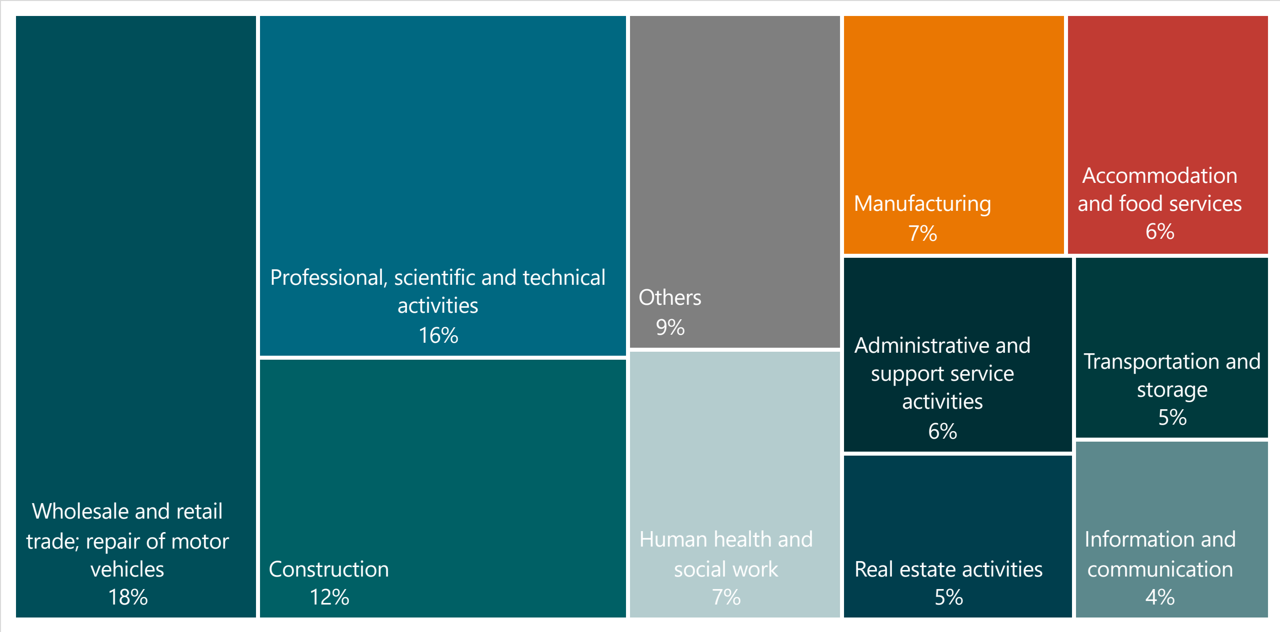
[34] It can also be used by companies in the primary sector (i.e. agriculture, fisheries and forestry); given their specific business form and the structure of EU statistics, these cannot be added to the analysis, but are likely to represent few additional million enterprises potentially involved.

[35] An undertaking is micro if it does not exceed two of the following threshold: i) €450,000 in balance sheet total, ii.) €900,000 in net turnover, and iii. 10 employees. An undertaking is small if it does not exceed two of the following thresholds: €5 million in balance sheet total, ii. €10 million in net turnover, or iii. an average of 50 employees. An undertaking is medium if it does not exceed two of the following thresholds: I €25 million in balance sheet total, ii. €50 million in net turnover, and iii . 250 employees. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (Text with EEA relevance), and related amendments ELI: http://data.europa.eu/eli/dir/2013/34/2024-01-09

[36] Eurostat (2023) Structural Business Statistics, retrieved from https://ec.europa.eu/eurostat/web/structural-business-statistics/database

[37] Commission Staff Working Document Impact Assessment Accompanying the document Proposal for a directive of the European parliament and of the Council on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/UE and 2009/110/EC and repealing Directive 2007/64/EC and Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions /* SWD/2013/0288 final */

Figure 3. Distribution of SMEs across sectors at the EU level



Source: Eurostat's Structural Business Statistics (2022)

4.2 VMSE preparers

Two categories of SMEs are likely to issue ESG reporting based on VSME:

- **Spontaneous preparers.** These are SMEs perceiving to receive a direct net benefit from issuing detailed and harmonised ESG statements based on the VSME. These are likely to be found among:
    - SMEs active in B2C '**green markets**', with value proposition targeted to environmentally-conscious consumers
    - SMEs selling products and services centred on sustainability (e.g. advanced manufacturing, ESG-related services), including when active in B2B value chains
    - SMEs active on the green public procurement market
    - SMEs with a special attention to ESG issues (e.g. B-corp)

Consistent data on these different populations are not available. However, the amount of spontaneous preparers is likely to correspond to the share of SMEs which, already today, voluntarily engage in ESG reporting. In 2023, about 5% of EU SMEs did so, and about 10% more expressed their intention to start in the following years.38 Spontaneous preparers are thus estimated to represent, in the following 5 years, about 15% of the EU SME population.

- **Preparers upon request**. This group includes SMEs receiving a request from the value chain or financial institutions to provide ESG information. In this case, the adoption can be direct, when the SME is requested to provide a VSME statement; or indirect, when the SME is requested to provide ESG information, and the SME decides to use VSME statements to this purpose.

  The potential population of preparers upon request include (i) those who demand bank credit, which are estimated to represent about 20% of the SME population;[39] (ii) suppliers of large corporations, which are estimated to represent about 12% of the SME population (see Box 2 overleaf); and (iii) those requesting funds or participating in the green public procurement market[40]. Of these potential population, some SMEs may still prefer to respond directly to the request (e.g.

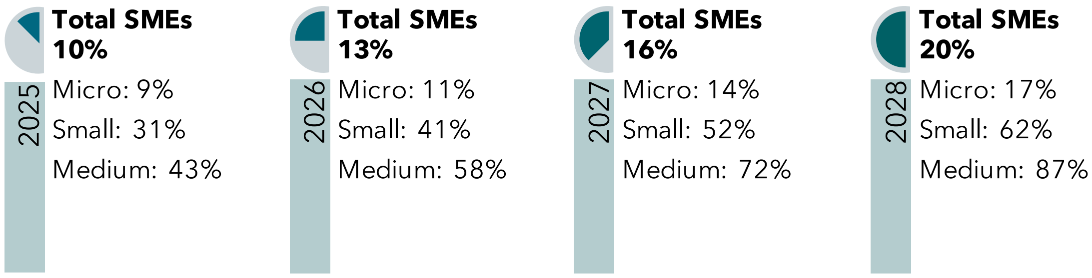
[38] SME survey.

[39] OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scoreboard, available at https://www.oecd.org/cfe/financing-smes-and-entrepreneurs-23065265.htm

[40] No detailed data is available in this respect, since, at the moment, ESG disclosures are not a mandatory requirement, though this is likely to become the case in the future.

when the request has scope much narrower than the VSME). Within this population, estimates on the number of preparers upon request are obtained by considering the number of SMEs which currently receive a request, and projecting a reasonable growth over the period of analysis, as shown in Figure 4 below. Preparers upon request are expected to represent a majority of the potential population.

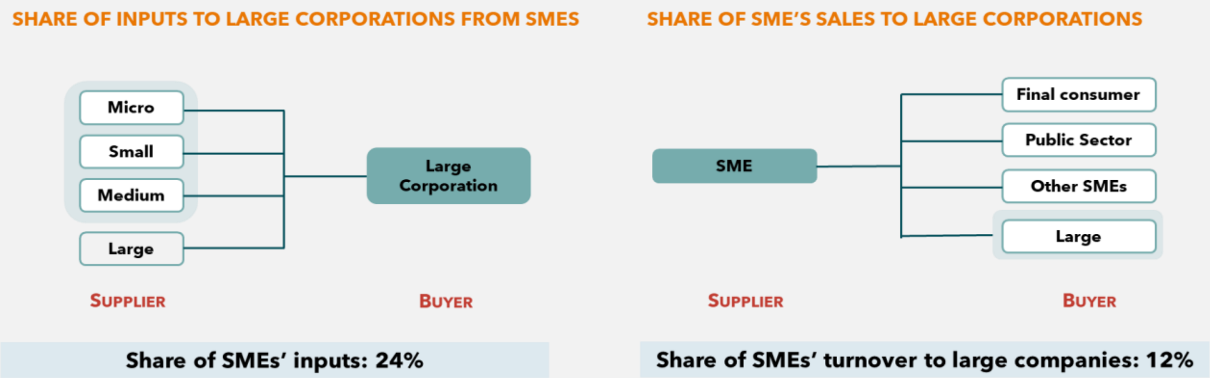
Figure 4. Potential population of prepares upon request



Box 2. Share of SMEs supplying to large corporations

SMEs are an important supplier for large companies, providing about a quarter (24%) of their inputs. Conversely, large companies are an important client for SMEs, albeit not on the same scale. SMEs supply to other SMEs, final consumers, public entities or large companies. The former represent about 12% of their turnover. These estimates, shown in Figure 5 below, are obtained from the EU supply and use tables provided in Eurostat's national accounts.

Figure 5. Supply relationships between SMEs and large companies



Source: Eurostat's national accounts

4.3 Specific populations

The VSME has a modular structure: the basic module is mandatory, and then companies can decide whether to use the comprehensive module. The latter module is likely to be requested by financial institutions, and hence its uptake is estimated to be higher compared to the business partner module that was foreseen in the VSME ED.[41] In particular, it is expected that **all medium enterprises and small enterprises with20 employees or more will use the comprehensive module; for micro enterprises and small enterprises with less than 20 employees, the uptake is expected to be lower, and is assumed to concern 50% of the preparers upon request**. This is based on the feedback received from banks during the workshops on the revised VSME draft. Given the uncertainty on this parameter, a sensitivity analysis is carried out as follows: (i) micro and small (less than 20 employees) enterprises: 25%, 50% (base) and 75% scenarios; (ii) for small (20 employees or more) and medium enterprises, 80% and 100% (base).

Additionally, the VSME includes a number of 'if applicable' requirements which are mandatory, but only they concern only a sub-set (sometimes very limited) of the population. Hence, the cost estimates need to

[41] It was estimated that 12-20% of preparers upon request would use the business partner module, and 1-5% more would use the full VSME.

take into account the more limited application of certain requirements. In Table 6 below, an attempt is made to measure some of these sub-populations for the requirements in the basic module.

Table 6. VSME sub-populations for the basic module

Requirement	Sub-population	Estimate	Source
B2 - Practices for transitioning towards a more sustainable economy	SMEs that have adopted practices, targets, actions or plans towards sustainability	It is very unlikely that SMEs have adopted sustainability policies and plans. Hence, the population concerned is residual, not higher than 1% of the total VSME population.[42]	Targeted consultation
B4 - Pollutants	SMEs that report on pollutants e.g. under the Industrial Emissions Directive or the Eco-Management and Audit Schemes (EMAS)	The Industrial Emissions Directive covers about 55,000 industrial sites; EMAS covers about 4,000 organisations and 13,000 sites. Another major certification, ISO 14001, covers about 92,000 companies in Europe. There may be a degree of overlap between the Industrial Emission Directive and the certification schemes. Considering that a large number of those sites belong to large companies, SMEs directly affected by this requirement can be estimated in the area of 50,000.	EMAS Factsheet, European Pollutant Release and Transfer Register ISO survey
B5 - Biodiversity	SMEs with operations near protected areas are more likely to have to report on biodiversity impacts	26% of EU land areas is protected (18% under Natura 2000 schemes, 8% under national schemes). Companies operating within or near these areas, typically belong to sectors like agriculture, forestry, tourism, and energy. Considering that protected areas have a much lower density of economic activities, it is considered that this requirement will concern less than 13% of the VSME population.	EU Biodiversity Strategy for 2030 - Bringing nature back into our lives (COM(2020)380).
B6 - Water	All SMEs should report their water withdrawal. When water is used for the production process (and withdrawal is different than discharge into sewer), water consumption should also be reported.	Water consumption is likely to be reported only by 'production' (as opposed as to 'services') sector, and in particular: Manufacturing SMEs (3.8 million); construction SMEs (2.1 million); energy, water and mining (about 300,000 SMEs).	Eurostat SBS
B 7 - Resource use, circular economy and waste management	All SMEs should report on resource management and the application of circular economy principles, including the amount of waste generated and diverted to recycling and re-use. Companies in the manufacturing, construction or packaging process should report on mass-flows.	Manufacturing SMEs: 3.8 million; Construction SMEs: 2.1 million; Packaging SMEs (NACE code N82.92): 10,000.	Eurostat SBS

[42] Cf. SME survey.

B8 - Workforce - General characteristics	SMEs with at least 50 employees should report on the turnover rate over the reporting period. This is a new datapoint introduced following the review process.	Medium enterprises: 247,000 (about 1% of the total SME population). The same population is also concerned by other disclosures adopting the same threshold (e.g. C5).	Eurostat SBS
B 10 - Workforce - Remuneration, collective bargaining and training	SMEs with at least 150 employees should report on the percentage gap in pay between its female and male employees. The threshold is reduced to 100 employees from 2031.	This datapoint only concerns a fraction of medium enterprises, i.e. less than 1% of the EU population, corresponding to about 50-100,000 enterprises.	

5 COST-BENEFIT ANALYSIS METHODOLOGY

This section describes the overall approach and the methodology for the estimation of the costs and benefits generated by the application of the VSME. Table 7 below summarises the categories of costs and benefits that have been assessed in the present study, identifying also the type of costs and benefits (whether direct or indirect), the stakeholders affected, and the methodology used to assess them. The following sections are going to describe in greater detail the methodology. More in detail, Section 5.1 is deals with administrative costs, Section 5.2 with financial benefits and 5.3 with other costs and benefits. Finally, section 5.4 described the overall CBA methodology.

Table 7. List of costs and benefits

	Type	Stakeholder	Methodology
COSTS			
Administrative costs of reporting	Direct	Preparers	Quantitative
BENEFITS			
Financial benefits: • Cost of credit • Access to credit	Direct	Preparers	Quantitative
Value chain participation	Direct	Preparers	Quantitative
Competitiveness	Indirect	Preparers	Qualitative
Management, reputation and improved internal organisation	Indirect	Preparers	Qualitative
Increased transparency, comparability accountability	Indirect	Preparers, users	Qualitative

5.1 Administrative costs, baseline costs and incremental costs

Administrative costs consist in those costs that firms must incur to provide information to public authorities and third parties because of a regulatory requirement, i.e. the so-called Information Obligation (IO).

To estimate administrative costs, first, the **administrative activities** for VSME reporting must be mapped. These are the steps taken by listed SMEs to collect and provide the required information. **Administrative costs are then calculated via the Standard Cost Model** (SCM), adapted as necessary. In a nutshell, the SCM takes the number of entities subject to an IO (the population) and multiply it by the estimated cost per occurrence, to obtain the total administrative costs generated by a regulatory provision. More details are provided in Box 3 overleaf.

Box 3. The Standard Cost Model

The Standard Cost Model (SCM) is a method for assessing the administrative costs imposed by regulation on i.a. businesses and public administrations. It is based on the identification of the basic components of a piece of legislation, i.e. the Information Obligations, whose costs for the regulatory addressees can be measured and quantified. An Information Obligation is a specific legal duty to gather, process or submit information to a public authority or a third party. The SCM can be used both on the stock of existing legislation to perform a baseline measurement, and on the flow of new legislative proposals to measure the cost increase or savings associated with a set of policy options.

The key outputs of the SCM are as follows:

- Administrative Costs (AC) are the overall costs incurred by businesses and public administrations to meet legal obligations to provide information, either to public authorities or private parties.
- The costs for information which is, at least partly, gathered, processed or submitted even in the absence of a legal requirement are considered Business-As-Usual (BAU) costs.
- Conversely, an administrative activity which is performed solely because of a legal obligation is defined as an Administrative Burden (AB). AC are thus formed by two components: BAU costs and AB. The estimate of ABs measures the additional effect of regulatory provisions.

As set out in the Better Regulation Guidelines, administrative costs should be assessed on the basis of the normal cost of the required administrative activity multiplied by the total number of activities performed per year. The core SCM formula can therefore be written as follows:

$$\mathbf{AC = \Sigma\ (P \times Q)}$$

Where:

[P] = the 'Price' is obtained by multiplying a tariff (based on average labour cost [43]per hour including overheads) by the time required to perform the required activity.

[Q] = the 'Quantity' is calculated as the number of required administrative activities, or as the population concerned (number of affected entities) times the frequency of the required activities.

In operational terms, the time devoted to complying with the IO by a "normally efficient firm" is estimated based on data from the targeted consultation. This value is then multiplied by the salary rate of the staff dealing with the IO and by the number of yearly occurrences (frequency) of the IO. When respondents do not possess detailed information on the cost of each occurrence, companies may be asked for more general information, such as the number of employees working on a certain IO and/or the share of working time per week or per year that each of them devotes to the IO. Once the annual cost per IO is identified, aggregate costs can be calculated for the whole industry by multiplying the cost per IO by the number of firms affected (the population). The administrative costs generated by an act can be thus quantified by summing up the costs of all IOs included therein.

In certain cases, compliance with an IO requires not only personnel time, but also out-of-pocket expenses (e.g. the fees for an external consultant or for accessing an online software). In this case, the quantification is based on a 'normal price' for the service required by the IO and on an estimation of the share or types of companies that outsource the IO vs. those dealing with it internally (e.g., medium enterprises are more likely to internalise tax and accountancy functions compared to micro). When expenses concern durable goods (e.g. IT equipment), this needs to be depreciated based on the appropriate time frame (e.g. 5 years), with financial costs added based on a typical interest rate for bank loans for corporations and/or the opportunity cost of capital.

Administrative costs are analysed across different dimensions:

- The analysis distinguishes between enterprises with 20 employees or more (medium and part of small enterprises) and enterprises with less than 20 employees (micro and part of small enterprises), given the different complexity of reporting, modalities of compliance and hence the costs associated.
- Another dimension analysed concerns internal and external costs, i.e., those costs that are born in-house versus those costs that are linked to outsourced activities.
- The analysis distinguishes between set-up costs and recurring costs, i.e. to implement and maintain the reporting processes. This is because the reporting costs are typically higher in the first year due

[43] This is estimated as an EU average value although it is acknowledged there can be major variations across Member States and by company size and sector.

to the familiarisation with the new requirements, and the set-up of the internal and data collection and analysis tools; they then decrease in the following years.

Following the assessment of the VSME uptake, described in section 4.2 **the analysis of costs concerns prepares upon requests.** This is because for spontaneous preparers the choice is 'purely' voluntary, and no regulatory costs can be attributed to voluntary decisions. Conversely, preparers upon request are SMEs that have to issue sustainability statements in response to demands for ESG information from their value chain or financing providers, particularly banks.

The analysis accounts for the following costs:

- **Administrative reporting costs**, i.e. the costs for preparing sustainability statements based on the VSME.
- **Baseline costs**, i.e., the costs for handling ESG requests and providing ESG information in the scenario without VSME. These are those borne by SMEs to handle requests from customers and financial institutions. These are in turn determined by: (i) the share of SMEs received those requests; (ii) the number of requests for each SME; and (iii) the cost of these requests.
- **Incremental costs**, i.e., the true regulatory costs of VSME, resulting from the difference between administrative reporting costs and baseline costs.

For the **analysis of the administrative costs,** the data have been retrieved from the targeted consultation of preparers and service providers, as well as on the estimates provided in other related studies, the SME survey, and the field test (see Table 8 below). To complement and validate the data collected during the interview programme, the impact assessment on CSRD[44], the CBA of the First Set of draft ESRS[45], and the CBA on SME disclosure of taxonomy alignment were also consulted and integrated in the analysis where relevant.

The **estimates deriving from the interview programme and EFRAG's field test were the main source of information for the analysis of the reporting costs**, including incremental costs and baseline costs as these provided real world cases directly reported from SMEs.

Table 8. Summary table for administrative costs and burdens

Cost/benefit	Methodology	Sources
Administrative costs of reporting	Analysis of administrative activities required	Targeted consultation of preparers, service providers, existing studies
	Estimation of internal and external costs, degree of outsourcing	Targeted consultation of services providers (preparers), existing studies
	Estimation of incremental costs vs. baseline costs	Targeted consultation of preparers, service providers
	Population concerned	See Section 4 above
	One-off vs- recurring costs	Targeted consultation of preparers, service providers, existing studies

5.2 Benefits: financial and value chain participation

5.2.1 Financial benefits

The financial benefits of ESG reporting have been extensively debated over the last two decades in the economic literature. Most of this literature on the impact of ESG disclosure has traditionally concentrated on the analysis of the relationship between ESG, the cost of capital and the overall firm value. with a focus on listed companies[46]. There is an emerging consensus that ESG disclosures **reduce the cost of capital,**

[44] Commission Staff Working Document-Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, 21 April 2021

[45] The cost estimates might appear, however, in retrospect as underestimated also because of data aggregation issues between different countries. CEPS and Mileu for EFRAG (2022), Cost-benefit analysis of the First Set of draft European Sustainability Reporting Standards, Brussels, 22 November 2022

[46] Albarrak, M.S.; Elnahass, M.; Salama, A. The Effect of Carbon Dissemination on Cost of Equity. Bus. Strateg. Environ. 2019, 28, 1179–1198. Botosan, C.A. Disclosure Level and the Cost of Equity Capital on JSTOR. Account. Rev. 1997, 72,

which broadly replicates similar findings for the benefits from traditional financial disclosures[47] in the past. **This is however not particularly relevant for non-listed SMEs, for which access to equity represents a residual source of financing accounting for 1% of total financing,** according to ECB and Commission SAFE survey figures[48]. Hence, prospective benefits from ESG reporting on the cost of capital would be poorly significant and hardly relevant for most preparers, for whom the most important source of financing is represented by far by bank financing and external lending.

Over the last few years, an increasing number of studies has demonstrated a relationship **between a ESG disclosures, their quality and granularity[49] and the cost of debt financing[50]** Hence there is growing evidence of a likely link between the issuance and quality of ESG reporting and the availability of better credit conditions for borrowers. This is believed to happen through several channels. Lenders incorporate ESG information into their decisions primarily by reducing their information asymmetries. Because of these information asymmetries, lenders are inclined to penalize information opacity and to reward corporate transparency with a lower cost of debt. More and better ESG information allows lenders to assess both **the reputational and credit risk linked to a loan[51]**. Reputational risk involves being perceived as a financial enabler of harmful ESG practices, which predominantly affects credit institutions. Credit risk pertains to the loss of the principal amount of the loan. According to the economic literature, the correlation mechanisms between ESG disclosures, those risks and then the cost of debt can emerge from several channels:

- ESG disclosures provide **additional information** that is not captured by traditional financial and risk metrics. Better ESG datapoints, after accounting for the information explained by conventional risk measures, are associated with lower costs of debt, suggesting that ESG factors offer unique insights into a company's risk profile and financial health.
- Companies with extensive disclosures are perceived to have **lower reputational and operational risks**, which can translate into lower borrowing costs. This perception stems from the understanding that strong ESG practices, of which reporting per se is already one, can mitigate potential negative impacts related to environmental, social, and governance issues, thereby reducing the overall risk profile of the company.

323–349. Botosan, C.A. Disclosure and the Cost of Capital: What Do We Know? Account. Bus. Res. 2006, 36, 31–40. Dhaliwal, D.S.; Li, O.Z.; Tsang, A.; Yang, Y.G. Voluntary Nonfinancial Disclosure and the Cost of Equity Capital: The Initiation of Corporate Social Responsibility Reporting. Account. Rev. 2011, 86, 59–100. Clarkson, P.M.; Fang, X.; Li, Y.; Richardson, G. The Relevance of Environmental Disclosures: Are Such Disclosures Incrementally Informative? J. Account. Public Policy 2013, 32, 410–431. Vitolla, F.; Salvi, A.; Raimo, N.; Petruzzella, F.; Rubino, M. The Impact on the Cost of Equity Capital in the Effects of Integrated Reporting Quality. Bus. Strateg. Environ. 2020, 29, 519–529.

[47] In traditional financial reporting, past researchers found that disclosure laws have a positive impact on firm value and argued that mandatory disclosure increases firm value by improving return on assets. La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R. (2000), "Investor protection and corporate governance", Journal of Financial Economics, Vol. 58 Nos 1/2, pp. 3-27

[48] Survey on the Access to Finance of Enterprises, available at: https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html

[49] Raimo N., Caragnano A., Marianil M., Vitolla F. Integrated reporting quality and cost of debt financing, Journal of Applied Accounting Research, 2022, vol.23, no. 1, pp.122-138

[50] The first study to document evidence suggesting that the debt market perceives value in the information presented in ESG reports, beyond what is furnished in financial reports was Mohammad Badrul Muttakin & Dessalegn Mihret & Tesfaye Taddese Lemma & Arifur Khan, 2020. "Integrated reporting, financial reporting quality and cost of debt," International Journal of Accounting & Information Management, vol. 28(3), pages 517-534. This was subsequently confirmed with reference to the European context by Gerwanski, J. (2020), "Does it pay off? Integrated reporting and cost of debt: European evidence",Corporate Social Responsibility and Environmental Management, Vol. 27 No. 5, pp. 2299-2319 by Raimo, N.; Caragnano, A.; Zito, M.; Vitolla, F.; Mariani, M. Extending the Benefits of ESG Disclosure: The Effect on the Cost of Debt Financing. Corp. Soc. Responsib. Environ. Manag. 2021, 28, 1412–1421. Eliwa et al. (2021). ESG practices and the cost of debt: Evidence from EU countries, Critical Perspectives on Accounting. Dunne T. C., In the interest of small business' cost. In general, the literature agrees that green finance leads to green results, such as emission reduction and energy saving, or improving green performances. Indeed, there is evidence in the literature that green finance can address and steer corporate sustainability levels by directing investment decisions towards more sustainable companies and penalizing those that are less so. of debt: A matter of CSR disclosure, Journal of Small Business Strategy, № 29, c. 58; Sengupta P., Corporate disclosure quality and the cost of debt, Accounting Review, № 73, c. 459.

[51] O. Weber, R.W. Scholz, G. Michalik Incorporating sustainability criteria into credit risk management, Business Strategy and the Environment, 19 (2010), pp. 39-50, 10.1002/bse.636

- The impact of ESG disclosures on the cost of debt operates through both direct and indirect channels. Directly, higher ESG disclosures can lead to a more favourable assessment of credit risk by lenders due to perceived lower reputational and operational risks. Indirectly, ESG scores may influence the cost of debt by affecting other variables that lenders consider when setting interest rates, such as the company's **long-term sustainability and resilience**. This is in line with the original rationale behind the introduction of the CRSD where ESG reporting was considered as a tool against financial market short-termism.
- The correlation between disclosures and debt costs also varies depending on a company's level of indebtedness. Firms with higher levels of debt may experience more significant benefits from higher ESG disclosures compared to those with lower levels of indebtedness. This suggests that the impact of ESG disclosures on borrowing costs is not uniform across all companies and may be more pronounced for those with greater financial obligations as it **enables their access to credit**. Moreover, the argument has been made that banks might benefit even more from ESG information because it provides them with a comprehensive view of a company's risk profile and sustainability, beyond what traditional financial metrics can offer. In bank-based financial systems where long-term relationships between lenders and borrowers are prevalent, the return on companies' ESG efforts in terms of reduced cost of debt is higher, indicating that banks value the additional information contained in ESG disclosures.

When it comes to the magnitude of the impact, however, the evidence base is thinner and contested[52]. Most of the studies estimate the impacts of an 'increase' in the amount of ESG information provided, rather than on whether ESG statements are issued or not. Those models allow to identify whether ESG information reduces the cost of debt, but do not provide any meaningful estimate of the amount of the reduction[53]. In addition, the available analyses focus on publicly listed companies, whose cost of debt and ESG disclosures are tracked by data providers and find it hard to disentangle between the effects of providing ESG information, the quality thereof, and ESG performance. Among those contributions, only two papers highlight a quantitative impact of issuing an Integrated Report. Gerwanski *et al*. estimate an impact between 35 and 44 basis points;[54] Muttakin *et al*. estimate an impact of 26 basis point, which however becomes significantly smaller when controlling for a company's ESG performance.[55] One study that tries to differentiate the impacts for listed vs. non-listed companies suggest that the effect of ESG disclosure for the latter may be nil[56]. All in all, the evidence from the economic literature is inconclusive and points out to a limited impact of ESG disclosure on the cost of debt. This is consistent with the results from the targeted consultation, which suggests that, at the moment, SMEs engaging in ESG disclosure enjoy very limited credit cost advantages, if anything.

A very recent analysis, carried out in cooperation with the European Central Bank, use an internal database of bank lending, which covers all lending relationships in the EU worth more than EUR 25,000.[57] This allows to capture a much broader number of companies in the analysis, the vast majority of which are SMEs. Their research strategy is different, as they try to estimate whether banks adhering to sustainability commitments increase the cost of debt for 'brown' sectors. Their estimates, in a 95% confidence interval, is that the debt cost increase is not higher than 5 basis point. This can be considered as the best estimate of the likely advantage for SMEs engaging in ESG disclosure, with sensitivity scenarios at 5, 10, and 25 basis points (bp),

[52] Eliwa et al. (2021). ESG practices and the cost of debt: Evidence from EU countries, Critical Perspectives on Accounting. Raimo, R., Caragnano, A., Zito, M., Vitolla, F., Mariani, M. (2021). Extending the benefits of ESG disclosure: The effect on the cost of debt financing. Corporate Social Responsibility and Environmental Management.

[53] Cf. e.g. Degryse, H., Goncharenko, R., Theunisz, C., & Vadasz, T. (2023). When green meets green. Journal of Corporate Finance, 78, 102355; Eliwa et al. (2021). ESG practices and the cost of debt: Evidence from EU countries, Critical Perspectives on Accounting; Raimo, R., Caragnano, A., Zito, M., Vitolla, F., Mariani, M. (2021). Extending the benefits of ESG disclosure: The effect on the cost of debt financing. Corporate Social Responsibility and Environmental Management.

[54] Gerwanski, J. (2020). Does it pay off? Integrated reporting and cost of debt: European evidence. Corporate Social Responsibility and Environmental Management, 27(5), 2299-2319.

[55] Muttakin, M. B., Mihret, D., Lemma, T. T., & Khan, A. (2020). Integrated reporting, financial reporting quality and cost of debt. International Journal of Accounting & Information Management, 28(3), 517-534.

[56] Chi, W., Wu, S. J., & Zheng, Z. (2020). Determinants and consequences of voluntary corporate social responsibility disclosure: Evidence from private firms. The British Accounting Review, 52(6), 100939.

[57] Sastry, P. R., Verner, E., & Ibanez, D. M. (2024). Business as Usual: Bank Net Zero Commitments, Lending, and Engagement (No. w32402). National Bureau of Economic Research.

representing more hypothetical scenarios in which regulatory or market pressure leads banks to compete for clients that disclose their ESG performance.

In addition, ESG reporting can indirectly provide benefits as an enabling factor. Since an increasing amount of concessional lending to SME is subject to ESG conditionalities, ESG disclosures represent a precondition and greatly enhance the chance that SMEs are recognized as eligible and can get **access to these concessional lending for sustainable investment** that can be granted at a 10-30 bp discount, although this is not necessarily additional to the pure effect from reporting above. Also, in that case ESG reporting can play the enabling factor to access to the possible 10-30 bp greeniums on concessional lending. The amount of concessional lending for sustainable investment is estimated at EUR 3-6 billion per year.[58]

Another direct effect related to the fact that ESG disclosure provides additional information to banks and financial institutions that enrich their credit risk analysis and decision-making, particularly if this is accessible to them in a codified standardized format and very low cost. By serving as a tool to transmit information not fully included in financial disclosures, ESG disclosure can reduce information asymmetries between firms and their investors or creditors, thereby potentially improving the firm's **access to lending**. Increased access to lending will not concern, in general, any form of loans, but those linked to sustainability (sustainable finance). In the EU, the value of these credit segments is estimated at EUR 15-27 billion. Results from a recent cost-benefit analysis carried out for the Commission shows as a part of that that banks can reward detailed environmental information with a 10-20% increase in SME access to lending, which is in line with findings from academic research.[59]

From a broader societal perspective**, ESG disclosure can have a positive impact on the corporate sustainability of firms**, as disclosing environmental and social strategies strengthens corporate sustainability performance. This not only benefits the firm internally but also enhances the social value created by corporations. For instance, initiatives promoting sustainability and ESG awareness can increase demand for sustainable investments. In general, the literature agrees that green finance leads to green results, such as emission reduction and energy saving[60], or improving green performances. Indeed, there is evidence that green finance can address and steer corporate sustainability levels by directing investment decisions towards more sustainable companies[61] and penalizing those that are less so.

The VSME can thus also result in the promotion of green lending and investment, as financial institutions encourage companies to adopt more sustainable practices by offering loans with reduced interest rates linked to sustainability criteria, with the amount of the loan adjusted according to the company's level of sustainability. The impact becomes even more significant when a sustainable company borrows from a sustainable lender[62]. The impacts on green financing are already included in the estimates above. More in detail, the reduction in the cost of credit and the increase in the access to credit incorporate both the effects of better disclosure, and the fact that part of the disclosure will show a positive ESG performance, which will give access to sustainable finance mechanisms, resulting from the joint actions of concessional lending, regulatory and marketing pressure on financial institutions.

Therefore, the use of the standardized and simplified frameworks proposed by the VSME can enable investors and financial intermediaries to assess sustainability-related risks and opportunities more effectively, when deciding on investments and financing. Moreover, the reporting framework allows for a comparison of investment possibilities and allocation of funds to more ESG responsible companies through a 'more sustainable is better' competition. Another relevant issue for financial institutions is compliance with increasing regulatory demands to enhance the sustainability of their assets. A more standardized approach in this respect can improve the usability of reporting. It is important to note that key barriers to

[58] European Commission, Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs, Giannotti, E., Bolognini, A., Pal, T., (2024) SME disclosure on taxonomy alignment – Cost/benefit analysis – Final report. Volume 1, Publications Office of the European Union

[59] *Ibidem*

[60] Cfr Note 50

[61] A matter of CSR disclosure, Journal of Small Business Strategy, № 29, c. 58; Sengupta P., Corporate disclosure quality and the cost of debt, Accounting Review, № 73, c. 459.

[62] Degryse, H., Goncharenko, R., Theunisz, C. and Vadasz, T. (2023). When green meets green. Journal of Corporate Finance, 78.

the use of ESG information are the lack of common reporting standards and, as a result, the lack of comparability, reliability, quantifiability and timeliness[63].

Based on the above analytical framework and parameters, the quantitative estimation needs to distinguish between benefits in the cost of and access to credit and capital:

- For the **reduction in the cost of credit,** the ESG credit premia (5-10-25 basis points, 10-30 bp for concessional lending) highlighted above needs to be multiplied by the amount of credit and concessional lending. The total outstanding SME loans in the EU, set at EUR 2.5 trillion, based on OECD data[64]; the preparers are assumed to receive, on average, the same amount of loans as the total SME population.[65] The amount of concessional lending for sustainable investment is estimated at EUR 3-6 billion per year.
- For **increase in access to credit,** the additional loans are not a monetary benefit per se, but only to the extent to which they generate additional profits. These are estimated by considering a typical Return-On-Investment (ROI) for SMEs, net of the cost of debt (5.9%, based on ORBIS data).

Table 9. Summary table for financial benefits

Benefit	Methodology	Sources
Cost of credit	Estimation of the relationship between quality of ESG disclosure and cost of debt	Economic literature
	Estimation of the 'greenium factor', including the effect of sustainable financing tools and concessional lending	Economic literature
Access to credit	Increased access to credit enabled by better ESG disclosure and sustainable financing	Economic literature, previous studies

5.2.2 Value chain participation

Together with request from financial institutions, the other big driver of ESG information requests consists of **large corporate buyers,** which have to collect ESG data for their own reporting duties, or for business and marketing purposes. Engaging in sustainability reporting thus may reduce the **risk of losing access to the value chain for SMEs**, or, conversely, provide benefits in terms of continuous access thereto. This risk concerns SMEs which are not subject to mandatory reporting requirements, and hence is relevant to the analysis of VSME.

To estimate the risk of losing access to the value chain, two parameters are important: the size of the effect, and its likelihood in the short- and medium- term.

- To measure the **size of the value chain participation effects**, national accounts data provide information on the supplies from SMEs to large corporations over total sales (which also include final consumers, public entities, other SMEs).
- As for the **likelihood of the effects,** this results from the reaction of large buyers. In particular, it requires determining, based on the analysis of existing studies and the targeted consultation, whether and to what extent ESG disclosure will result in increased revenues. In this respect, there is no available evidence in the economic literature and the findings from the targeted consultation suggest that this is very limited at the moment. Hence, this will be calculated based on a scenario analysis.

[63] Zadeh et al. (2018) Why and How Investors Use ESG Information: Evidence from a Global Survey, Financial Analysts Journa

[64] OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scoreboard, available at https://www.oecd.org/cfe/financing-smes-and-entrepreneurs-23065265.htm

[65] In other words, if VSME preparers are 5% of the population, they are expected to receive 5% of the oustdanding amount of loans.

5.3 Other costs and benefits

Adopting the VSME standard – either spontaneously or upon request - can trigger other indirect costs and benefits in three areas identified, namely (i) competitiveness, (ii) management, reputation and improved internal organisation; and (iii) increased transparency and accountability.

In terms of **competitiveness**, although there is no strict correlation, adherence to the VSME standard can enhance a company's market position by improving the perceived value of its products or services. This can lead to access to green markets, such as green public procurement and environmentally conscious consumers. However, there are also potential downsides, such as the risk of EU companies becoming less competitive against companies not reporting voluntarily on ESG matters, thus avoiding associated costs and disclosing possibly sensitive information, especially for that typically operate on very thin competitive advantages.

From a **management and organizational perspective**, sustainability reporting can significantly influence how companies manage their activities and allocate responsibilities. By requiring companies to disclose their sustainability performance, the importance of ESG policies within the organization is heightened, reducing operational risks and the likelihood of defaults. This increased awareness can lead to better integration of ESG considerations into daily management, ensuring functions and responsibilities are aligned accordingly. Also, by promoting green lending and investment, financial institutions encourage companies to adopt more sustainable practices by offering loans with reduced interest rates tied to sustainability criteria.

Increased transparency and accountability are significant outcomes of adopting the VSME standards. By committing to open communication and providing a clear understanding of their operations and impact, companies can align their practices with societal expectations and values. This transparency not only fosters trust among investors, customers, employees, suppliers, and the broader community but also holds companies accountable for their environmental, social, and governance impacts. The ongoing dialogue and collaboration resulting from ESG reporting can increase social capital, as stakeholders observe and trust the company's commitment to sustainable practices.

The analysis of these indirect costs and benefits has been carried out based on qualitative sources. More in detail, the possible correlation between the publication of ESG reports and effects on competitiveness have been addressed for instance by Breuer, M. (2021), and Dinh, T., Husmann, A. and Melloni, G. (2021) and Allen, A., Lewis-Western, M. and Valentine, K. (2022). Importantly, the targeted consultation provided first hand evidence on how current ESG practices are generating positive or negative effects on SMEs' competitiveness, internal management and increased transparency and accountability, which allowed to have a baseline scenario. Evidence was also collected directly by SMEs – and their federations, and by civil society to understand what will change in these three areas if an SME decides to comply with the VSME.

5.4 Overall CBA methodology

The CBA[66] is a method of comparing the costs and benefits associated with a certain policy, regulation or requirement, in order to assess whether it generates net costs of benefits for the entities concerned. A **key feature of the CBA is that all or most costs and benefits are quantified and expressed in monetary terms**. Once costs and benefits have been monetised and discounted (if occurring at different time horizons), they are summed up, with the aim of identifying the policy option based on the net impacts (i.e. benefits minus costs). The major limitations of the CBA concern the difficulties in attributing a monetary value to items for which no market exists, and the fact that non-monetizable effects (e.g. certain social impacts) cannot enter the calculation.

In addition to primary and secondary data, the CBA requires setting a series of analytical assumptions e.g. on the future market acceptance of VSME. CBA results may be sensitive to these assumptions, up to the extreme case in which, under certain assumptions, the net benefits may vary from positive to negative or visa. To verify whether results are robust, a **sensitivity analysis** will be performed. The sensitivity analysis consists of the following steps: (i) identification of the variables with the expected largest impacts on final results; (ii) identification of scenarios leading to alternative values for these impacts; and (iii) re-calculation of results based on selected alternative scenarios.

[66] The methodology is in line with the European Commission's Better Regulation Toolbox, Tool #55.

Based on the list of benefits and costs discussed above and on the previous analysis[67], not all impacts will be quantified, as some of them are of a qualitative and subjective nature. Thus, the final approach will consist in a partial, or soft, CBA. In a partial CBA, most costs and benefits are monetised, and the net benefits are calculated.

[67] CEPS and Mileu for EFRAG (2022), Cost-benefit analysis of the First Set of draft European Sustainability Reporting Standards, Brussels, 22 November 2022; and Commission Staff Working Document Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, SWD/2021/150 final; and CEPS for DG FISMA (2020) Study on the Non-Financial Reporting Directive, ISBN 978-92-76-18196-5 doi: 10.2874/229601 EV-02-20-277-EN-N

6 COSTS AND BENEFITS FOR SMEs

This section presents the estimation of the costs and benefits generated by the application of the VSME. Based on the assessment of the population of SMEs that voluntarily implement these standards, the costs and benefits for spontaneous preparers and preparers upon request are analysed separately in sections 6.1 and 6.2.

6.1 Spontaneous preparers

Spontaneous preparers are those SMEs which decide to use the VSME not upon request of third parties (banks, larger customers), but for their own business reasons. Their choice is 'purely' voluntary, and this means that they expect to receive net benefits from their decision. In any case, no incremental regulatory costs can be attributed to voluntary decisions.[68]

As mentioned above, companies that are likely to reap the largest benefits from voluntary disclosures are those that operate in green markets (public or private), that need to build a stronger brand with consumers, or that sell products centred on sustainability (e.g. advanced manufacturing). In addition, some companies pay special attention to sustainability for business reasons (e.g. B-Corps). For these companies, the VSME is likely to represent a net benefit. Hence, they are likely to be among the early adopters.

Metanalyses have been carried out on the benefits of ESG reporting, with the main quantifiable effects being related to the capital markets, through greater liquidity, lower costs and better resource allocation[69]. Concurrently, other positive effects have also been reported on SME preparers concerning the transparency and acceptability of their operations. This enhances their reputation and brand image, and thereby increases their competitiveness in the business environment. In general, however, research[70] on the specific effects of ESG reporting on SMEs is lacking for the very simple reason that SMEs have not often engaged in ESG reporting yet[71] and this literature is only slowly emerging. This section will summarize the main findings from the targeted consultation and the literature review as regards: (i) competitiveness; (ii) management, reputation and improved internal organisation; and (iii) increased transparency and accountability.

- **Competitiveness**

A company's financial results and competitive position are influenced by manifold factors. Neither ESG reporting nor a better ESG performance possibly triggered by reporting will per se translate into stronger financial outcomes and a better competitive position. Nonetheless, empirical evidence is gradually emerging of a correlation between ESG disclosure and competitiveness, at least with reference to specific ESG factors[72].

Various stakeholders agreed that SMEs that will start engaging in ESG reporting might also reap various benefits for their businesses. These benefits include **a stronger competitive position and an enhanced reputation among consumers,** which can be conducive to higher sales. These benefits are more likely to occur in B2C industries and for companies with a well-established brand, because by transparently reporting on their sustainability efforts and social impact SMEs can differentiate from competitors. ESG reporting is then considered a necessary condition to access green procurement and increasingly perceived as a requirement to apply for Government grants particularly in the field of manufacturing.

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[68] Cf. Better Regulation Toolbox, Tool#58 EU Standard Cost Model. It remains possible to estimate the costs associated to voluntary actions linked to the regulatory framework, such as a voluntary standards, but those cannot be considered administrative or regulatory costs.

[69] Christensen, H. B., Hail, L., & Leuz, C. (2021). Mandatory CSR and sustainability reporting: economic analysis and literature review. Review of Accounting Studies, 26(3), 1176 1248

[70] Trautwein, C. (2021). Sustainability impact assessment of start-ups–Key insights on relevant assessment challenges and approaches based on an inclusive, systematic literature review. Journal of Cleaner Production, 281, 125330.

[71] Shields, J., & Shelleman, J. M. (2015). Integrating sustainability into SME strategy. Journal of Small Business Strategy, 25(2), 59-78.

[72] For instance Ecovadis has recently investigated together with Bain the correlation between certain disclosures and value creation at least in a sample of their reporting companies. Bain - EcoVadis Joint Study: Do ESG Efforts Create Value?, 2024.

A strong ESG focus can also help building a positive brand reputation, attract socially conscious consumers and foster customer loyalty. Benefits in B2B industries are more indirect and related to the supply chain effects discussed above in Section 5.3. They can be better framed in terms of maintaining, rather than winning, market shares. Company owners interested in facilitating the generational shift could be particularly motivated to engage in reporting.

On the more negative side, some participants to the targeted consultation highlighted that SMEs, that typically operate on very thin competitive advantages, might be particularly exposed to the risk that disclosures affect their competitive position vis-à-vis non-preparers. This may be due, on the one hand, to the reporting costs incurred and, on the other, to the negative effects of increased transparency, which may expose some of the companies' competitive advantages (e.g. a very high energy efficiency). These risks might ultimately discourage the uptake of the VSME, irrespective of any provision EFRAG might include on the confidentiality of commercially sensitive information.

As for the cost impacts, the estimates provided above show that the costs are too limited to significantly affect the cost structure of SMEs and their competitiveness vis-à-vis non-preparers. For smaller preparers (micro and small enterprises up to 20 employees), the VSME Basic Module would cost a few thousand EUR per year; while not negligible, this amount is unlikely to represent a significant share of total costs. For larger preparers (small enterprises with 20 employees or more and medium ones), costs are higher (up to EUR 20,000 for the full VSME), as they grow less than proportionately compared to the company's size.

As for the risk of disclosure, this concern also emerges from the literature.[73] Conditions were analysed where disclosing information on market-specific supply and demand conditions can create competitive disadvantages for preparers over potential market entrants. This was found of particular concern to smaller preparers, which are not familiar with disclosing information in general. In the financial reporting literature[74], the risk that the disclosure of information poses to competitive advantages has been used in many cases as the rationale for non-disclosure.

- **Management, reputation and improved internal organization**

Reporting encourages SMEs to assess their ESG performance, leading to better management practices. ESG reporting provides the company's decision-makers with valuable data and insights that can inform strategic planning and decision-making processes. By analysing ESG metrics and performance indicators, companies can identify opportunities to optimize resource allocation, mitigate risks, and capitalize on emerging trends related to sustainability and social responsibility. By identifying areas for improvement in these domains, SMEs can implement more sustainable and responsible business strategies. This includes actions such as reducing waste and energy consumption, improving labour practices and enhancing corporate governance structures.

One of the most relevant benefits from engaging in ESG reporting on which interviewees generally concurred is the increased awareness of ESG aspects, a better understanding of the related risks and their incorporation into the decision-making process. By disclosing information about potential risks, such as supply chain disruptions, regulatory non-compliance or reputational damage, SMEs can demonstrate their understanding of the subject and a likely commitment to a proactive ESG risk management. This result is enhanced by the involvement of the SME owners/top management into the disclosure process, which translates into stronger engagement and propensity to act. This is one of the reasons why stakeholders reported that in France banks are finding increasingly effective to accompany their requests for ESG information with face-to-face interviews with the top SME decision-makers.

Finally in terms of positive impacts on internal organisation, smaller preparers are often not sufficiently structured to benefit from them, but the larger can experience better intra-company cooperation, as a result of the horizontal nature of some of these disclosures, forcing internal cooperation in data gathering and analysis.

[73] Breuer, M. (2021), 'How Does Financial-Reporting Regulation Affect Industry-Wide Resource Allocation?', Journal of Accounting Research, 59(1), pp. 59–110, https://doi.org/10.1111/1475- 679X.12345.
[74] Allen, A., Lewis-Western, M. and Valentine, K. (2022), 'The Innovation and Reporting Consequences of Financial Regulation for Young Life-Cycle Firms', Journal of Accounting Research, 60(1), 45–95, https://doi.org/10.1111/1475-679X.12398.

Sustainability reporting increases the transparency to SME employees and contributes to build a better perception of the SME reputation among them, which can lead to greater employee satisfaction. It has been reported during the targeted consultation that, in many labour markets, particularly those where labour shortage is becoming evident and filling job positions has become increasingly difficult, ESG reporting is increasingly becoming a tool to attract and retain talent particularly among the younger generations.

ESG reporting also fosters a sense of purpose and meaning among newly hired employees in particular. When employees understand how their daily activities contribute to positive outcomes in areas such as sustainability, community engagement, and ethical business practices, they are more likely to feel motivated and engaged in their roles. Hence, young candidates are more likely to be attracted to and remain with organizations that demonstrate a commitment to ethical behaviour, employee well-being, and environmental stewardship. This can lead to lower turnover rates and higher levels of employee satisfaction and loyalty. When employees feel that their contributions are valued and aligned with the organization's values and mission, they are more likely to feel a sense of belonging and commitment to the company.

- **Increased transparency and accountability**

By providing detailed and standardized reports on the ESG aspects of their operations, businesses become more transparent about their activities, policies, and performance. Adhering to a harmonized ESG standard endorsed at the EU level could further enhance an SME's credibility among stakeholders and community members. By promoting and utilizing standardized SME ESG reports, NGOs can enhance their effectiveness in driving corporate responsibility, sustainability, and positive social change. Data-driven advocacy can be more persuasive and lead to more effective environmental and social policies. Standardized ESG reporting can enhance the credibility of corporate social responsibility initiatives undertaken by SMEs. NGOs can support and publicize these initiatives, helping SMEs gain recognition for their efforts.

NGOs are particularly keen on having standardized ESG reports from SMEs for a combination of different reason. First, this is believed to promote comparability and benchmarking and results in increased transparency and accountability. Standardized reports would allow NGOs to better compare ESG performance across different companies and industries more effectively. This comparability would help in identifying best practices and areas that need improvement, facilitating more informed advocacy and policy recommendations. With standardized reports, NGOs can also track the progress of SMEs over time. This long-term view would aid them in assessing the impact of policies, programs, and interventions designed to improve ESG performance. Then standardized ESG reports make it easier for NGOs to access consistent and reliable data, thereby promoting corporate transparency. By means of standardization, NGOs can monitor compliance with regulatory frameworks, voluntary commitments, and international standards more efficiently, promoting better corporate behaviour.

This transparency enables the public to better understand how companies operate and the impact they have on society and the environment. Some professionals have remarked that, at least in certain national contexts, one of the main perceived benefits for SMEs from engaging in ESG reporting is represented by the ensuing improvement in the undertaking’s perceived legitimacy. By transparently disclosing information about their social and environmental performance, SMEs can demonstrate their commitment to responsible business practices and accountability to local stakeholders. This can help prevent or mitigate conflicts with community members, regulatory authorities, and other stakeholders’ groups, ensuring the long-term sustainability of SME operations.

ESG reporting can demonstrate SME commitment to supporting local communities, over and above their more traditional contribution to economic growth and job creation or to sourcing goods and services from local suppliers and investing in local infrastructure and facilities. ESG reporting can better frame these contributions, showcasing SMEs' role in minimizing their environmental impact, with related benefits for local ecosystems and natural resources. By disclosing information about their efforts to reduce emissions, waste and water consumption, and mitigate pollution, SMEs demonstrate their commitment to environmental stewardship and sustainability, contributing to the health and resilience of local environments. Finally, ESG reporting promotes social inclusion and diversity within SMEs and their surrounding communities. By disclosing information about their efforts to promote diversity, equity, and inclusion in the workplace, SMEs demonstrate their commitment to equity and inclusivity, although it is acknowledged that family businesses have more constraints in this. By disclosing information about their efforts to provide safe working conditions, promote employee wellness, and minimize environmental hazards, SMEs contribute to healthier and more resilient communities. Table 10 below summarises the analysis of these benefits.

Table 10. Voluntary preparers: benefits

Competitiveness	Management, reputation and improved internal organization	Increased transparency and accountability
Stronger competitive position and enhanced reputation with consumers (B2C companies)	ESG reporting fosters SMEs to improve their performance, strategic planning and decision-making	Increase in company's legitimacy, especially vis-à-vis local communities, stakeholders, regulatory authorities
Better access to green markets, including green public procurement	Increased awareness of ESG aspects and related risks, with positive effects on company's management	
Negligible / minor impacts of reporting costs	Positive impacts on workers' attractiveness and retention	
Negligible risks from disclosure of competitive advantage		

6.2 Preparers upon request

Preparers upon request are defined as those SMEs that engage into ESG disclosures not because of a spontaneous business-motivated decision, but in response to a demand for ESG information originating from within their value chain or financial institutions (in particular, for SMEs, banks). Since these requests are, in turn, often motivated by regulatory requirements on the originators themselves (compliance with CSRD disclosures with a value-chain dimension or SFDR and Pillar 3 reporting requirements on investee/financed companies), these are assimilated to regulatory costs for SMEs, from a methodological perspective.

For the analysis of the costs and benefits on preparers upon request, the following approach is adopted:

1. The **baseline costs** for handling ESG requests and providing ESG information in the baseline scenario (without VSMEs) are quantified;
2. The **incremental costs** of VSME are measured by quantifying its reporting costs and subtracting the costs borne by SMEs in the baseline scenario;
3. **Benefits** for VSME preparers (financial benefits, value chain participation) are quantified;
4. The **net impacts** are calculated via the cost-benefit analysis (CBA); and

Since ESG reporting is a fast-moving area, and the current baseline cannot be assumed to represent the baseline without the VSME in the future **additional considerations and scenarios** then complement the analysis of net impacts.

6.2.1 Baseline costs

The baseline costs are determined by the administrative costs for SMEs to handle requests from customers and financial institutions. These are in turn determined by: (i) the share of SMEs received those requests; (ii) the number of requests for each SME; and (iii) the cost of those requests.

These parameters were investigated via the SME survey. In 2023, about, respectively, one third and half of small and medium companies received a request from customers or financial institutions. In the vast majority of cases, they received only a request per year, from their major customer or financial counterpart. The share was much lower for micro companies, with only 8.5% of them receiving any request. The costs for handling these requests varied from EUR 2,100 for micro companies to EUR 7,100 for medium ones; these costs consisted mostly of internal (i.e. personnel's costs), with a limited number of SMEs using consultants or online platforms. For companies receiving multiple requests, the costs add up (except when requests often concern similar information).

Findings are shown in Table 11 below. As it can be seen costs are relatively limited as in most cases these requests were received in a very simple questionnaire format and did not require major quantification efforts or narrative disclosures, which also explains the limited recourse to external support reported by survey respondents. The data from the SME survey, however, represents a picture of the situation in 2023 and does not distinguish between requests originated from compliance with SFDR or Pillar 3 requirements, national legislation or compliance with quality schemes/contractual obligations. Requests stemming from compliance with ESRS Set 1 requirements, for instance, are unlikely to be factored in to any significant degree in these figures, as the ESRS Set 1 standard was released after the survey was carried out. In this regard, any comparison with the SME survey baseline can provide a first good approximation of the additional regulatory costs triggered by the CSRD on SMEs, but it is unlikely to provide an up-to-date representation of the number of SMEs concerned.

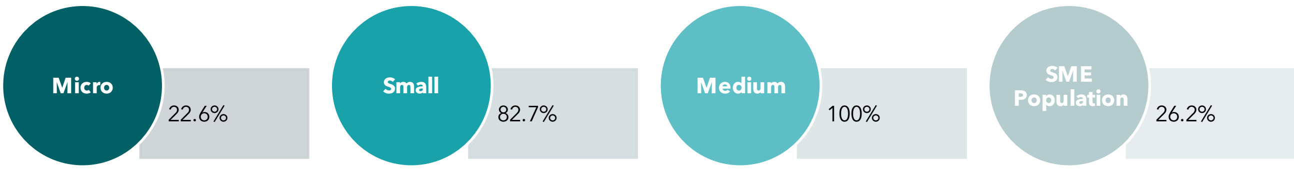
Table 11. Baseline scenario – number and costs of ESG requests

Size	Share of companies receiving ESG requests (2023)	Cost per request (€/request)
Micro	8.5%	2,100
Small	31.1%	4,700
Medium	43.4%	7,100
SME Population	9.9%	

Source: SME Survey

For the above reasons, **the number of requests percolating on SMEs is expected to grow significantly in the following years,** in particular due to the progressive implementation of the CSRD and of the Pillar 3 reporting obligations for banks that the ECB has found to be poorly complied with until recently[75]. By 2028, this scenario considers an increase by about three times for micro companies, while nearly all small and medium enterprises will receive such a request. The share of companies receiving multiple requests is also expected to increase exponentially, doubling every year. Based on this scenario and a reasonable evolution from the situation emerging from the SME survey, it is expected that, by 2028, about 26% of SMEs will receive an ESG request, and 14% of those will receive more than one. This comes close to the maximum potential population, which is given by the sum of SMEs applying for a loan (20%) and participating in value chain with large customers (12%), while accounting for an overlap between the two populations.

Figure 6. Baseline scenario – estimated growth of ESG requests to SMEs (2028)



Source: Authors' elaboration

Based on these parameters, **the costs for handling ESG requests in the baseline scenario** (i.e. without VSMEs and with the limitations explained above) **are estimated at about EUR 12 billion in 2025, more than doubling to EUR 27 billion in 2028** because of the increased number of companies affected and the increased likelihood of receiving multiple requests. The two components and the trend are shown respectively in Table 12 and Figure 7 overleaf.

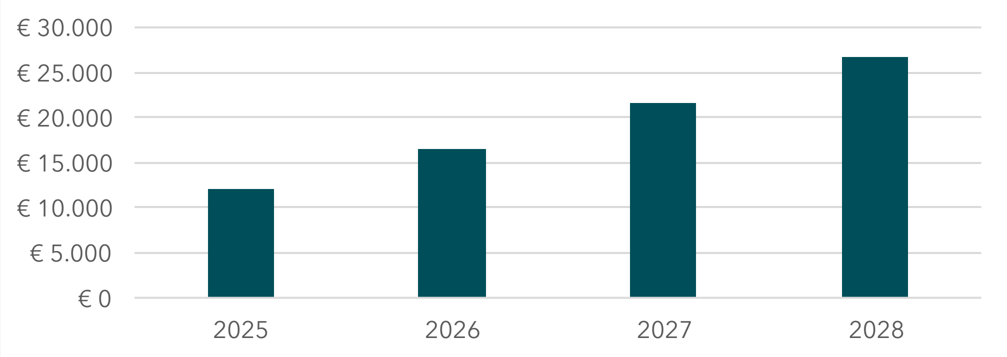
[75] ECB The importance of being transparent. A review of climate-related and environmental risks disclosures practices and trends. Results of the 2022 supervisory assessment of institutions' climate-related and environmental risks disclosures, April 2023. See also PWC Germany Zwischen Transparenz und Nachhaltigkeit Die ESG Säule III Offenlegungsstudie Offenlegung von ESG-Risiken gemäß Artikel 449a CRR, September 2023

Table 12. Baseline scenario – Total costs EUR million

	2025	2026	2027	2028
Costs of handling ESG requests	11,400	15,100	18,800	22,500
Micro	7,300	9,700	12,100	14,500
Small	3,100	4,100	5,200	6,200
Medium	1,000	1,300	1,500	1,700
Costs of handling multiple ESG requests	700	1,400	2,900	4,300
Total costs - Baseline scenario	**12,100**	**16,500**	**21,600**	**26,800**

Source: Authors' own elaboration

Figure 7. Baseline scenario – Total costs (trend in EUR million)



Source: Authors' own elaboration

6.2.2 Incremental costs of VSME

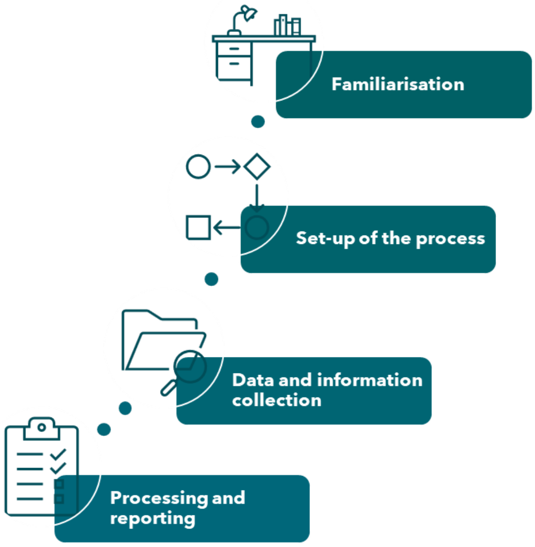
In this sub-section, **the incremental costs and burdens generated by the Information Obligation (IO) "drafting the ESRS sustainability statements according to the VSME standards" are calculated.**

- **Mapping the administrative activities**

The administrative activities required to comply with this IO can be described as follows:

1. **Familiarisation** with the applicable legal framework, that is the CSRD, the VSME and its scope, components and disclosures.
2. **Set-up of the process.** The requirements of the VSME must be matched with the reporting company and its activities. The company needs to decide which modules are to be compiled and, within each module, the applicable disclosure requirements. The company needs to decide whether and to what extent carry out the activity internally, hire an external consultant, entrust its accountant, or use an IT solution. In-house activities need to be allocated to the various people and functions. Internal sources of data should be mapped, gaps identified.
3. **Data and information collection.** Preparers have to collect the data and information requested to prepare the statements, in the format and based on the metrics required. Data and information will be partly available to the preparer; in part, new data and information will have collected and produced.
4. **Processing and reporting.** Once all the necessary data and information are prepared, these need to be processed and analysed to produce the VSME sustainability statements.

Figure 8. VSME administrative activities



Source: Authors' own elaboration

➢ **Segmentation**

While the various activities are the same for all SMEs using the VSME, the process is likely to be different for smaller and preparers. Based on the qualitative elements emerging during the targeted consultation, two groups of companies can be distinguished[76]:

- **Smaller preparers**: micro companies and small companies with up to 20 employees. These entities often lack internal people dealing with sustainability matter and have a higher tendency to outsource the work to their accountant or may resort to platform solutions. They are more likely to use the basic module only (about 70%) and tend to prefer simpler but cheaper compliance solutions, having a limited budget available.
- **Larger preparers**: small companies with 20 employees or more and medium companies. These entities may already have people and functions which, at least on a part-time basis, deal with ESG matters and related certification issues, which means they are more likely to use internal resources. In terms of outsourcing, they may prefer to resort to more expensive specialised ESG consultants – as opposed as to accountants and platform solutions. They are more likely to use the comprehensive module too (about 70%).

➢ **In-house vs. outsourcing**

Based on the findings from the targeted consultation, it is assumed a scenario where **only a minority (at most 10% of larger preparers) will carry out this process wholly or mostly internally,** at least in the first year; only larger preparers that are already structured in terms of sustainability reporting requirements may be able to familiarise with the standard and set-up the internal process required.

Most of the smaller preparers will, at least in the first place, ask the support of their accountants; a minority of them will use online platforms, either spontaneously or based on the indications of banks and suppliers. Following the revision of the ED and the simplification and streamlining of the text, it is considered that the final version of the VSME is conducive to a wider usage of online solutions, which are typically cheaper.

As for larger preparers, they may outsource to specialised ESG consultants but most of them, especially small companies, may still resort to their accountants our use online platforms. The share of larger preparers which are expected to prepare the VSME report internally is expected to grow in the subsequent years. The parameters describing outsourcing and the modalities of compliance, based on the findings of the targeted consultation, are shown in Table 13 overleaf.

[76] These categories are not mentioned, used or referred in the VSME.

The decision to outsource the preparation of the VSME report is determined by two main drivers. First, stakeholders concur that, especially for micro enterprises but not only, **most SMEs would not have the expertise and resources to understand and manage the process internally** irrespective of the extent to which the language of the VSME standard is simplified and made accessible. However, this is not only a matter of simplification. **SMEs are likely to hire external support for ESG reporting and use their resources for their core activities**, as it is already the case for financial accounts, labour consultants, safety managers, etc. It is important to note that in this context, outsourcing does not mean that the SME needs not to spend internal resources on this activity: as a minimum, it should collect data for the accountant, consultant or online platform, and it should verify and review the analysis and the report.

Table 13. In-house and outsourcing

	Micro enterprises Small enterprises with less than 20 employees	Small enterprises with 20 employees or more Medium enterprises	
		First Year	Following years
Fully In-house	0%	10%	30%
Accountants	50%	22.5%	12.5%
ESG Consultants	0%	30%	17.5%
Online platform	50%	27.5%	40%

Source: Authors' elaboration on targeted consultation and field test

- **Set-up and recurring costs**

Reporting costs are higher in the first year, due to set-up and familiarization activities, and lower in the subsequent years, because of the reduction in the number of activities and learning economies. This is confirmed unanimously by all stakeholders that were able to provide consideration on the evolution of reporting costs, as well as from the participants to the field test. Estimates vary from a moderate reduction (around 20%) to a significant (around 50%) or very significant (more than 50%) one depending on a number of factors.

The reduction is however not homogenous across internal and external costs. Internal costs are estimated to decrease the most as there learning economies always apply, with the time required by internal resources expected to decrease by 50%. Costs of consultants and accountants are also likely to decrease by the same amount, based on the estimates provided by participants to the field test. As for platforms, their business model is often based on an annual subscription, which is expected to remain at the same (or similar) price level across time[77].

- **Cost parameters**

Table 14 and Table 15 overleaf present the cost parameters needed to quantify reporting costs. They are sourced and triangulated from both the targeted consultation and the field test results; cost estimates were provided both by SMEs and their associations, as well as by consultants, accountants and platforms. As prescribed by the SCM methodology, the costs for a normally efficient firm are estimated; this is done by considering the median or average cost, or range thereof; extreme values have been expunged from the analysis. This means that, for specific cases, costs borne by companies can be higher or lower than the standard parameters presented.

More in detail, Table 14 presents detailed cost estimates, including internal personnel time, for the basic module. Table 15 presents cost estimates for other costs, which are estimated based on the data collected on the business partner module included in the ED. For all cost parameters, recurring costs are estimated, to account for their decrease from the second year of adoption.

[77] This is confirmed in the field test, where IT costs show the least difference between first and subsequent years of implementation.

Table 14. Cost parameters – Basic module

Basic module	Micro & Small (less than 20 employees)		Small (20 employees or more) & Medium	
	First year	Following years	First year	Following years
Accountants	1,000 - 2,000	500 – 1,000	3,000 - 6,000	1,500 -3000
Consultants	-	-	5,000 – 10,000	2,500 – 5,000
Platforms	300 - 600	600	1,000 - 3,500	1,000 - 3,500
Internal personnel - Outsourcing	10 days of a clerk, 5 days of a manager	5 days of a clerk, 2.5 days of a manager	15 days of a clerk, 10 days of a senior professional	7.5 days of a clerk, 5 days of a senior professional
	3,000 Range: 1,100 – 7,100	1,500 Range: 600 – 3,500	4,200 Range: 1,500 – 9,100	2,100 Range: 800 – 4,600
Internal personnel - In house	-	-	25 days of a clerk, 15 days of a senior professional	12.5 days of a clerk, 7.5 days of a senior professional
			6,800 Range: 2,500 - 14,400	3,400 Range: 1,200 – 7,200

Notes. Extreme values removed based on SCM methodology; figures rounded to the hundreds EUR. For internal personnel costs, the ranges are calculated based on the highest (LU) and lowest (BG) salaries; central estimates are calculate based on the average EU salaries for the professional figures identified. Source: targeted consultation, Field Test, Eurostat mean annual earnings by sex, age and occupation

Table 15. Other cost parameters

Other costs and fees	Additional costs	Notes
DRs from the PAT module included in the basic module after the revision	1,000	Includes both internal and external costs; 50% decrease in subsequent years. Only applies to larger preparers, due to the fact that the PAT DRs would not apply to most of micro and small companies.
Comprehensive module – Micro enterprises & Small enterprises with less than 20 employees	5,000	Includes both internal and external costs; 50% decrease in subsequent years.
Comprehensive module – Small enterprises with 20 employees or more and medium enterprises	10,000	

Source: Authors' elaboration on targeted consultation

➢ **Total Reporting Costs**

Based on the above analysis and parameters, the cost for the normally-efficient company can be calculated. These represent total reporting costs; incremental costs are calculated further below.

For the VSME reporting costs, several standard companies should be identified, over the following dimensions:

- Smaller vs. larger preparers;
- Compliance in-house vs. outsourcing;
- VSME module: basic only vs. basic + comprehensive.

Costs per companies are shown in below. In most cases, they are lower compared to the costs of the VSME ED, thanks to streamlining, simplification and a larger recourse to online compliance tools. The largest difference, up to more than 50% of reporting costs in the first year, concerns the submission of the VMSE, thanks to the removal of the DMA requirement.

Figure 9. Cost per company (EUR range)

Micro enterprises Small enterprises with less than 20 employees	First year (range)	Following year (range)
Basic module	3,500 - 4,500	2,000 - 2,300
Basic + Comprehensive	8,500 - 9,500	4,500 - 4,800

Small enterprises with more than 20 employees Medium enterprises	First year (range)	Following year (range)
Basic module	7,500 - 12,800	3,500 - 6,000
Basic + Comprehensive	17,500 - 22,800	8,500 - 11,000

Source: Targeted consultation, field test. Notes: figures are rounded to the hundred EUR; average is weighted by the share of population for the various modalities of compliance.

The estimates, based on the cost data provided during the field test and the targeted consultation, show that, for a smaller preparer, the total costs of the basic module are of about EUR 4,000 in the first year, and about half of it in the subsequent years. This results from about 15 days of internal work and some limited support by its accountants or an online platform. The costs about double for the comprehensive module.

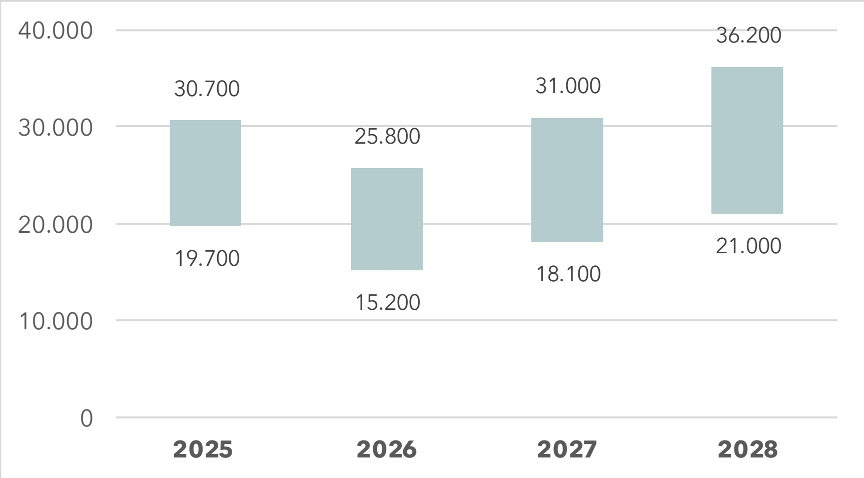
For larger preparers, costs for the basic module fall in between EUR 7,500 and 13,000 EUR the first year, and slightly more than half of it in the subsequent years. Again, costs are about double when the comprehensive module is concerned, especially in the year of implementation.

These estimates are to be considered as an average cost for preparers, because the disclosures required, and hence the total cost of the VSME, will vary with the features of the reporting company. On one extreme, a company active in the services sector operating in an urban zone and with no employees (e.g. a retail shop) is likely to have to report very few disclosures, potentially only the introductory disclosure and scope 1 and scope 2 emissions. Its VSME costs would hence be smaller than what estimated above. At the opposite end, an SME active in an energy-intensive basic manufacturing industry (e.g. a small steel roll mill) is likely to have to report several more disclosures, and the costs reported above would be an underestimate. Importantly, preparers upon request include SMEs active in value chains with large customers, or demanding access to bank credit. This means that the population is less likely to include very small service companies, while it is more likely to include SMEs active in the manufacturing or construction sector, which will have to cover more disclosures.

Total reporting costs are calculated by multiplying the costs per company shown above by the estimated number of companies adopting the VSME, as described in Section 5 above. Results are presented in range, to account for the uncertainty on the costs. Results are presented taking into account a progressive growth of the VSME population of preparers upon request; for any new company adopting the VSME, costs are higher in the first year of adoption and decrease in the following years.

Total reporting costs at EU level are estimated at 27.1 billion in 2025 (range: 19.7 - 30.7 billion). They decrease in the two following years and reach about EUR 31.8 billion (range: EUR 21 - 36.2 billion) in 2028, because of the growth in the number of adopters. While the number of VSME preparers doubles by 2028, the total reporting costs remain almost the same, because of the decrease in costs after the first year of adoption.

Figure 10. Reporting costs (EUR mn, range)



Source: Authors' own elaboration based on targeted consultation and field test

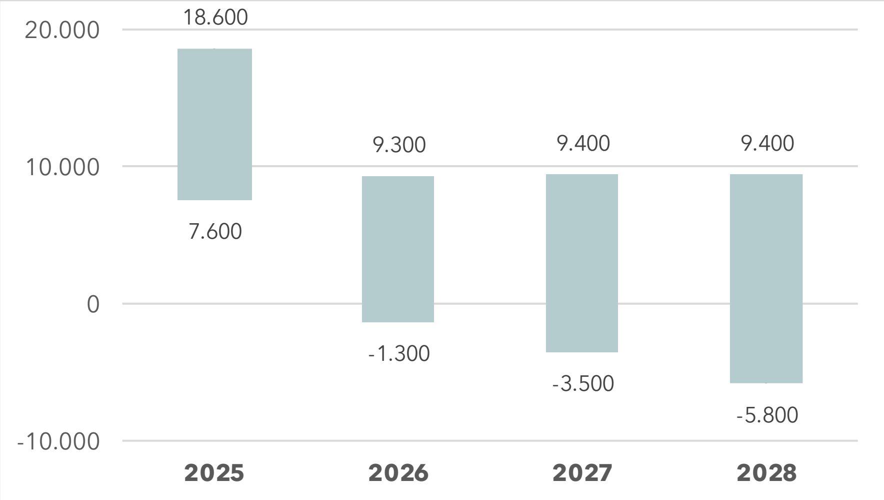
- **Incremental costs**

Incremental costs are the additional costs generated by the VSME as compared to the baseline scenario in which SMEs will have to reply to uncoordinated ESG requests from their large customers or financial institutions based on the same reporting standards as declared in the SME survey.

Incremental costs are very high in the year of first implementation of the VSME, because of its higher cost in the first year; they are estimated at about EUR 15 billion (range: EUR 7.6 – 18.6 billion). Then, they decrease for two reasons: on one side, costs per company decrease because of learning economies; on the other, the costs in the baseline scenario grow because more and more SMEs receive a request to disclose their ESG performance and information. In 2028, incremental costs decrease at about EUR 5 billion (range: EUR -5.8 – 9.4 billion). Estimates are shown in Figure 11 overleaf.

The incremental costs of the VSME compared to the baseline scenario are in line with the findings of the VSME. On the one side, the VSME has been carefully designed based on the requests from banks and large corporate customers; at the same time, by including data points requested in various questionnaires, in its entirety it is broader than most of the requests currently administered to SMEs. Moreover, and differently from typical ESG requests, the VSME is intended to be a basis for a full-fledged ESG report, rather than just providing answer to specific ESG questions. The difference between a report- and questionnaire-approach explains part of the additional costs, especially in the first year of implementation. However, the range of estimates for the last year includes negative results; this means that, depending on the actual costs of the VSME and the trends in ESG requests, the costs of uncoordinated replies can become higher than the cost of VSME, despite it being a more comprehensive tool.

Figure 11. Incremental costs (EUR mn, range)



Source: Authors' own elaboration based on targeted consultation and field test

6.2.3 Benefits: financial and value chain participation

➢ **Financial benefits**

SMEs engaging in voluntary ESG disclosure can benefit from lower cost of and greater access to credit. As explained in Section 5.3 above, this may consist in a lower interest rate on bank lending, which is more pronounced in the case of concessional lending, and in increased opportunities to access sustainable lending. The former, the so-called greenium on lending, is measured as the cost differential between companies engaging or not engaging in ESG disclosure.

The findings from the targeted consultation suggest that these benefits, at the moment, are largely potential. Especially when it comes to the cost of bank lending, at the moment banks are not yet discriminating among clients that provide or do not provide ESG information or full disclosure. However, with the growing regulatory pressure, these benefits could materialize. For this reason, the assessment considers a conservative measure of the greenium (5, 10 and 25 basis points), which would correspond to more mature market situation and to a significant change of lending practices by banks. As for concessional lending, the greenium is more pronounced, and estimated in the range of 10 to 30 basis point. For access to credit, sustainable lending to SMEs is estimated in the range of 15 to 27 billion per year, and the potential increase in the range 10 to 20%; additional credit is converted into benefits by using an average ROI for EU SMEs (5.9%)

Based on those parameters, **financial benefits are limited, in line with the findings of the targeted consultation. They amount to about EUR 190 million in 2025 and grow to about EUR 580 million in 2028.** At the beginning, two thirds of the benefits result from the increased access to sustainable credit; over the period of the analysis, benefits from the cost of bank loans grow more than proportionally, reflecting the increase in the population of VSME preparers upon request.

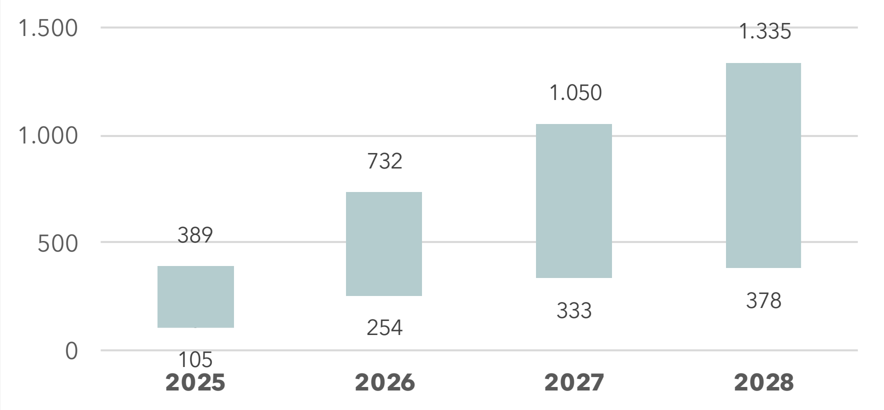
Table 16. Financial benefits (EUR mn, central value)

	2025	2026	2027	2028
Lower cost of bank loans	120	239	359	478
Lower cost of concessional loans	0.4	0.9	1.3	1.7
Benefits from access to credit	67	100	113	102
Total financial benefits	187	340	474	582

Source: Authors' own elaboration

Given the uncertainty on the amount of financial benefits, a sensitivity analysis is carried out on the estimated impacts on the cost of bank loans, of concessional loans, as well as on the increase in the access to credit. Results are shown in Figure 12 overleaf.

Figure 12. Financial benefits (EUR mn, range, sensitivity analysis)



Source: Authors' own elaboration

➢ **Value chain participation**

It is more and more likely that large corporations demand their supplies ESG data and disclosure, for their own business or marketing reasons, or to comply with the CSRD. Now, these requests concern a minority of SMEs, but the situation is evolving, mostly in respect to the implementation of the CSRD, which has just started. So far, most large companies have been focused on the DMA; when it comes to value chain data, these have been often estimated by means of secondary data and sector averages. However, in the future, they will have to resort more and more to primary information provided by suppliers. Hence, the provision of this information may become a criterion to direct purchase decisions.

At the moment, there is limited evidence that suppliers that do not provide ESG information face negative impacts, such as decrease in orders or expiration of contracts. One stakeholder mentioned that one larger retailer announced that, for its largest suppliers, the provision of certain ESG information may become a pre-requisite for supplies, but this is one of the few instances of actual negative impacts occurring so far. Also, suppliers are not all the same. Those providing standards or commoditised products and services may face a risk of downsizing or cutting commercial relationships. For key suppliers, those providing tailored or specialised inputs, or those operating in sectors at full capacity or with limited alternative suppliers, it remains unlikely that the threat of lower sales can materialise, at least in the medium term. This is particularly so also where alternative suppliers were not established in the EU, as this would likely cause additional difficulties in accessing ESG reporting data.

At the same time, it is reasonable to assume that **the increasing pressure on SMEs to disclose their ESG performance may benefit those that voluntarily decide to do so.** This effect is largely redistributive, with disclosing SMEs gaining some of the revenue lost by other businesses, and possibly, from the re-shoring of activities linked to the complexity of measuring impacts on an extended value chain. The analysis thus considers three scenarios: a central one in which sales by VSME preparers to large companies increase by 20%, with sensitivity analysis at 10% and 30%.

Based on this framework, the benefits from the value chain are calculated as follows:

- Total SME revenue in 2022 amounted to about EUR 19,000[78] billion; turnover from sales to large corporations were estimated at about EUR 2,300 billion (12%). Turnover by VSME preparers upon request is estimated based on their share of SME population;[79] it amounts to about EUR 300 billion in 2025, and it increases up to EUR 600 billion in 2028 (following the increase in the number of VSME preparers).
- The additional revenue is estimated in the three scenarios. In the central scenario, it goes from EUR 60 billion in 2025 (range EUR 30 – 90 billion) to EUR 120 billion in 2028 (range EUR 60 – 180 billion).

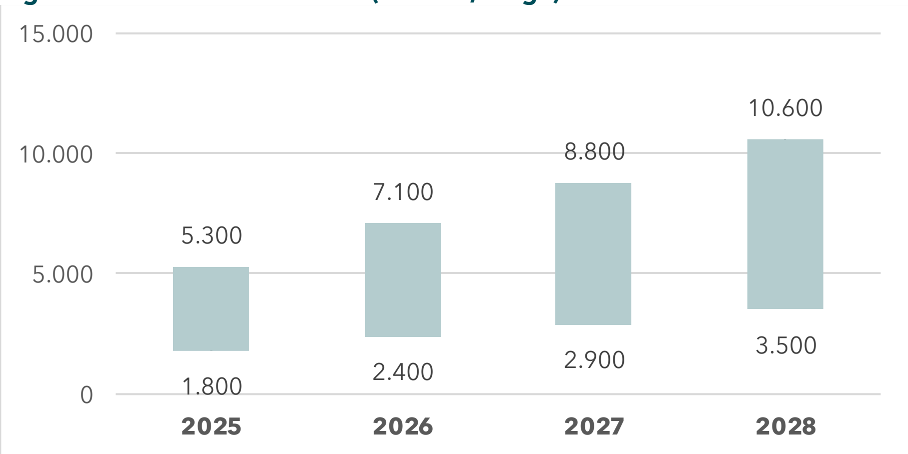
[78] Eurostat (2023) Structural Business Statistics, retrieved from https://ec.europa.eu/eurostat/web/structural-business-statistics/database

[79] In other words, it is assumed that, on average, there is no difference in sales to large companies among VSME preparers and other companies.

- Additional revenues are converted into benefits (i.e. profits) using the average ROI for EU SMEs (5.9%).

Estimated benefits from value chain participation amount to about EUR 3.5 billion in 2025 (range EUR 1.8 - 5.3 billion); they grow to EUR 7.1 billion in 2028 (range EUR 3.5 - 10.6 billion). These are shown in Figure 13 below.

Figure 13. Value chain benefits (EUR mn, range)



Source: Authors' own elaboration

7 CONCLUSIONS: CBA OF VSME

The CBA reviews the costs borne by VSME preparers and compares them with the associated benefits. Some of these (financial benefits and benefits stemming from participation in the value chain) lend themselves to monetary quantification, while others, pertaining to broader competitive, managerial or reputational aspects, are dealt with in qualitative terms.

The population of likely VSME preparers is split into two groups:

- **Spontaneous preparers**. These are SMEs perceiving to receive a direct net benefit from issuing detailed and harmonized ESG statements based on the VSME. These are likely to be found among:
    - SMEs active in B2C 'green markets', with a value proposition targeted to environmentally-conscious consumers;
    - SMEs selling products and services centred on sustainability (e.g. advanced manufacturing, ESG-related services), including when active in B2B value-chains;
    - SMEs active on the green public procurement market;
    - SMEs with a special attention to ESG issues (e.g. B-corp).
- **Preparers upon request**. This group includes SMEs receiving requests to provide ESG information from the value chain or financial institutions. In this case, the adoption can be direct, when the SME is requested to provide a VSME statement, or indirect, when the SME is requested to provide ESG information and decides to use VSME statements to this purpose.

As for spontaneous preparers, the choice is 'purely' voluntary. This means that they perceive net benefits from their decision, with qualitative benefits representing the prevailing motivation. In any case, no incremental costs can be attributed to voluntary decisions.

For the analysis of the costs and benefits on preparers upon request, the following approach is adopted:

1. The baseline costs for handling ESG requests and providing ESG information in the baseline scenario (without the VSME) are quantified;
2. The incremental costs of the VSME are measured by quantifying its reporting costs and subtracting the costs borne by SMEs in the baseline scenario;
3. The benefits for VSME preparers (financial benefits and benefits from value chain participation) are quantified;
4. The net impacts are calculated via the CBA. Sensitivity analyses are performed to ensure the robustness of the result.[80]

The cost estimates for the VSME are based on the **targeted consultation with SMEs and their associations, consultants, accountants and platforms. These were triangulated with the results from the EFRAG field test**, that was run independently from the targeted consultation and led to comparable figures. As a result, the two exercises strongly confirm each other's reliability. The costs for a normally efficient firm were estimated using median or average costs, excluding extreme values. The estimates show that, for a smaller preparer (less than 20 employees), the total costs of the Basic Module amount on average to about **EUR 4,000 in the first year and about half in subsequent years**. This results from about 15 days of internal work and some limited support by the SME's accountants or an online platform. The costs for the full VSME, including the comprehensive module amount to about EUR 9,000 per year. For larger preparers (with 20 employees or more), the costs for the Basic Module amount to **between EUR 7,500 and 12,800** in the first year, and about half in subsequent years. Again, costs are higher (about EUR 20,000) when the comprehensive module is also prepared.

These estimates are to be considered as an average cost for preparers; costs for preparers will vary with the features of the reporting company. As preparers upon request include SMEs asking for a bank loan active in value chains with large customers, **they are less likely to include very small service companies**

[80] This involves identifying variables with the largest expected impacts, creating scenarios with alternative values for these impacts, and recalculating the results based on these scenarios. This step has been crucial for verifying and validating the reliability of the CBA findings under different assumptions.

and more to include SMEs active in the manufacturing or construction sector, which will have to report more disclosures.

In the central scenario, incremental costs are expected to be higher than zero; in other words, the VSME is expected to cost more than ESG questionnaires currently in use. Though the VSME has been carefully designed based on the requests from banks and large corporate customers, including data points requested in various questionnaires, it is broader than most of the requests currently administered to SMEs. Moreover, and differently from typical ESG requests, the VSME is intended to be a basis for a full-fledged ESG report, rather than just providing answers to specific ESG questions. The difference between a report- and questionnaire-based approach explains part of the additional costs, especially in the first year of implementation.

More specifically, incremental costs peak in the year of first implementation of the VSME, because of its higher cost in the first year. Then, they decrease for two reasons, i.e. learning economies and the fact that the costs in the baseline scenario will grow, as more and more SMEs are expected to receive a request to disclose their ESG performance and information. In 2028, incremental costs have decreased at about EUR 5 billion (range: EUR -5.8 – 9.4 billion).

Moreover, there are signs that **ESG requests, particularly from banks, are becoming more complex and sometimes even more complex than the VSME**, and that banks may become more demanding in obtaining replies to their questionnaire. If this turns out to be true, in the future the costs under the baseline scenario will grow significantly and the incremental costs of the VSME will in turn become lower, possibly even negative (as shown by the negative range in 2028), i.e. the costs for handling ESG requests will become higher than the costs of reporting under the VSME.

To estimate the net impacts of the VSME, its incremental costs should be compared with quantifiable benefits:

- Financial benefits are primarily estimated based on the relationship between the quality of ESG disclosure and the cost of debt. The analysis incorporates the concept of an 'ESG credit premium', which is quantified at 5 -10 – 25 bp and 10 and 30 bp for concessional lending. Based on those parameters, financial benefits are limited, in line with the feedback from the Targeted Consultation. **They amount to about EUR 100-390 million in 2025 and grow to about EUR 380-1,340 million in 2028**.
- The size of benefits from the value chain participation effects is measured via scenarios relying on national accounts data, which provide information on the supplies from SMEs to large corporations over total sales. The likelihood of these effects is determined based on assumptions about the reaction of large buyers. **Estimated benefits from value chain participation amount to about EUR 1.8-5.3 billion in 2025 and grow to EUR 3.5–10.6 billion in 2028.**

The net impacts for preparers upon request can be calculated as follows: **expected benefits (financial and value chain participation) minus incremental costs (given by the difference between VSME reporting costs and the baseline scenario).** The range for net impacts is shown in Figure 14 overleaf.

Net impacts are negative the first year, due to the implementation costs. In the central scenario, **net impacts become positive from 2027,** and even more so in 2028. The positive results are driven by the lower recurring reporting costs, as well as the increasing benefits. Net benefits amount to EUR 800 million in 2027 and reach EUR 2,600 million in 2028.

Figure 14. CBA of the VSME standard for preparers upon request (EUR mn, range)

	2025	2026	2027	2028
Central	-11,100	- 1,100	800	2,600
High range	- 1,900	9,100	13,400	17,700
Low range	-16,700	-6,700	-6,100	-5,500

Source: Authors' own elaboration

Figure 15 shows the difference between the CBA of the VSME ED and its final version. The improvement is evident and significant, at about EUR 6.3 billion in the first year (when most of the one-off costs are borne), and about EUR 3 billion in the following years. The streamlining and simplification, the removal of the DMA, as well as the more fitness for use online platforms are instrumental in reducing reporting costs, while benefits remain largely unchanged.

Figure 15. VSME – Variation in net benefits between the ED and the final draft (EUR mn per year)

	2025	2026	2027	2028
Improvement	6,300	2,700	2,900	3,200

Source: Authors' own elaboration

7.1 Additional considerations and scenarios

As shown above, with assumptions based on the analysis of the current evidence and situation, the VSME already generates positive net impacts. This comes together with the expected net benefits for those VSME preparers which voluntarily opt for it for market and business considerations. In other words, **the CBA delivers a positive result.**

However, the field of ESG reporting and related consequences is evolving fast, for the evolution of the regulatory framework and its impact on business practices. Hence there are other scenarios, based on non-linear evolutions of the current situation, in which the impact of VSME would become significantly more positive. They are mostly linked to the behaviours of banks, which are considered a key transmission mechanism to nudge SMEs towards disclosing, and eventually improving, their ESG performance. These are presented separately from the above CBA, given the uncertainty associated with their occurrence; however, these far-reaching evolutions which have been mentioned by a significant group of stakeholders (although a minority thereof).

- **Credit curtailment.** Net impacts would become significantly positive in the scenario, mentioned by some financial institutions, of a significant curtailment or increase in the costs of credit for non-compliant SMEs. With an average loan of EUR 200,000, the opportunity cost of curtailed access to bank credit for an SME would be up to EUR 11,800 per preparer, higher than the average cost of the full VSME (basic + comprehensive). This scenario would be justified by the growing pressure on banks to provide data on environmental impacts to regulators. The likelihood and magnitude (in terms of market diffusion) of the risk of curtailment, however, remains unclear.
- **Complexification of requests beyond VSME requirements.** As mentioned before there are there are signs that ESG requests are becoming more complex, sometimes even more complex than the

VSME[81], and that banks may become more demanding in obtaining replies to their questionnaire because, under increasing pressure from supervision authorities. In other words, it can be expected that the VSME will become a module of a broader patterns of ESG requests to SME clients that are also likely to include taxonomy alignment data, particularly if a simplified version is devised for SMEs. In such a framework the benefits and the avoided costs above should be assessed against the entire costs of preparing ESG reporting for banks. This means that baseline costs would be significantly higher than what estimated above, and incremental costs would correspondingly decrease.

In addition to the costs and benefits quantified in the CBA, the Study Team's analysis and the various streams of consultation activities touched upon several additional topics:

1. Market acceptance of the VSME from the viewpoint of users' needs.
2. Market acceptance of the VSME from the viewpoint of preparers' needs

➢ **Acceptance of the VSME by Users**

The VSME pursues **multiple objectives**. It is designed to enable non-listed SMEs to respond to sustainability information requests from customers, banks, investors or other stakeholders, and thereby enabling synergies and cost savings. The VSME is also expected to make these users converge and limit data requests to SMEs to those included in the VSME standard. Finally, the Commission, in its September 2023 SME Relief Package, specifically refers to the VSME as a tool to support SME access to sustainable financing.

This presupposes that:

- a **minimum common denominator** is found among the information needs of users,
- the resulting standard is authoritative enough to **set a boundary for most of these requests**,
- the information contained therein is a sufficient tool to **help SMEs apply for green financing**.

The main users of the VSME will be, on the one hand, banks, which represent by far the most important source of financing for EU SMEs, and, on the other, large corporate customers. Their needs, however, may not be fully aligned.

- Banks' ESG requests to SMEs are mainly dictated by their own reporting requirements under Pillar 3, and this is even more so after the Capital Requirements Regulation (CRR#3)[82] was eventually released. These information needs only partly overlap with those of investment funds that are regulated by the SFDR PAI. If the purpose of the VSME is to help SME apply for green financing, **Pillar 3 reporting requirements should remain prominent,** as the importance of bank lending far outweighs that of SME access to the capital market across the EU.
- However, the VSME is also to ensure some degree of vertical coherence with the ESRS, because ESG requests along the value chain will be largely triggered by the need of large companies to comply with the CSRD. Similarly, the VSME may have to include some of the requirements trickling down from the SFDR PAI, as part of the information may be requested to invested companies, and hence to their suppliers.

The two objectives may be conflicting and the VSME could run two risks:

- If too close to banks' needs, it may result into a leaner, simpler instrument; however, as argued by some stakeholders, it may fall short of the needs of large customers, especially in sectors which have specific disclosure needs (e.g. fashion, luxury). Hence, the VSME may need to be complemented by sector-specific disclosures.

[81] It was anecdotally reported the case of a medium-sized SME that to get a € 1 mn green loan in an ESG critical sector had to fill in a questionnaire considerably more complex than the VSME in the opinion of the accountant who assisted in its preparation. The loan was conditional on having the questionnaire filled in and validated.

[82] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance

- If it incorporates the needs of both banks and large customers, it may result into an instrument which is comprehensive but, at the same time, more complex, with higher costs and potentially a lower uptake.

Given this context and considering that the value chain cap for corporate requests is determined only by the LSME, the VSME has possibly achieved one of the best possible results in attempting to limit the potential information requests to SMEs from ESRS preparers and investors' reporting under the SFDR. However, **the VSME capacity to set a boundary on information requests from banks is more uncertain.** It will ultimately depend on some factors which are still unknown, including the final format of EBA guidelines on managing ESG risks, the discussions on the Banking Book Taxonomy Alignment Ratio (BTAR) and the possibility of having a simplified version of the EU Taxonomy for SMEs. As importantly, or possibly even more so, the extent to which concessional lenders (e.g. EIF, EIB, KFW, SACE) will align their own information requests to intermediary banks to what is included in the VSME. The VSME in its current draft format will therefore be launched in a context in which:

- **It is likely to meet the data requirements of both banks and corporates**, but not exhaustively. The rationale behind the basic module is to make it friendly to micro companies and maximise uptake; however, it may not be sufficient for accessing bank credit. To access related benefits, a share of SMEs will have to us the comprehensive module as well.
- The VSME as such **may not allow preparers to meet Pillar 3 information requirements in full, notably taxonomy alignment disclosure, but most related datapoints are already covered**.
- The VSME is less likely to meet information requirements of large corporations. However, a strategy to overcome the issue could be to deal with sector-specific requests via sectoral standards.

As for other considerations, it was anecdotally reported that **some large multinationals might be reluctant to accept the VSME as a valid non-financial disclosure document to be used as basis to meet CSRD requirements if simply endorsed by means of a Commission Recommendation.** This is believed to justify requests not to abandon current data gathering practices accepted by auditors. Importantly, however, the only SME standard to have a clear legal endorsement by means of a delegated act will remain the LSME. In any case, since the consideration was based on hearsay, drawing conclusions about how representative this apparently very cautious attitude might be is difficult. It still may be an extreme position bound to disappear as the VSME gets increasingly acknowledged and accepted by the market.

Finally, and importantly, prospective users are uncertain as to the modalities in which VSME reports will be made available. **Whether they will be published in the European Single Access Point (ESAP) or not remains unclear. As mentioned before, this is deemed to be one of the key factors influencing the degree of market uptake of the VSME**, because users will be greatly encouraged by its availability in a common processable format at little or no cost. This is seen as one of the big competitive advantages of the VSME as compared to other in-house or platform-based solutions. Similar considerations apply to the availability of the VSME in national databases and company registers.

- **Acceptance of the VSME by preparers**

The VSME is considered as a **relatively simple tool by most users**, striking a positive balance between complexity, comprehensiveness and most of the needs of the stakeholders. However, **most SMEs will still be likely to need or prefer to get external support for preparation**. This is for various reasons:

- Most SMEs have very little familiarity with ESG topics. This means that they would need to spend a significant amount of time to familiarise with the standard;
- Albeit very simplified compared to the ESRS, the standard is considered complex and technical by some stakeholders, as not all disclosures are immediately understandable in their technicalities (e.g. the disclosures on biodiversity and water).
- Few disclosures remain open-ended. SMEs are typically used to structured questionnaires, mostly consisting of closed numerical questions. Open-ended questions may also be more difficult to process by users. This aspect was thoroughly addressed by the final revision of the VSME.
- Even when SMEs can prepare the report internally, they may prefer to focus on their core activities and hire to this purpose a third party (e.g. their accountant), who is already familiar with company

data. Also, small SMEs may lack internal resources for this job and could need external support regardless of the complexity of the standard.

The targeted consultation confirmed that propensity to delegate ESG reporting preparation is already quite widespread. **No further simplification of the VSME is likely to change this situation**. The above implies that any massive and rapid uptake of the VSME as an ESG reporting standard will face major bottlenecks in the **availability of supporting expertise** in the market. Given the difficulties which most SMEs are likely to experience in preparing the statement internally, the availability of a sufficiently large number of trained accountants - as consultants appear likely to cater to the more lucrative market of larger corporations - will be a key adoption factor. Therefore, a major element influencing the VSME uptake and market acceptance will also be the amount of training provided to SME accountants, the majority of whom reportedly still lack familiarity with ESG concepts and reporting frameworks. In this regard, comments on the readiness to cope with the likely future demand were very diverse depending on the different national or regional contexts.

Moreover, it was reported that SMEs tend to have an understanding of **business confidentiality** that is very broad in scope and possibly goes beyond the relevant VSME clause. This clause allows undertakings to omit classified or sensitive information from their reports if the information has commercial value because it is secret and if its publication is likely to negatively affect the financial performance or position of the undertaking even for matters that might go beyond protection of intellectual property or innovation. It is generally estimated that these companies are unlikely to adopt the VSME in any format that would require publication but would only transmit related information to the relevant counterparts upon request and bound to confidentiality. This is particularly the case for SMEs which are not required to publish their financial accounts. The latter might be an obstacle also irrespective of preparers confidentiality concerns, as it is currently unclear how the VSME can be officially published if the main financial accounts are not[83].

Conversely, the interviews showed that in a number of Member States – particularly in Southern Europe - **requests to have the VSME verified or assured by third parties** may be frequent, either because of explicit demands coming from banks or because the ESG statements are "attracted" within the sphere of the assurance requirements envisaged for the financial accounts. In a similar vein, it was noted that, at least in some jurisdictions, this parallelism with the financial statements, and in particular the possibility of being published as an annex to the financial statements, might push the VSME - or at least its disclosures more directly related to financial materiality - towards the sphere of criminal responsibility for preparers, which might be a deterrent for them to publish the document.

Another challenge relates to the **Scope 1 and Scope 2 GHG emissions** reporting required by disclosure B3, as well as Scope 3 GHG emissions, that must be disclosed in specific circumstances. While Scope 1 and 2 can be tricky for SME preparers and would ideally require an official calculator to convert energy consumption values into GHG emissions Scope 3 information is included as an entity-specific consideration in VSME, and not as a mandatory disclosure; its calculation is indeed deemed very difficult for most SMEs in terms of availability of information and costs of carrying out a detailed analysis. Most VSME statements will not include Scope 3 emissions; however, the very fact that these are mentioned in the standard indicating that their disclosure is necessary in specific, though limited, circumstances risks creating unnecessary complexity and confusion on the subject.

Online platforms are likely to play a key role in facilitating the market uptake of the VSME, as they will account for a large share of VSME early users and key stakeholders, and even more so after the review and the simplifications introduced. The VSME will be used to simplify and harmonize their own data gathering process; even if a public repository is not made readily available, this might mean that VSME contents are integrated within their surveys and translated into a questionnaire format that can be relatively far from the original reporting standard. ESG reporting platforms that currently face challenges in integrating SME data from disparate sources, leading to data quality issues, inconsistencies and gaps in reporting, are certainly more at ease in implementing an even more simplified and checklist-type version of the VSME. Furthermore, users, particularly banks, might decide that increased recourse to platforms is more expedient than having a separate data collection process, as this might trigger substantial savings.

[83] Examples of these companies include *die offene Handelsgesellschaft* and *die Kommanditgesellschaft* in Germany, *societa in nome collettivo* and *società in accomandità semplice* in Italy and their corresponding entities in France, *półka akcyjna, spółka z ograniczoną odpowiedzialnością, spółka komandytowo-akcyjna* in Poland.

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