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**Barriers to ESG Adoption in Malaysian SMEs:
A stakeholder theory perspective**

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Abstract

Environmental, Social, and Governance (ESG) practices are vital for responsible business conduct, yet adoption among Malaysian manufacturing SMEs remains limited. Using Stakeholder Theory, this concept paper examines internal barriers such as resource constraints, limited ESG expertise, and low awareness, including external barriers like complex regulations and weak stakeholder support. These challenges hinder SMEs from meeting stakeholder expectations and aligning with sustainability goals. This paper offers a structured understanding of why ESG is underutilized in SMEs, highlighting implications for policy, stakeholder engagement, and SME resilience, and suggesting future research on how stakeholder demands interact with these barriers.

Keywords: Environmental, Social, and Governance (ESG); Small and Medium-sized Enterprises (SMEs); Stakeholder Theory; Sustainability barriers

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1.0 Introduction

Imagine small and medium-sized enterprises (SMEs) leading a quiet revolution towards ethical and sustainable business. SMEs, which account for more than 90% of all firms globally, are the foundation of the global economy (Algan, 2019). Once seen primarily as drivers of economic growth, these enterprises are now emerging as powerful agents of social responsibility and environmental stewardship. In an era marked by shifting consumer expectations, climate challenges, and tightening regulations, their role in shaping a sustainable future is critical. SMEs can improve competitiveness and sustain commercial success by integrating environmental, social, and governance (ESG) principles into their core strategies.

In Malaysia, SMEs accounted for 98.5% of business establishments, contributing about 36% of the GDP, 65% of employment, and 18% of exports (Yin, 2023). The adoption of ESG has become increasingly crucial for businesses as global sustainability gains importance. Despite their economic importance, Malaysian SMEs face several obstacles that hinder their effective implementation of ESG. Financial constraints remain a major obstacle, as they make it difficult to prioritise investments in sustainability (Hassan et al., 2023). This is made worse by a lack of technical and ESG competence and lack of understanding of sustainability concepts, leading to fragmented, compliance-driven practices rather than strategic integration (Gamage et al., 2020). From the outside, SMEs face a complex

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ESG regulatory environment characterised by ambiguous regulations and limited standardised guidance for smaller businesses. ESG implementation is further hampered by inadequate stakeholder support, which includes limited access to incentives, training programs, and coordinated institutional support (Alhoussari, 2025). Taken together, these barriers indicate that ESG adoption among Malaysian SMEs is shaped by the interaction between internal capability constraints and locally embedded institutional and stakeholder limitations.

Against this backdrop, the study is guided by three research questions:

- **RQ1:** What internal barriers hinder ESG adoption in Malaysian SMEs?
- **RQ2:** What external barriers hinder ESG adoption?
- **RQ3:** How can Stakeholder Theory explain these barriers?

The study contributes by (i) identifying internal barriers, (ii) identifying external barriers, and (iii) interpreting these barriers within a stakeholder framework. Theoretically, it enriches the literature on ESG adoption in SMEs, particularly in the context of emerging economies. In practice, it offers guidance to SME managers, policymakers, and industry groups on strengthening ESG integration. From a policy perspective, the study supports Malaysia's national development priorities and advances progress toward the United Nations Sustainable Development Goals (SDGs).

2.0 Literature review

2.1 SMEs and Economic Contribution in Malaysia

SMEs are the foundation of Malaysia's economy, accounting for the largest share of the country's GDP and offering the greatest number of job opportunities across a variety of industries (Yin, 2023). They play a critical role in maintaining economic growth, fostering innovation, assisting supply chains, and guaranteeing workforce inclusion. Adopting ESG is becoming more important for SMEs in today's quickly evolving business climate. The integration of ESG could enhance business resilience by improving stakeholder trust, aligning with global sustainability standards, and meeting regulatory expectations. SMEs that embrace ESG are better positioned to attract investment, remain competitive, and adapt to future economic and environmental challenges, which is crucial for long-term growth.

Although previous research highlights the economic significance of Malaysian SMEs, most studies view ESG adoption as an expected outcome of business growth rather than a process constrained by institutional and firm-level factors (Singh & Tarkar, 2024). This implies that SMEs are capable of internalising environmentally friendly practices. By focusing on the obstacles that economically significant SMEs face in translating their operations into meaningful ESG engagement, the current study challenges this assumption.

2.2 ESG Adoption: Global vs Malaysian Context

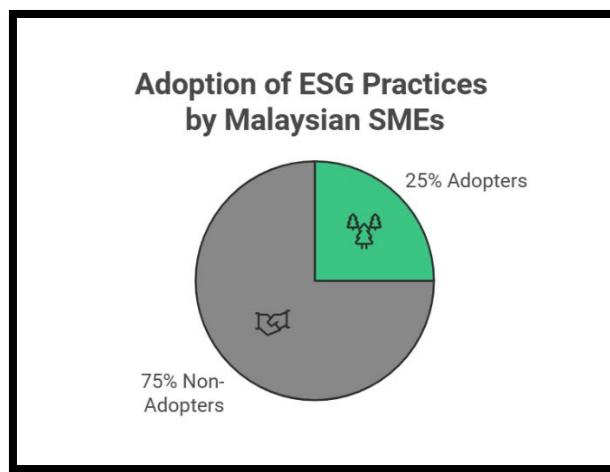


Fig. 1: Adoption of ESG Practices by Malaysian SMEs
(Source: Author's own illustration)

Many SMEs in India, Singapore, and Canada have embraced ESG (Gupta, 2023). Alliance Bank Berhad, in its survey, found that only one in four (25%) of Malaysian SMEs have embarked on ESG, indicating a need for greater strategy to catch up with other Commonwealth countries (Ignatius, 2023).

In Malaysia, the adoption of ESG practices is becoming crucial among SMEs, given their significant role in the national economy and global supply chains. However, ESG adoption among Malaysian SMEs remains relatively low, as illustrated in Figure 1 (Alliance Bank Malaysia, 2023). Although ESG compliance is voluntary, global clients are increasingly emphasising sustainability, which risks excluding SMEs from supply chains (UNGC, 2023). In response, the Malaysian government has incorporated ESG considerations into

economic policies and foreign investment strategies, underscoring its importance for competitiveness (Husain, Razali, Jazimin & Hamid, 2025). This context highlights the urgency for SMEs to embed ESG principles into their culture and operations.

Previous studies from both developed and developing nations have frequently identified market pressure and regulations as the main drivers of SMEs' adoption of ESG practices (Hakim & Fuad, 2024). These results, however, might not apply directly to Malaysia, where ESG compliance remains largely voluntary. By analysing ESG adoption in a setting where global sustainability expectations are in place, this study adds to the literature and reveals a unique set of internal and external barriers to ESG adoption.

2.3 Stakeholder Theory Overview

A stakeholder is any individual or group that can influence or be influenced by an organisation to fulfil its objectives (Leal Filho et al., 2025). Although Stakeholder Theory has been frequently used to explain the sustainability concept, most research has either assumed balanced stakeholder influence or focused primarily on large firms (Richter & Dow, 2017). Stakeholder power imbalances and inadequate engagement capacity remain understudied in the context of SMEs, especially in emerging economies (Lyra & Lehtimäki, 2023). Accordingly, Stakeholder Theory provides a useful lens for explaining ESG adoption among SMEs not as a firm-level choice alone, but as an outcome shaped by uneven stakeholder power, limited engagement capacity, and resource asymmetries.

As ESG adoption involves managing numerous stakeholders' expectations rather than focusing solely on firm-level outcomes, Stakeholder Theory is applicable to this study. Stakeholder Theory considers relational boundaries, conflicting demands, and uneven stakeholder power, all of which pose important challenges for Malaysian SMEs. In an environment where ESG compliance is optional, SMEs must address demands from key stakeholders. According to this idea, stakeholder interactions, power imbalances, and contextual limitations all influence ESG adoption.

2.4 Internal Barriers to ESG Adoption

From a stakeholder perspective, internal barriers such as financial constraints, limited ESG expertise, and low sustainability awareness weaken SMEs' capacity to respond efficiently and effectively to stakeholder expectations.

2.4.1 Financial constraints

Financial constraints are one of the main challenges for SMEs. Many lack the resources to implement ESG principles due to low capital, poor management, and the effects of the pandemic (Hassan et al., 2023). SMEs' ability to invest in ESG activities can be negatively affected by the need to maintain financial viability, competition, and limited budgets. Moreover, many SMEs view ESG costs as costs rather than opportunities, and thus focus on the short term when evaluating investments (Akilah, 2024).

2.4.2 Lack of expertise and knowledge in ESG

Another issue that SMEs confront is a lack of ESG competence and understanding (Hassan et al., 2023). Gamage et al. (2020) argue that because SMEs lack sufficient sustainability departments or access to external sustainability consultants, they may not have the expertise needed to properly integrate ESG principles. Smaller businesses with fewer committed sustainability specialists may find it difficult to handle the complexity of ESG reporting, compliance, and monitoring (Akilah, 2024). SMEs may find it difficult to successfully execute ESG activities without professional assistance.

2.4.3 Low awareness of ESG

SMEs' awareness of ESG sustainability is a major factor too, according to Prasanna et al. (2019). To promote adoption, SMEs need to understand ESG issues. Nonetheless, Malaysian SMEs continued to emphasise financial outcomes over ESG and were still ignorant of ESG practices (Hassan et al., 2023). According to Fung et al. (2021), Malaysian SMEs are still unaware of sustainable practices, especially energy efficiency and waste reduction.

2.5 External Barriers to ESG Adoption

From a stakeholder perspective, ESG adoption is constrained by external barriers such as regulatory complexity and insufficient stakeholder support.

2.5.1 The complexity of the ESG regulatory framework

Regulations are another barrier to SMEs (Hassan et al., 2023). As different regions and sectors have distinct ESG standards, exporting to multiple countries poses additional challenges. Compared to publicly traded companies, SMEs are subject to fewer regulations, which makes it challenging for them to achieve strict ESG standards. Due to a lack of resources, SMEs may find it difficult to effectively analyse and report ESG performance (Akilah, 2024; Alhadhrami & Nobanee, 2019).

2.5.2 Lack of stakeholder support

Another major obstacle is the absence of stakeholder support (Hassan et al., 2023). Resistance may arise from customers or employees who refuse to change their habits, which can discourage SMEs from investing in such initiatives. Engaging with stakeholders and local communities is crucial as a cornerstone of ESG adoption. SMEs need to build strong relationships with the surrounding community to understand their needs and concerns and redirect them to the organization's sustainability initiatives.

Although internal and external ESG barriers are frequently examined independently, little is known about how they interact within the stakeholder ecosystem. Taken together, the reviewed literature further suggests that ESG adoption among Malaysian SMEs is best

understood as the result of interacting internal and external barriers operating within a stakeholder-driven ecosystem. Based on Stakeholder Theory, this study considers these obstacles as interrelated factors influencing the adoption of ESG in Malaysian SMEs.

3.0 Literature findings and justification

According to prior studies, SMEs encounter a variety of internal and external barriers when implementing ESG practices, such as financial constraints, a lack of technical know-how, low awareness of sustainability, complex regulations, and a lack of support from stakeholders (Hassan et al., 2023; Akilah, 2024; Fung et al., 2021). These results emphasise the necessity of a stakeholder-focused viewpoint since ESG adoption is shaped by the interplay between business capabilities and stakeholder pressures. The current study justifies the conceptual approach and research aim by placing Malaysian SMEs inside this framework through the synthesis of these discoveries.

4.0 Conceptual framework

4.1 Stakeholder Theory and Its Application to the Study

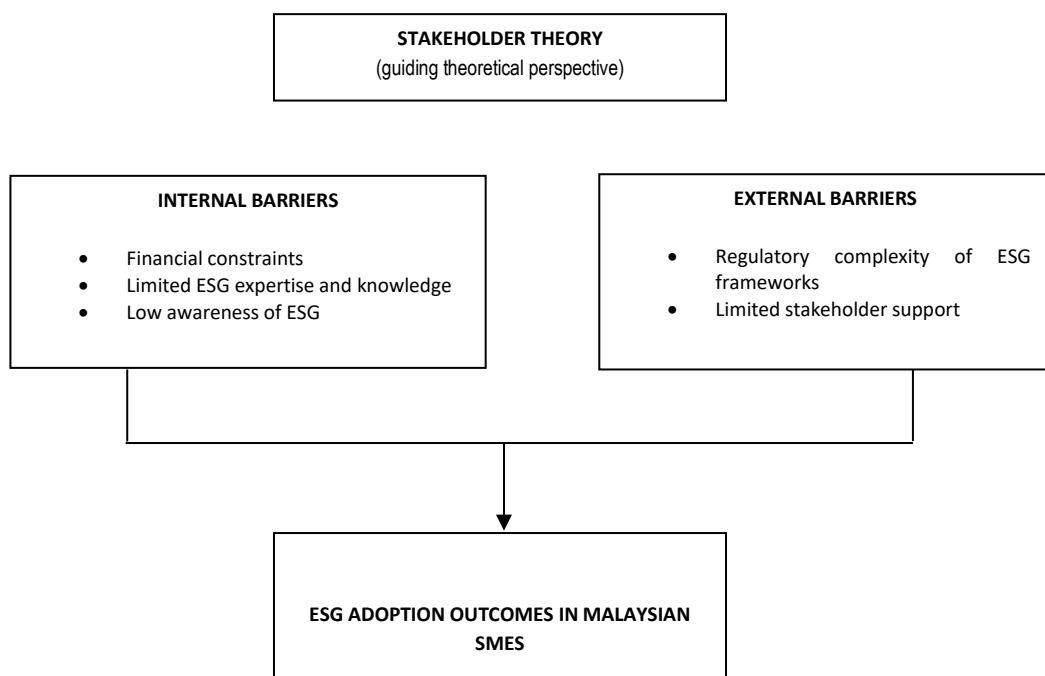


Fig. 2: Conceptual framework illustrating internal and external barriers to ESG adoption among Malaysian SMEs, grounded in Stakeholder Theory
(Source: Author's own illustration)

In this study, Stakeholder Theory provides the foundation for understanding the barriers SMEs face in adopting ESG practices (Mahajan, Lim, Sareen, Kumar, & Panwar, 2023). The theory emphasizes that organizations must respond to the expectations of diverse stakeholders, including demands for environmental responsibility, social commitment, and governance transparency. These differing and sometimes conflicting expectations help explain why SMEs encounter both internal and external barriers to ESG adoption. Internally, SMEs often struggle with financial constraints, limited knowledge and expertise in ESG, and low awareness of ESG, which weakens their ability to meet stakeholder demands. Externally, challenges such as the complexity of ESG frameworks and limited stakeholder support further hinder adoption. Accordingly, the proposed conceptual framework illustrates how stakeholder pressures translate into both internal and external barriers that shape ESG adoption among SMEs through the lens of Stakeholder Theory.

5.0 Methodological positioning and scope

This study uses a conceptual research design based on theory synthesis combined with literature analysis. As a result, it creates a cohesive conceptual framework that explains both internal and external ESG barriers among Malaysian SMEs; the research methodically synthesises previous theoretical and empirical research on ESG adoption and stakeholder theory. Future research may use survey-

based approaches, moderation, or structural equation modelling techniques to empirically validate the suggested framework. The goal is to develop a theory while laying the groundwork for further empirical investigation.

5.1 Rationale for Research Context

Since Malaysian SMEs represent the backbone of the country's economy and make substantial contributions to GDP, employment, and innovation, they were chosen as the study's focus. Despite their economic significance, many businesses have certain internal limitations that affect the adoption of sustainable practices, such as a lack of funding, technical know-how, and ESG awareness. Because of its mostly voluntary ESG regulations, scattered institutional funding, and stakeholder demands that depart from international norms, Malaysia offers a significant context. Studying SMEs in this setting enables the examination of the interactions between internal and external barriers, offering insights not possible in settings with stricter regulatory enforcement.

6.0 Limitations of the study

The limitations of this conceptual paper need to be acknowledged, although it provides a clear examination of ESG implementation for Malaysian SMEs. Firstly, the findings are based on secondary literature and concepts rather than collecting first-hand information, therefore limiting the application of the proposed framework. Secondly, while the focus is on Malaysian SMEs to gain insight into a developing economic context, the outcomes cannot necessarily be generalised to SMEs in other countries that have different regulations and institutions. Finally, new developments and trends may not be captured by the current research due to the rapid evolution of ESG standards.

7.0 Discussion

7.1 Strategies to Address Barriers

7.1.1 Access to funding and investment

Governments have a fundamental duty to improve SMEs' access to funding and investment opportunities for ESG projects (Salin, Shamsudin, Omar & Abdul Raman, 2023). SMEs could be linked with influential investors who are dedicated to promoting ethical businesses, starting venture capital programs, or setting up specialised sustainability funds. Governments may offer a pitching platform where SMEs could display their eco-friendly technologies and ESG integration plans. These companies might then receive funding from interested private investors.

7.1.2 Knowledge transfer and upskilling

By providing training courses, workshops, and educational materials, governments can increase SMEs' knowledge and comprehension of ESG (Salin, Shamsudin, Omar, & Abdul Raman, 2023). Initiatives for continuous learning targeted at SME owners can also be implemented by providing funding to encourage employers to invest in ESG-related training for their staff. Additionally, ESG-related courses must be taught at every level, from elementary schools to universities. In order to help students better understand the significance of a greener world for both current and future generations, these programs should also place an emphasis on practicality rather than being overly theoretical.

7.1.3 Simplified regulations and compliance

Governments can assist by standardising ESG regulations and simplifying them for SMEs. Clear regulations, checklists, and digital tools would assist businesses in better managing the regulatory environment and achieving compliance (Salin, Shamsudin, Omar, & Abdul Raman, 2023). For example, a dedicated reference unit to assist SMEs in meeting ESG-related standards may be established. Even if it offers more precise instructions, resources, and financial support systems, SMEs' continued involvement and successful implementation will be crucial to its long-term success in overcoming adoption obstacles.

7.1.4 Collaborations and partnerships

Governments can promote cooperation between SMEs and bigger companies. The creation of networks will facilitate the sharing of ideas and offer helpful advice (Salin, Shamsudin, Omar, & Abdul Raman, 2023). Through such partnerships, the government could instruct GLCs to link SMEs with their ESG partners to support capacity building, organize knowledge-building workshops, and provide participatory site visits to strengthen SMEs' understanding of sustainable business practices. Together, these strategies show how SMEs can better respond to a range of stakeholder expectations by overcoming both internal and external barriers. Malaysia may become more competitive in global supply chains and align SMEs with global sustainability norms. From a conceptual standpoint, this supports the applicability of Stakeholder Theory in comprehending SMEs' adoption of ESG practices as a result of resource asymmetries, unequal stakeholder power, and restricted engagement capacity.

8.0 Implications

8.1 Theoretical Implications

This paper contributes to the literature on sustainability in SMEs by reaffirming the relevance of Stakeholder Theory in understanding the challenges of ESG adoption. Adopting a stakeholder-centric perspective shows that ESG barriers are not only internal organizational issues but also reflect the needs and demands of multiple stakeholder groups. Categorizing these barriers into internal and external dimensions provides a useful lens to distinguish between challenges arising from within the organization (Mahajan, Lim, Sareen, Kumar, & Panwar, 2023). This distinction offers a structured framework for analysing how stakeholder relationships influence organizational responses to sustainability pressures. Moreover, the paper emphasizes that although SMEs are resource-constrained, they remain vital actors in advancing the sustainability transition.

8.2 Practical Implications

From a practical perspective, this paper offers key insights for SME owners and policymakers. For SME owners, strengthening internal capacity is essential to overcoming barriers. This includes investing in employee training, fostering a culture that values sustainability, and engaging with key stakeholders. For policymakers, the identification of external barriers calls for targeted interventions. These include providing financial incentives to ease adoption costs, simplifying regulatory frameworks, and designing support programs tailored to SME needs. Such measures would help SMEs integrate ESG more effectively while ensuring alignment with national sustainability goals. Overall, ESG adoption requires collaboration between SMEs and policymakers. Combining supportive policies with proactive business strategies can create an enabling environment that drives sustainable practices and strengthens SMEs' role in advancing broader sustainability objectives (MITI, 2025).

9.0 Conclusion

In conclusion, this paper examined the key barriers to ESG adoption among SMEs using Stakeholder Theory as a guiding lens. It shows that both internal and external barriers are strongly connected to key stakeholders. Understanding these connections is crucial, as stakeholders can either support or hinder the integration of ESG practices. Addressing these barriers is not only important for improving SME performance but also for advancing Malaysia's sustainability agenda and meeting the United Nations Sustainable Development Goals (SDGs). National progress relies heavily on the ability of SMEs to adopt responsible practices, including sustainable production, climate action, and inclusive growth. This paper also highlights the need for further research to refine these insights, particularly in exploring the relative impact of barriers and testing targeted interventions. Such efforts will help develop effective, evidence-based strategies to support sustainable SME development.

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Paper contribution related to the field of study

This paper contributes to the field of sustainability and SME by providing a conceptual insight into the barriers to ESG adoption through the lens of Stakeholder Theory. This paper extends the application of Stakeholder Theory by outlining several internal and external barriers to relevant stakeholder groups, which provide a more nuanced framework for analysing ESG challenges in SMEs. From a practical standpoint, it offers actionable insights for specific key groups such as SMEs, policymakers, and industry associations in designing targeted strategies to tackle such stakeholder-specific barriers. In the policy domain, this paper aligns with Malaysia's national development agenda and supports progress towards the United Nations Sustainable Development Goals (SDGs).

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