

Analysis of Opportunities and Challenges of ESG Implementation in the Financial Statements of MSMEs in West Java: A Qualitative Perspective

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Abstract

This study aims to qualitatively analyze the opportunities and challenges in the implementation of Environmental, Social, and Governance (ESG) principles in the financial statements of Micro, Small, and Medium Enterprises (MSMEs) in West Java Province. By utilizing descriptive data from a survey of 100 MSME players and reviewed through the theoretical approaches of Stakeholder Theory and Institutional Theory, this study explores structural barriers and strategic potentials in the implementation of ESG. The findings show that the main constraints include low understanding of ESG regulations, limited resources, and administrative complexity. On the other hand, there are significant opportunities in the form of increased access to funding, business reputation, and long-term competitiveness. This study suggests the need for affirmative policies and continuous training to make ESG integration more inclusive and applicable in the MSME sector.

Keywords: ESG, MSMEs, financial reporting.

Introduction

The issue of business sustainability through the application of Environmental, Social, and Governance (ESG) principles is no longer limited to large companies, but has begun to penetrate the Micro, Small and Medium Enterprises (MSMEs) sector. ESG as a framework that assesses the environmental, social, and governance impacts of business activities has become a global concern as investors, consumers, and regulators increasingly demand responsible business practices (Charl de Villiers et al., 2022). This paradigm shift signifies that business success is not only determined by profit, but also by its contribution to sustainable development and social responsibility.

MSMEs as the backbone of Indonesia's national economy contribute more than 60% to the Gross Domestic Product (GDP) and absorb more than 97% of the national workforce. In West Java, the population of MSMEs reaches hundreds of thousands of business units spread across various sectors, from culinary, textiles, to digital services. With this large contribution, MSMEs have a strategic role in achieving the Sustainable Development Goals (SDGs), especially in the aspects of economic inclusiveness, poverty reduction, and environmental preservation. However, this potential has not been fully utilized due to the lack of integration of ESG principles in their business practices.

While ESG is starting to become a global standard in investment decision-making and business relationships, its implementation in MSMEs still faces major barriers. Unlike larger companies with compliance teams, consultants and complex reporting systems, MSMEs tend to operate with limited resources

and minimal knowledge of ESG policies. ESG regulations in Indonesia itself tend to be generic and have not been technically implemented in a format that is accessible to MSME players.

Previous studies, such as by Noer et al. (2024) and Puspa Widya Rahmah (2024) show that MSME players experience confusion in understanding the substance of ESG, both in terms of legal compliance, reporting, and its relevance to small businesses. On the other hand, initiatives from the Financial Services Authority (OJK) and the Ministry of Finance that encourage sustainable finance practices have not yet reached the MSME sector. This strengthens the argument that there is an implementation gap between formal ESG policies and the reality of MSMEs on the ground.

On the more positive side, a new awareness is emerging among MSMEs that are beginning to see ESG not as a burden, but as an opportunity. Businesses are beginning to realize that reputation, brand value and market access can be improved through responsible business practices. Some financial institutions and investors even require ESG implementation as part of the credit and investment assessment process, as expressed by (Kräussl et al., 2024). Thus, ESG can be a strategic tool to improve the competitiveness and sustainability of MSMEs amidst dynamic market pressures.

This study aims to qualitatively explore the opportunities and challenges of ESG implementation in the financial statements of MSMEs in West Java, based on descriptive findings from 100 MSME respondents who already have financial statements. Special emphasis is given to business perceptions of ESG regulations, access to fiscal incentives, barriers to implementation in the field, and strategic potential that can be utilized. By understanding the qualitative side of MSMEs' experiences, this research is expected to contribute to the development of more contextualized and responsive public policies and accounting practices.

Theoretically, this research is based on Stakeholder Theory and Institutional Theory. Stakeholder Theory emphasizes the importance of the relationship between MSMEs and their stakeholders, such as consumers, government, and society (Freeman & McVea, 2005). Meanwhile, Institutional Theory highlights how social norms and institutional pressures-including regulations and tax incentives-drive organizations to behave in accordance with external expectations (DiMaggio & Powell, 2010). These two theories complement each other in explaining the dynamics of ESG adoption: stakeholders demand transparency and accountability, while institutions provide the formal framework that shapes organizational behavior. In the context of MSMEs, both are important drivers despite often being constrained by internal capacity and uneven external pressures.

Methods

This research uses a descriptive qualitative approach to deeply understand the opportunities and challenges faced by MSMEs in implementing ESG. This approach allows researchers to capture the social reality and subjective experiences of MSME actors based on their respective contexts (John W. Creswell & Poth, 2018). This research focuses on interpreting the meaning given by businesses to their experiences in dealing with ESG regulations and engagement in sustainability reporting practices.

Primary data was collected through a closed survey instrument consisting of 15 Likert scale-based question items, but analyzed qualitatively by emphasizing the narrative trends that emerged from the respondents' responses. The survey was distributed to 100 MSME players in the West Java region through a purposive sampling technique, with the criteria that respondents are businesses that have financial statements and have a basic understanding of government regulations or policies related to sustainability.

Despite the qualitative approach, descriptive quantitative data was utilized as a source of baseline information. This data is used to identify common patterns, such as the frequency of certain perceptions of barriers to ESG implementation, the level of utilization of tax incentives, and perceptions of ESG benefits. However, the core of this research is to examine “why” and “how” these perceptions and experiences are formed, rather than simply counting the numbers.

Analysis was conducted using a thematic analysis approach as described by (Braun & Clarke, 2006), which includes six stages: (1) familiarization with the data, (2) initial coding, (3) search for themes, (4) review of themes, (5) defining and naming themes, and (6) report preparation. This technique was chosen because it is flexible and suitable for identifying, analyzing and reporting patterns in data, especially on social and public policy issues such as ESG.

Furthermore, this research is supported by secondary data triangulation to strengthen the credibility of the findings. Secondary sources include academic journals, government policies, ESG training reports, and MSME-related studies. According to Matthew B. Miles et al. (2020), triangulation not only increases internal validity, but also enriches understanding of complex phenomena.

This research also adopts the epistemological principle of interpretivism, where knowledge is seen as the result of social interaction and contextual construction of meaning. In this case, the experiences of MSME actors are considered a valid reality and need to be understood empathetically, not assessed through a purely normative framework (Denzin, 2017). Therefore, the results of this research place more emphasis on extracting narratives and critical reflections rather than statistical generalizations.

Thus, this research method is designed to comprehensively explore the meaning of MSME actors towards ESG, both in terms of barriers, potential, and institutional support that they experience in their daily business practices. The results of this approach are expected to provide practical and academic contributions in formulating more inclusive sustainability strategies for the MSME sector.

Results and Discussions

Based on thematic analysis of descriptive data from 100 MSME respondents in West Java, two main themes were identified: (1) barriers to ESG implementation in MSME financial reporting and (2) strategic opportunities from ESG implementation in the MSME sector. This analysis is tailored to the theoretical

approaches of Stakeholder Theory and Institutional Theory to link the field findings with the conceptual framework.

The most dominant barriers faced by MSMEs in adopting ESG relate to aspects of knowledge and technical capacity. Most respondents showed limited understanding of the ESG concept and its relation to financial statements. ESG is still considered a complex concept and more relevant for large companies, so MSME players feel they do not have the need or obligation to implement it.

In addition to limited understanding, structural constraints are also a major inhibiting factor. The majority of respondents do not have sufficient human resources to conduct structured ESG reporting. The absence of professional accounting personnel in most MSMEs makes the process of integrating ESG in financial reports a challenge.

In terms of policy, respondents stated that there are no ESG technical guidelines that can be accessed and practically applied by MSME players. Although the Financial Services Authority (OJK) has issued sustainable finance guidelines, the contents of the document have not been widely recognized or utilized by MSMEs. This indicates an information gap between regulators and businesses.

Another obstacle is the unaffordability of fiscal incentives. Although there are policies on tax incentives that support sustainable practices, respondents admitted that they are not aware of the access mechanism and the requirements that must be met. This shows that institutional pressure from normative policies is not enough to encourage behavior change without adequate technical assistance and literacy (DiMaggio & Powell, 2010).

Despite facing various barriers, the data shows that some MSME players are starting to realize the strategic opportunities of ESG implementation. One of the benefits identified by many respondents is the potential to improve business reputation. By demonstrating responsibility to the environment and society, MSMEs have the opportunity to attract consumers who are increasingly conscious of sustainability.

In addition, ESG is also considered to improve access to financing. Respondents noted that some financial institutions have started to consider sustainability aspects in the credit assessment process and funding support. MSMEs that implement ESG are considered more transparent and trustworthy, which adds value in the eyes of investors and business partners (Momtaz & Parra, 2024).

ESG is also considered to be in line with global market trends that increasingly demand traceability and socio-environmental accountability from all actors in the supply chain. For MSMEs that are suppliers to large companies or who want to expand into the export market, the implementation of ESG is a determining factor to meet the requirements of business cooperation.

Within the framework of Stakeholder Theory (Freeman & McVea, 2005), this opportunity can be interpreted as a strategic response of MSMEs to stakeholder expectations. ESG implementation is not just a

fulfillment of regulations, but an adaptive effort to strengthen social legitimacy and expand business opportunities.

From an Institutional Theory perspective, the low effectiveness of regulatory and normative pressures in encouraging ESG adoption suggests the need for a renewed policy approach. Instead of emphasizing formal obligations, the government and financial institutions need to develop more applicable incentive instruments, as well as build the capacity of businesses through training and technical assistance.

Overall, the results of this study show that the success of ESG adoption in the MSME sector is strongly influenced by the interaction between the internal understanding of businesses and external support from the institutional environment. ESG is not just a reporting framework, but part of a sustainable business transformation that requires multidimensional support. Therefore, a collaborative strategy between regulators, academics, business associations, and financial institutions is needed to ensure that ESG principles can be implemented gradually, proportionally, and contextually according to the characteristics of MSMEs.

Conclusion and Suggestions

This study concludes that the implementation of Environmental, Social, and Governance (ESG) principles in the MSME sector in West Java still faces various obstacles, both in terms of understanding, technical, and policy. The main obstacles identified include low ESG literacy, limited resources, absence of appropriate technical guidance, and lack of access to available fiscal incentives. These barriers indicate a structural gap that needs to be addressed through a more contextualized and participatory approach.

On the other hand, there are significant strategic opportunities. ESG has the potential to enhance business reputation, expand access to finance, and strengthen the position of MSMEs in supply chains that demand sustainability. ESG can also be a tool for MSMEs to respond to stakeholder expectations and strengthen the social legitimacy of their businesses.

Based on these findings, this study recommends several things. First, the government needs to provide ESG guidelines that are tailored to the capacity and characteristics of MSMEs. Second, ESG literacy and technical assistance programs that are integrated with business capacity building programs need to be developed. Third, financial institutions and investors are expected to provide incentives and financing schemes that consider sustainability as an added value.

With policy support and increased awareness of business actors, it is expected that ESG integration in MSME financial reporting can be more inclusive and sustainable, thus supporting economic transformation that is not only profit-oriented, but also social and environmental impacts.

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