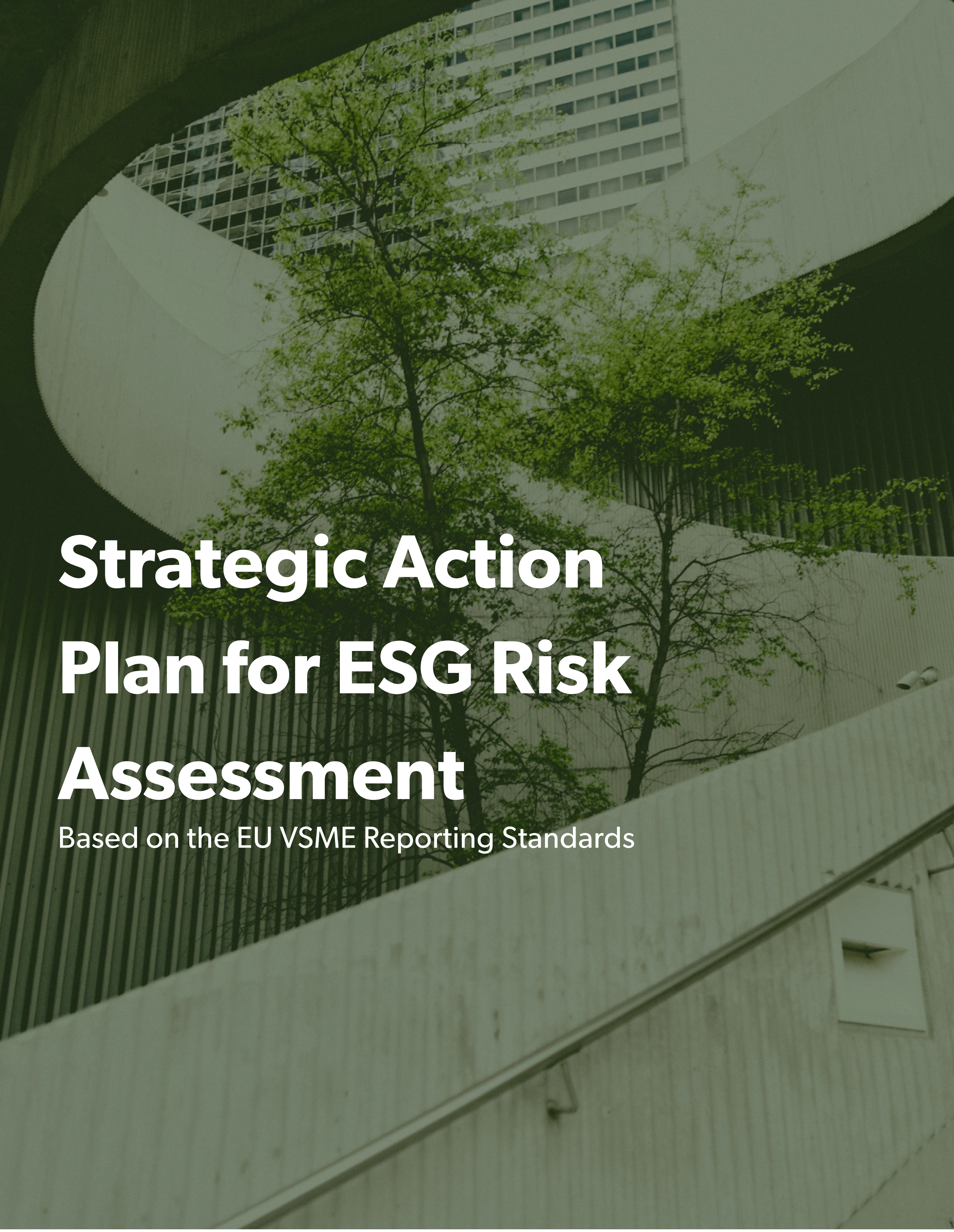

Strategic Action Plan for ESG Risk Assessment

Based on the EU VSME Reporting Standards

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This document was produced as part of the bilateral project
“Designing a Risk Intelligence Methodology for ESG evaluation” managed by the
PRINCEPS Risk Intelligence Institute (CZ) and Prios Kompetanse (NO).
The project is funded by EEA Norway Grants 2014-2021.

You can learn more about the project at **princepsinstitute.com/esgmethodology**.

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1. Introduction

The importance of ESG (environmental, social and governance) and risk intelligence to small and medium-sized enterprises (SMEs) lies in their ability to adapt to ever-changing economic circumstances, and requirements. Currently, long-term sustainability and resilience are increasingly important trends in the economy. More and more public and financial institutions, investors and customers are paying closer attention to the non-financial aspects of companies. By integrating ESG principles, SMEs can meet regulatory and stakeholder expectations, while simultaneously identifying and mitigating potential risks, therefore safeguarding their operations and reputation.

The proposed guidelines for applying the principles of risk intelligence to action planning on ESG and the reporting thereof are intended to help SMEs effectively navigate the identification and management of ESG-related risks. By pinpointing ESG-related risks, SMEs can better anticipate potential challenges that impact their operations, reputation and financial performance. Evaluating the identified risks allows SMEs to prioritise their efforts and focus on the most significant threats to them. Developing a comprehensive and manageable mitigation strategy for high-score risks helps safeguard their business against potential disruptions and aligns them with regulatory and stakeholder expectations. Continuous risk monitoring and mitigation enable SMEs to adapt to changing circumstances and maintain a competitive edge. By identifying, evaluating and mitigating the risks on a timely and regular basis, SMEs increase their chances of surviving and thriving in this turbulent and fast-paced period of economic transition.

The guidelines are based on the Risk Intelligence Methodology, which is also part of the project.

2. Determining the type of entity: micro, small, or medium

In the European Union (EU), the classification of an enterprise into micro, small or medium is based on the number of employees, annual turnover and the balance sheet total:

- The average number of employees is calculated over the course of a year and includes full-time, part-time and temporary staff. This criterion helps gauge the workforce size and capacity of an enterprise. In the EU, an enterprise employing up to 10 persons is considered a microenterprise, up to 50 persons as a small enterprise, and up to 250 persons as a medium-sized enterprise.

- Net turnover is the total revenue generated by an enterprise from its regular business activities, minus any returns, allowances or discounts. A net turnover of up to €10 million classifies an enterprise as small, and up to €50 million as medium-sized. Net turnover provides insight into the market reach and operational scale of the business.
- The balance sheet total refers to the total assets held by an enterprise at the end of the financial year. It is a critical measure of the enterprise's size and financial capacity. SMEs are classified based on whether their balance sheet total stays within the specified limits for micro, small or medium-sized enterprises. For instance, an enterprise with a balance sheet total of up to €2 million is classified as a micro-enterprise.

The EU defines SMEs, as set out below, in order to ensure a consistent understanding and support framework across member states:[1]

Type of entity	Average number of employees	Net turnover	Balance sheet total
Micro	< 10 people	Less than €2 million a year	Less than €2 million a year
Small	< 50 people	Not exceeding €10 million	Not exceeding €10 million
Medium	< 250 people	Not exceeding €50 million	Not exceeding €43 million.

- Micro-enterprises typically include very small businesses, family-owned businesses and startups.
- Small enterprises are more established than micro-enterprises but still operate with limited resources.
- Medium-sized enterprises are often well-established businesses with a significant market presence and more complex organisational structures.

Of the three parameters, the number of employees is mandatory for enterprise classification. Entities also need to be below the threshold for either net turnover or balance sheet total to be classified in the respective SME category. If the metrics for the entity are above the threshold values for

1 'SME Definition - User Guide 2020', European Commission, 7 September 2020, https://ec.europa.eu/docsroom/documents/42921.

two consecutive accounting periods, it can no longer be classified in the same category. Vice versa also applies. In other words, falling below the thresholds for two consecutive accounting periods also changes the entity's classification. Partnerships and linkages to other companies may affect how these thresholds are calculated.

For example, take an enterprise that employs 35 people, has an annual turnover of €8 million and a balance sheet total of € 5 million. Based on these metrics, this enterprise would be classified as a small enterprise because all three metrics fall within the defined thresholds.

Further, suppose an enterprise employs 52 people, has an annual turnover of €8 million and a balance sheet total of €5 million. In this case, it is considered a medium-sized company because the headcount is above the respective threshold. However, if a similar company employs 42 people, has an annual turnover of €15 million and a balance sheet total of €5 million, it would be classified as a small enterprise because the headcount and balance sheet total fall under the respective thresholds.

Besides the classification of the company, the type of ESG reporting standards to be used is also affected by whether or not a company is listed on the stock market; listed and non-listed SMEs are subject to different standards.

Understanding the category your entity falls under helps determine the non-financial reporting standards applicable to the entity's use case.

Entity Classification	Applicable ESG Reporting Standard
Non-listed SME	VSME (Voluntary Sustainability Reporting for SMEs)
Listed SME	ESRS LSME (European Sustainability Reporting Standards for Listed SMEs)
Large entity	ESRS (European Sustainability Reporting Standards)

Actionable steps to determine the type of entity:

1. **Is the entity in question listed on the stock market?** Listed and non-listed entities are subject to different sets of reporting standards, as explained in the subsequent steps.
2. **Analyse the relevant financial documents of the last closed accounting period (balance sheet, profit and loss accounts, staff headcount).**
3. **Compare the numbers in the documents with the thresholds for the classification of SMEs.** If the entity is non-listed and is micro, small or medium, then the VSME standard applies. If the entity is listed and is micro, small or medium, then the ESRS LSME standard applies. If the entity is large, then the ESRS standard applies for both listed and non-listed companies.

Helpful online tools:

SME Self-Assessment Questionnaire (link, European Commission)

SME Definition (link, European Commission)

3. Stakeholder Mapping

Effective stakeholder engagement ensures that a company's sustainability initiatives are relevant, impactful and supported by those who are affected by or can influence the business. Stakeholder engagement helps build trust, improve decision-making and enhance a company's reputation.

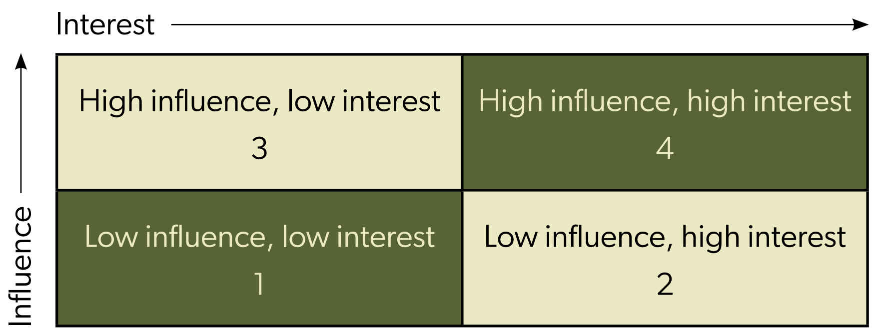
Identifying key external stakeholders involves recognising the individuals or groups that significantly impact or are impacted by an SMEs operations. High-priority stakeholders are those with both high influence and high potential for engagement. Low-priority stakeholders are those who either have low influence on the given matter or are challenging/risky to engage with.[2] Business stakeholders can be categorised as seen in the Stakeholder Mapping Template below.
Outlining the role and interests of stakeholders for a company can help entities establish stake-

2 For more information, please refer to the "Risk Intelligence Methodology for ESG Evaluation".

holder needs regarding information about the entity's ESG performance. Various engagement methods and techniques can be employed for the purpose, such as formal and informal conversations, customer surveys, customer feedback, participation in industry forums and follow-ups on industry-centred sources of information.

Documenting stakeholder insights is vital for ESG efforts and risk management because it ensures that key decision-makers have access to the collected information about the needs and expectations of those affected by an entity's operations. These insights can help align a company's strategy and operations with stakeholders' needs and influence the choice of reporting standards to meet disclosure expectations.

Prioritising stakeholders' needs based on the impact on business outcomes of key external players ensures that sustainability efforts are focused where they matter most.
The following matrix can be utilised for this purpose:



Stakeholder prioritisation matrix

External Stakeholder	Influence Score	Interest Score	Stakeholder Role	Stakeholder Interests	Engaging with the Stakeholder
Customers			Customers drive revenue and influence market reputation.	Product quality, ethical sourcing, environmental impact, transparency, and corporate responsibility	Feedback surveys, customer service interactions, sustainability reports
Investors			Provide capital and influence corporate governance.	Financial performance, ESG risks, long-term sustainability, ethical business practices	Financial reports, investor meetings, ESG disclosures, sustainability briefings
Employees			Execute business operations and drive innovation.	Fair wages, safe working conditions, career development, diversity and inclusivity, corporate ethics	Internal communications, employee surveys, training programmes
Suppliers			Provide goods and services essential for company operations.	Fairtrade practices, timely payments, long-term partnerships, sustainability requirements	Supplier audits, code of conduct agreements, collaborative projects, regular meetings
Regulators			Enforce laws and regulations that impact the business.	Compliance with legal standards, environmental protection, social responsibility, transparency	Regulatory compliance, compliance reports, consultations, industry forums
Community			Residents and organisations affected by business operations.	Environmental impact, job creation, community support, ethical conduct	Community meetings, impact assessments, social responsibility and ESG initiatives, partnerships with local organisations

Stakeholder Mapping Tool

Stakeholder mapping should be an ongoing process to capture changes in the business environment and stakeholder dynamics. In accordance to the importance and influence of each type of stakeholder, proposed monitoring frequencies and possible KPIs are set out below. SMEs can adjust both according to the availability of resources and their monitoring goals.

	High influence, Low interest 3	**High influence, High interest 4**
Monitoring Frequency	Quarterly, due to the power to affect the company significantly opposed to the low interest in its day-to-day operations.	Continuous, due to the significant impact on the company and high interest in its activities.
Suggested KPIs	• Regulatory changes and updates • Investor sentiment • Supplier performance	• Customer satisfaction scores • Investor Feedback • Employee engagement levels • Supplier compliance rates • Regulatory compliance status • Community impact metrics
	Low influence, Low interest 1	**Low influence, High interest 2**
Monitoring Frequency	Annually or biannually, to track changes regularly with minimal resources.	Every 6 months or annually, to make sure their interest is satisfied while preserving resources.
Suggested KPIs	• General market trends • Broad regulatory developments	• Community feedback • Employee satisfaction surveys • Local environmental impact

Stakeholder prioritisation matrix with suggested monitoring frequency and KPIs

1. **Use the Stakeholder Mapping Template to list all stakeholders in your business.** For greater clarity, use concrete names of entities and institutions wherever possible.
2. **Interact with the stakeholders to determine their level of interest in your company's ESG performance and its influence on their decisions.**
3. **Assess the level of influence of each stakeholder over your business.** You can opt for simpler prioritisation based on the influence of the stakeholders on the bottom line. Alternatively, you can select a broader spectrum of stakeholder influences to explore. The more complex the evaluation of stakeholder influence, the longer it will take to complete.
4. **Use the Stakeholder Prioritisation Matrix to visualise the importance of each stakeholder.** The stakeholders in Quadrant 4 - high influence and high interest - are the ones to focus your ESG efforts on. Stakeholders in Quadrants 2 and 3 should be re-examined regularly and integrated into the focus of your sustainability initiatives once they turn into a Quadrant 4 stakeholder. Stakeholders in Quadrant 1 - low impact and low interest - can be monitored for changes in the level of influence and interest on a semi-regular basis
5. **Outline monitoring action plan**. Determine who will monitor changes in the stakeholders, by what means, what KPIs will be monitored, how often and to whom the monitoring results will be reported.

Example of stakeholder mapping

An SME in the textile industry that focuses on sustainable fashion lists the following as its stakeholders:

- **Customers:** Eco-conscious consumers
- **Investors:** Ethical investment funds
- **Employees:** Factory workers and office staff
- **Suppliers:** Organic cotton farmers
- **Regulators:** Environmental protection agencies
- **Community:** Local communities near production facilities

The company conducted surveys and meetings to determine stakeholders' interests and influence and drew the following conclusions:

- **Customers** have a high interest in sustainable practices and product quality.
- **Investors** have high influence due to financial support but moderate interest in day-to-day operations.
- **Employees** are highly interested in fair wages and safe working conditions, while having moderate influence.
- **Suppliers** are moderately interested in long-term partnerships and have high influence on supply chain stability.
- **Regulators** have high influence due to regulatory compliance requirements, but moderate interest in daily operations.
- **Community** has low to moderate interest in environmental impact and moderate to low influence.

Using the gathered data, the company assessed the influence and interest of each stakeholder:

Stakeholder	Influence	Interest
Customers	High	High
Investors	High	Medium
Employees	Medium	High
Suppliers	High	Medium
Regulators	High	Medium
Community	Low	Low

The company placed the stakeholders in the prioritisation matrix:

High influence, low interest 3 **Investors, Suppliers, Regulators**	High influence, high interest 4 **Customers**
Low influence, low interest 1 **Community**	Low influence, high interest 2 **Employees**

Based on the prioritisation matrix, the company developed a monitoring action plan:

	High influence, Low interest **3** **Investors, Suppliers, Regulators**	**High influence, High interest** **4** **Customers**
Monitoring Frequency	Quarterly	Continuous
Suggested KPIs	• Regulatory changes and updates • Investor sentiment • Supplier performance	• Customer satisfaction scores • Sustainability Reporting Feedback
Monitoring Plan	• Supplier audits • Compliance reports • Quarterly investor meetings	• Regular feedback surveys • Custormer service interactions • Sustainability Reports
	Low influence, Low interest **1** **Local Community**	**Low influence, High interest** **2** **Employees**
Monitoring Frequency	Biannually	Every 6 months
Suggested KPIs	• Local community trends reported by the local authorities and NGOs	• Employee satisfaction surveys
Monitoring Plan	• Biannual trend and/or community sentiment analysis, regulatory review sessions	• Biannual employee surveys, community meetings, working conditions assessment

This structured approach enables the SME to proactively address stakeholder needs and align its sustainability initiatives with stakeholder expectations, and in so doing, enable it to effectively manage its ESG-related risks.

4. Determination of Applicable Reporting Standards[3]

The European Financial Reporting Advisory Group (EFRAG) is continually developing the European Sustainability Reporting Standards (ESRS) to further enhance transparency and accountability in sustainability reporting across the European Union. The comprehensive ESRS, designed for large companies and publicly listed entities, requires detailed disclosures to meet stringent regulatory and stakeholder expectations. To address the needs of small and medium-sized enterprises (SMEs), EFRAG had developed the ESRS for listed SMEs (ESRS LSME), which balances the rigour of full ESRS with practical considerations. For non-listed SMEs, the Voluntary Sustainability Reporting Standards (VSME) offer a tailored, modular framework that addresses specific needs and resource constraints, ensuring all companies can engage in meaningful ESG reporting and contribute to sustainable development. The reporting standards are compared below.

Area of Disclosure	**ESRS (High detail – large listed and non-listed entities)**	**ESRS LSME (Moderate detail – listed SMEs)**	**VSME Basic Module (Basic detail – non-listed SMEs)**
Climate change	Detailed metrics on greenhouse gas emissions (Scopes 1, 2 and 3), energy consumption and transition plans for climate mitigation and adaptation.	Simplified reporting on greenhouse gas emissions (primarily Scopes 1 and 2), energy consumption and high-level transition plans.	Basic data on energy consumption and general environmental impacts.
Biodiversity and ecosystems	In-depth reporting on impacts on biodiversity, measures taken to protect ecosystems and biodiversity-related risks.	General information on impacts and mitigation measures, without requiring exhaustive data.	Fundamental information on general environmental impacts and basic mitigation actions.

3 'First Set of Draft ESRS', EFRAG, https://www.efrag.org/en/sustainability-reporting/esrs/sector-agnostic/first-set-of-draft-esrs; 'Voluntary Reporting Standard for SMEs', EFRAG, https://www.efrag.org/en/projects/voluntary-reporting-standard-for-smes/exposure-draft-consultation; 'ESRS for Listed Small - and Medium - Sized Enterprises (ESRS LSME)' (EFRAG, January 2024), https://www.efrag.org/sites/default/files/sites/webpublishing/SiteAssets/ESRS%20LSME%20ED.pdf.

Water and marine resources	Comprehensive data on water usage, wastewater management and impacts on marine resources.	Basic data on water usage and wastewater management, with less emphasis on detailed metrics.	Essential data on water usage and general management practices.
Pollution	Detailed disclosures on air, water and soil pollution, including hazardous waste management.	Basic disclosures on key pollutants and waste management practices.	Key information on waste generation and general pollution management.
Circular economy	Extensive information on resource efficiency, recycling rates and circularity initiatives.	General information on resource efficiency and recycling initiatives.	Basic data on resource use and fundamental recycling efforts.
Social factors	Detailed information on human rights policies, labour practices, diversity and inclusion, employee well-being and community engagement.	High-level reporting on human rights, labour practices and community engagement, focusing on key policies and actions.	Fundamental information on workforce demographics, basic health and safety statistics and general community engagement.
Governance	Comprehensive reporting on governance structures, anti-corruption measures, business ethics and board diversity.	Simplified governance reporting, covering essential aspects of business conduct and ethics.	Key disclosures on anti-corruption measures, basic governance structures and ethical business practices.

The Basic Module of VSME standards is non-negotiable since it contains the absolute minimum reporting requirements that a company must fulfil. The Basic Module can be supplemented with two modules for extended disclosures:

- **Narrative-PAT (Policies, Actions, Targets) Module** - adds depth in areas such as policies, strategic actions and target-setting for sustainability goals. Disclosures in this module are applicable if the SME aims: a) to align its business strategy with sustainability goals to meet stakeholder expectations or regulatory requirements; b) to develop comprehensive sustainability policies and wants to communicate these to stakeholders; c) to undertake specific actions targeted at identified sustainability; d) to set measurable sustainability targets and to report on such undertaken initiatives.

- **Business Partners Module** - focuses on detailed disclosures relevant to business partners, such as revenue from controversial sectors, gender diversity in governance bodies and compliance with international standards. Disclosures in this module are applicable if the SME aims: a) to seek investment or loans; b) to become part of the value chain of larger companies with stringent ESG criteria; c) to apply for sustainability certifications or comply with industry-specific regulations that require detailed ESG reporting; d) to voluntarily enhance transparency to build trust with stakeholders and the public.

Stakeholder mapping can inform non-listed SMEs which modules of the VSME standards to apply in their reporting.

Actionable steps for the determination of the applicable VSME reporting standards for non-listed SMEs:

1. **Study the VSME standards to determine the minimum reporting requirements for the type of entity you are reporting about.** Currently, the VSME standards do not explicitly disclose which modules are obligatory based on company size. Other factors, such as stakeholder requirements, may be more informative. However, familiarity with the VSME standards is a necessary first step to reporting.
2. **Analyse the disclosure needs of your high influence, highly interest stakeholders.** Refer to the section on "Stakeholder Mapping" for guidance.
3. **Based on the identified disclosure needs in the previous steps, determine which of the three VSME standard modules are applicable.**
4. **Determine the key data to be collected, assign responsibilities to relevant team members and organise the data collection, analysis and reporting process.**
5. **Use the collected data to report your non-financial indicators in the respective VSME modules.**

Examples of the determination of the applicable VSME reporting standards

Two hypothetical companies, EcoThreads and GreenTech Solutions, are used here to illustrate how SMEs can determine the appropriate VSME reporting standards.

EcoThreads is a micro-enterprise with 8 employees, an annual turnover of €1.5 million and a balance sheet total of €1.2 million.

As a micro-enterprise, EcoThreads starts by applying the Basic Module of the VSME standards, which is mandatory for all SMEs. This module includes essential disclosures, such as energy consumption and general environmental impacts. EcoThreads conducts stakeholder mapping and identifies that its primary stakeholders (customers and local community) have a high interest in the company's environmental practices, but have limited influence. Key stakeholder interests include product sustainability and local environmental impact. Given the stakeholder needs, EcoThreads decides to focus on the Basic Module. Due to its micro size and limited resources, it will not opt for the Narrative-PAT or Business Partners Modules at this stage. Key data points include energy consumption, waste generation and water usage. Responsibilities are assigned to relevant team members to gather and analyse this data. EcoThreads uses the collected data to complete the Basic Module, ensuring they meet minimum reporting requirements. EcoThreads successfully reports its ESG metrics using the Basic Module, aligning its reporting with stakeholder expectations and regulatory requirements.

GreenTech Solutions is a small enterprise with 45 employees, an annual turnover of €9 million and a balance sheet total of €7 million.

GreenTech Solutions reviews the VSME standards and understands that, in addition to the Basic Module, it may need to consider applying the Narrative-PAT Module and Business Partners Module based on stakeholder needs. Through stakeholder mapping, GreenTech Solutions identifies that its investors and major customers have high influence and interest in its sustainability performance. Key stakeholder interests include detailed policies on sustainability, strategic actions and compliance with international standards. To meet stakeholder expectations, GreenTech Solutions decides to use the Basic Module, the Narrative-PAT Module for detailed policy and action disclosures and the Business Partners Module to address investor and customer requirements. Key data include energy consumption, carbon footprint, sustainability policies and compliance with international standards.

Relevant team members are assigned to collect, analyse and report this data. GreenTech Solutions uses the collected data to complete the Basic, Narrative-PAT and Business Partners modules of the VSME standards and provides comprehensive ESG reporting that meets the detailed needs of its investors and customers.

5. Definition, evaluation, monitoring and mitigation of risks related to ESG requirements and reporting standards

In the outline of the Methodology, the main components of risk intelligence analysis are: Identify, Assess, Mitigate and Monitor. Risk definition, as part of the "Identify" stage, begins with a risk appetite assessment.

Risk appetite refers to the type and amount of risk that an organisation is willing to take to meet its objectives.[4] This involves evaluating the organisation's goals, gathering input from key stakeholders, identifying and categorising potential risks and developing clear statements that define acceptable levels of risk. It sets the boundaries within which risks should be managed and ensures that the company's risk-taking aligns with its strategic goals and available resources.

Organisations can exhibit various attitudes towards risks, ranging from risk-averse to risk-eager. A risk-averse organisation tends to avoid risks and prioritises stability and security, implementing stringent controls to minimise potential threats. An organisation with a minimal risk attitude accepts some level of risk but remains cautious, only taking calculated risks when necessary. Cautious organisations carefully analyse risks and take preventive measures but are open to moderate risk-taking if it aligns with their strategic goals. Open organisations are more willing to engage with risks, viewing them as opportunities for growth and innovation, while still maintaining some level of control. Finally, risk-eager organisations actively seek out high-risk opportunities, embracing uncertainty and potential volatility to achieve significant rewards and competitive advantages.
Risk attitudes are often influenced by industry standards and past experiences. To some of the risks

4 'Risk Appetite Guidance Note' (GOV.UK Government Finance Function, August 2021), https://assets.publishing.service.gov.uk/media/61239758e90e0705481fc085/20210805_-_Risk_Appetite_Guidance_Note_v2.0.pdf.

it is exposed to, an organisation may adopt a more conservative attitude, while to other risks the same organisation may adopt a more open approach.

By aligning risk appetite with ESG reporting requirements, organisations can ensure that their risk management strategies support sustainable practices and regulatory compliance. The following actionable steps outline how to effectively implement risk management within the context of ESG reporting.

Actionable steps for risk appetite assessment:

Identify:

- **Review business objectives:** Define main goals and key value drivers, ensuring alignment with ESG priorities.
- **Gather team input:** Hold a brief meeting to discuss risks and gather feedback, including ESG considerations.
- **Identify risk areas:** List major risk categories, including environmental, social and governance risks, and create simple scenarios.

Assess:

- **Create risk inventory:** List current risks, including ESG-related risks and use past data to assess exposure.
- **Write risk statements:** Develop simple risk appetite statements and set basic limits for optimal and tolerable risk.
- **Use risk tools:** Plot risks and rate them using the 5x5 Matrix (see Methodology for detailed explanation).

Mitigate:

- **Communicate:** Share risk appetite with employees and provide basic training on the risks, including ESG risks and their management.

Monitor:

- **Review regularly:** Schedule regular reviews and adjust the risk appetite as needed based on new insights and changes in the business environment.

Example of risk appetite assessment

The hypothetical company GreenTech Solutions is used here to illustrate the process of risk appetite assessment.

GreenTech Solutions is an SME that manufactures eco-friendly packaging materials. The company aims to expand its market share by 20% over the next three years, while maintaining high sustainability standards, i.e. all products must remain 100% recyclable and environmentally friendly.

In line with the aforementioned, GreenTech Solutions undertook a review of its business to assess its risk appetite. It defined its key value drivers to be innovation in eco-friendly materials, market expansion and sustainability leadership. The management team held a meeting with key departments, including production, marketing and sustainability, to identify the potential risks associated with their growth and sustainability goals, as well as to gather diverse perspectives. As a result of this process, **the following risks were identified**:

- **Environmental risks:** Supply chain disruptions for sustainable materials.
- **Social risks:** Workforce safety and community impact.
- **Governance risks:** Compliance with evolving sustainability regulations.
- **Market risks:** Competitor actions and market acceptance of new products.

The **following potential scenarios were also scripted**:

- A major supplier of recycled materials fails to meet delivery schedules.
- New environmental regulations increase compliance costs.
- A competitor launches a similar eco-friendly product.

In its risk inventory, the company included supply chain reliability, regulatory compliance and competitive pressure. The conducted analysis showed the impact on operations of previous disruptions in supply chains and recent changes in environmental regulations.

Based on the performed analysis and scenarios, GreenTech Solutions drew up the following risk appetite statements:

- **Environmental:** GreenTech Solutions has a low appetite for risks that could compromise product recyclability.
- **Social:** GreenTech Solutions is willing to accept moderate risks related to workforce safety

improvements.

- **Governance:** GreenTech Solutions has a low tolerance for non-compliance with environmental regulations.
- **Market:** GreenTech Solutions is open to moderate risks in pursuing new market opportunities.

The company used a **5x5 risk matrix** to rate the probability and impact of each risk as follows:

- **Supply chain disruption:** Likelihood 4, Impact 4 (High risk).
- **Regulatory changes:** Likelihood 3, Impact 3 (Moderate risk).
- **Competitive pressure:** Likelihood 3, Impact 2 (Moderate risk).

The management communicated the company's risk appetite to all its employees, emphasising the importance of maintaining product recyclability and provided training on tackling potential market expansion challenges. The risk appetite statements and 5x5 risk matrix were documented and re-evaluated annually.

Risk assessment

Risk assessment includes analysing the identified risks to determine their likelihood and impact, typically by using a 5x5 risk matrix as detailed in the Methodology.[5] To conduct a comprehensive assessment, the following Risk Assessment Tool based on the Risk Intelligence Methodology can be used:

Risk description	Probability score: 1 (very unlikely) - 5 (very likely)	Impact score: 1 (negligible) - 5 (catastrophic)	Risk rating: 1 (very low) - 25 (extreme)	Monitoring indicator	Indicator mitigation alert threshold
Risk 1					
Risk 2					

5 For more information, please refer to the "Risk Intelligence Methodology for ESG Evaluation".

Bearing the organisation's risk appetite in mind, it is possible to define the optimal and tolerable levels of individual risks. Optimal risk refers to the ideal level of risk that an organisation aims to operate at, balancing potential opportunities and threats while achieving strategic objectives. Tolerable risk is the maximum level of risk that an organisation is willing to accept in pursuit of its goals without compromising its integrity or stakeholder expectations. The organisation can define monitoring indicators and alert thresholds for the chosen indicators in order to determine at what moment it needs to mitigate the risk. The organisation can then examine its current risks, defined as the level of risk that the organisation is currently exposed to, given its existing control measures and operational environment. By comparing the current risk levels to the predetermined optimal and tolerable risk levels, the organisation can evaluate the necessity for risk mitigation.

Example of risk assessment

Once again, the hypothetical company GreenTech Solutions is used here to show what a risk assessment based on the Risk Assessment Tool could look like:

Risk description	Probability score 1 (very unlikely) - 5 (very likely)	Impact score 1 (negligible) - 5 (catastrophic)	Risk rating (1-very low to 25-extreme)	Monitoring indicator	Alert threshold (if indicator surpasses tolerable risk level, initiate mitigation plan)
Supply chain disruption	4 (Likely)	4 (Major)	16 (High)	Delivery delays	Optimal: <1 week delay Tolerable: <2 weeks delay
Regulatory compliance	3 (Possible)	4 (Major)	12 (High)	Compliance status	Optimal: 100% compliance Tolerable: >95% compliance
Competitive pressure	3 (Possible)	3 (Moderate)	9 (Moderate)	Market share	Optimal: >20% market share Tolerable: >15% market share

Data Breach	2 (Unlikely)	5 (Catastrophic)	10 (High)	Security incidents	Optimal: 0 incidents Tolerable: <2 incidents per year
Employee Turnover	5 (Very Likely)	2 (Minor)	10 (Moderate)	Turnover rate	Optimal: <10% annual turnover Tolerable: <15% turnover

Risk monitoring

Effective risk monitoring involves selecting appropriate indicators that accurately reflect the risk's status and potential impact on the organisation. The chosen indicators should be specific, measurable and directly related to the risk being monitored. For instance, supply chain risks might be monitored through delivery delay metrics, while regulatory compliance risks could be tracked via compliance audit results. Additionally, the monitoring frequency should align with the risk's likelihood and impact; high-priority risks require more frequent monitoring to promptly detect and address issues, whereas lower-priority risks can be reviewed at longer intervals.

Risk mitigation plan

Developing a risk mitigation plan is necessary to be able to proactively manage and reduce the potential impact of identified risks. Key components of an effective mitigation plan include defining clear and actionable mitigation strategies, assigning responsibilities and resources, setting measurable targets and indicators and establishing a timeline for implementation.

Choosing the appropriate risk mitigation strategy depends on several factors and principles. The primary consideration is the nature and severity of the risk, as well as its potential impact on the organisation’s objectives. For high-impact risks, strategies like avoiding the risk or removing the risk source are often preferred to eliminating the threat altogether. In cases where the risk cannot be completely avoided, altering the probability or impact through preventive measures can be effective. Sharing the risk, through mechanisms such as contracts or insurance, is another viable option to spread the potential impact. Retaining the risk may be appropriate for less significant risks where the cost of mitigation exceeds the potential loss. Conversely, taking or increasing the risk might be justified for opportunities with high rewards, where the potential benefits outweigh the risks. The decision-making process should also consider the organisation’s risk appetite, available resources and overall strategic goals to ensure that the chosen strategy aligns with its long-term objectives and sustainability.

Actionable steps for risk identification, assessment and monitoring:

1. **Make a list of identified risks.** You can use those suggested in Annex 1 as a starting point or start from scratch.
2. For each identified risk **evaluate the likelihood and impact** on the company.
3. **Use a 5x5 risk matrix to prioritise each of the identified risks; document the risk evaluation and prioritisation.**
4. **Determine mitigation indicators and alert thresholds for each risk.**
5. **Outline all high-priority risks** for the development of a mitigation plan.
6. **Outline all medium-priority risks** for the development of a quarterly monitoring plan.
7. **Outline all low-priority risks** for the development of an annual or bi-annual monitoring plan.
8. **Compile quarterly, annual and yearly monitoring plans** with a defined monitoring team, schedule and responsibilities.
9. If necessary, provide **training and guidance to the monitoring team**.
10. **Regularly evaluate and adjust the monitoring plans** if needed.

Actionable steps for mitigation plan development:

1. **Consider each of the identified risks.** Based on its priority score, the organisation's determined risk appetite and available resources, decide on the most appropriate strategies to apply. The 4As framework, described in greater detail in the Methodology, can aid the choice of mitigation strategy.
2. Based on the selected mitigation strategy, **curate a list of available actions**.
3. **Consider the potential outcomes of each listed action.**

The following tool can be used for mapping strategies, actions and outcomes: **Strategy > Sub-strategy > Action > Outcome**

4. **Assess the effects of the listed outcomes**, focusing on possible costs and benefits. Detailed materials on cost-benefit analysis are provided in the Resources section. The total strategy outcome cost-benefit score can be used for the alleviated assessment of overall performance. The downside of this is that it may oversimplify the decision, which is why it is marked as optional.
5. Based on the mapping and evaluation of the actions and outcomes for each explored strategy, **decide on the best mitigation strategy and define the relevant mitigation goals for its execution**. Use the SMART system to achieve this.

   (*Side note: The SMART acronym stands for specific, measurable, achievable, relevant and time-bound.)*

   You can use the SMART Mitigation Goal Setting Tool below.
6. **Allocate the necessary resources and take steps in line with the company's preferred project management approach.**

Strategy	Sub-strategy	Action	SMART goal description	Resources needed	Knowledge and capabilities needed	Permissions needed (internal and external)	Help (if) needed – what type and from whom	Actionable steps breakdown

Smart Mitigation Goal Setting Tool

Example of the application of the tools

The application of the tools is applied to the example of GreenTech Solutions. Supply chain disruption could threaten the company's ability to deliver 100% recyclable products to its customers and lead to a worse performance in its ESG report. To mitigate this risk, GreenTech Solutions explored the possible strategies it could implement. Given that the risk scored high in the risk rating, the company decided to dive deeper into avoidance and reduction strategies. For example, it applied the following Avoidance Atrategy, Actions and Outcomes Mapping Tool for the in-depth exploration of both strategies:

Strategy	Sub-strategy	Action	Outcome
Avoidance	1.1 Switching suppliers	1.1.1 Identify and contract with new suppliers.	1.1.1.1 Reduced risk of supply chain disruptions.
			1.1.1.2 Improved supplier reliability.
		1.1.2 Transition existing supply chain to new suppliers.	1.1.2.1 Loss of established relationships with current suppliers.
			1.1.2.2 Potential contractual penalties.
	1.2 Increasing inventory	1.2.1 Increase stock levels.	1.2.1.1 Increased buffer stock to mitigate delays.
			1.2.1.2 Increased warehousing requirements.
		1.2.2 Expand warehouse capacity.	1.2.2.1 Increased warehousing costs.
			1.2.2.2 Improved inventory management.

Based on the assessment, GreenTech Solutions decided to opt for the avoidance strategy and used the SMART Mitigation Goal Setting Tool to outline the resources, knowledge, capabilities, permissions and help needed, as well as the breakdown of actionable steps:

Sub-strategy	Action	SMART goal description	Resources	Knowledge and capabilities	Permissions	Help	Actionable steps breakdown
1.1	1.1.1	By the end of Q2, identify and contract at least three new suppliers who can provide the necessary materials with a reliability rate of 95% or higher.	Procurement budget, supplier databases	Supplier evaluation expertise, negotiation skills	Internal: Approval from procurement manager	External: Market research firm for supplier identification	1. Research and shortlist potential suppliers 2. Conduct supplier evaluation 3. Negotiate and finalise contracts 4. Obtain necessary approvals from management
	1.1.2	By the end of Q3, successfully transition 50% of the supply chain to new suppliers with minimal disruption.	Transition budget, logistics support	Supply chain management, logistics planning	Internal: Approval from logistics and operations managers	External: Consultancy for supply chain transition planning	1. Develop a detailed transition plan 2. Communicate changes to existing suppliers 3. Coordinate logistics for integrating new suppliers 4. Monitor the transition and address any issues

After outlining the actionable steps, the management team of GreenTech Solutions documented the entire mitigation plan with responsible team members, timelines and resources. They also modified their budget and schedules to make room for the mitigation plan. Training and guidance were provided to the respective team members and a monitoring plan was set in place.

6. Conclusion

A structured approach to ESG risk management transforms risk management from an abstract concept to a practical, actionable plan. Pairing the Risk Intelligence Methodology and Strategic Action Plan provides SMEs with the tools to proactively address potential complications, thereby enhancing their preparedness, adaptability and resilience. By integrating a comprehensive risk management methodology and action plan, companies can effectively safeguard their transition to a circular economy and regular ESG reporting practices.

This structured approach begins with a clear understanding of an organisation's risk appetite, followed by the identification, evaluation and prioritisation of risks. Mitigation strategies are then developed using structured evaluation and action-planning approaches to ensure they are appropriate, actionable and achievable, as well as agreed upon by relevant stakeholders. Continuous monitoring with defined indicators and regular reviews ensures that the organisation remains vigilant and responsive to new risks and changing circumstances.

Through these steps, SMEs can align their operations with sustainability goals, meet regulatory and stakeholder expectations and mitigate high-priority risks. In this way, companies can adopt a practical approach to protecting their business operations while positioning themselves favourably in the circular market.

Annex 1: List of potential ESG-related risks

Type of risk	Risk sub-category	Risk
Political		Failure to achieve sustainability goals in unstable political environments
		Missed opportunities for innovation due to political instability
Regulatory	Risk of choosing inappropriate reporting standard	Ineffective strategies that fail to meet regulatory requirements
		Resource misallocation resulting in regulatory penalties
		Failure to address key issues mandated by regulations
	Risk of inappropriate disclosure	Inaccurate reporting leading to regulatory penalties
		Incomplete data failing to meet regulatory standards
		Non-compliance with reporting standards
	Risk relating to data collection and management	Data accuracy and integrity issues affecting regulatory compliance
		Data security breaches leading to regulatory action
		Insufficient data collection systems failing regulatory audits
		Non-compliance with laws and regulations
		Legal liabilities and penalties
		Increased regulatory scrutiny
	Other regulatory risks	Non-compliance with laws and regulations
		Legal liabilities and penalties
		Increased regulatory scrutiny
Market	Strategic risks	Misalignment with business strategy due to market changes
		Failure to achieve sustainability goals in a competitive market
		Missed opportunities for innovation due to market dynamics

	Financial risks	Increased costs of compliance affecting market competitiveness
		Potential fines and penalties impacting financial stability
		Loss of investment or funding opportunities due to market changes
	Market change risks	Competitive disadvantage due to market shifts
		Loss of market share to more sustainable competitors
		Changes in market demand for sustainable products affecting business operations
Reputational	General reputational risks	Damage to brand reputation due to poor ESG performance
		Loss of stakeholder trust due to inadequate ESG practices
		Negative media coverage impacting public perception
	Operational risks	Employee resistance or lack of engagement reflecting poorly on the company
		Increased operational costs perceived negatively by stakeholders
		Disruption to business processes harming reputation
	Environmental risks	Environmental damage due to inadequate policies or operations, leading to reputational damage
		Increased carbon footprint tarnishing the company's image
		Resource depletion causing negative public perception
	Social risks	Poor labour practices leading to reputational harm
		Community opposition impacting the company's standing
		Human rights violations damaging the company's reputation

	Governance Risks	Weak governance structures leading to reputational issues
		Lack of transparency harming the company's image
		Corruption and unethical practices affecting the company's standing

Other useful tools and resources

What is Risk Management?

Business Insights Blog. 'What Is Risk Management & Why Is It Important? | HBS Online', 24 October 2023. https://online.hbs.edu/blog/post/risk-management.

Simplified 3-step sustainability risk assessment for SMEs

'3-Step Sustainability Assessment for SMEs'. Accountancy Europe, May 2021. https://accountancyeurope.eu/wp-content/uploads/2022/12/3-STEP-sustainability-assessment-for-SMEs.pdf.

ENISA's risk management toolbox

ENISA. 'Interoperable EU Risk Management Toolbox'. Report/Study. Accessed 25 July 2024. https://www.enisa.europa.eu/publications/interoperable-eu-risk-management-toolbox.

Cost-benefit analysis

'Cost-Benefit Analysis: What It Is & How to Do It'. Accessed 25 July 2024. https://online.hbs.edu/blog/post/cost-benefit-analysis.

Detailed cost-benefit analysis with templates and examples

'Cost Benefit Analysis: An Expert Guide | Smartsheet'. Accessed 25 July 2024. https://www.smartsheet.com/expert-guide-cost-benefit-analysis.

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'ESRS for Listed Small - and Medium - Sized Enterprises (ESRS LSME)'. EFRAG, January 2024. https://www.efrag.org/sites/default/files/sites/webpublishing/SiteAssets/ESRS%20LSME%20ED.pdf.

European Commission. 'SME Definition - User Guide 2020', 7 September 2020. https://ec.europa.eu/docsroom/documents/42921.

European Commission. 'SME Self-Assessment Questionnaire'. Accessed 25 July 2024. https://ec.europa.eu/growth/tools-databases/SME-Wizard/smeq.do;SME_SESSION_ID=f_HqBkbK_zlaSFnTw9GYjcpXiSsAhIxjLNLnbXBwVqIh92CO7nao!-1697150755?execution=e1s1.

'Risk Appetite Guidance Note'. GOV.UK Government Finance Function, August 2021. https://assets.publishing.service.gov.uk/media/61239758e90e0705481fc085/20210805_-_Risk_Appetite_Guidance_Note_v2.0.pdf.

PRINCEPS Risk Intelligence Institute

PRINCEPS Risk Intelligence Institute is a Czech non-profit organisation dedicated to developing the risk intelligence industry standards in Central and Eastern Europe. PRII aspires to create a regional centre of excellence in risk intelligence that connects experts, executives, and young professionals. It likewise aims to establish a shared network, educational opportunities, and modern tools to navigate any current risk intelligence challenges.

www.princepsinstitute.com

Prios Kompetanse AS

Prios Kompetanse AS is a Norwegian nationally recognised centre for adult education and lifelong learning. Consulting activities mainly support Prios' clients with internal innovation processes, economic advice, ESG management, green innovations, circular economic development, and management improvements. As a research centre, Prios aims to implement the idea of lifelong learning and constantly updating training contents and methods in response to the ongoing digitalisation and developments of the business sector.

www.prios.no

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