Sustainability Regulations and the Impact on the Business Landscape & Conformity Assessment Bodies

EUROLAB Position Paper

The term ESG (Environmental, Social, and Governance) is used to define "the factors that make a company sustainable through its environmental, social, and governance commitments, without ever neglecting financial aspects." Corporate sustainability has increasingly been regulated under frameworks such as ESG, promoted by the UN through the Sustainable Development Goals (SDGs). ESG was conceived as a standard to measure corporate responsibility in three key areas: environmental, social, and governance. The ESG framework has been formalised in regulations such as the *Corporate Sustainability Reporting Directive* (CSRD) in Europe. Although it was adopted with the intention of improving sustainable practices in companies and increasing transparency by disclosing their actions to avoid greenwashing, this standard has become a bureaucratic tool emulating the principles of centralized planning, while creating more questions, unclarities and the need for additional resources for companies in order to meet all the legislative reporting requirements. Rather than fostering substantive changes, this approach promotes formal compliance and discourages innovation, continuous improvement, as well as the dynamics of a free market. As a result, many companies divert resources towards regulatory and bureaucratic compliance instead of investing in genuine sustainable solutions.

The problem is not that Europe lacks ideas or ambition. We have many talented researchers and entrepreneurs filing patents. But innovation is blocked at the next stage: we are failing to translate innovation into commercialisation, and innovative companies that want to scale up in Europe are hindered at every stage by inconsistent and restrictive regulations.[1]
As a result, many European entrepreneurs prefer to seek financing from Non-EU venture capitalists and scale up in the US market. Between 2008 and 2021, close to 30% of the "unicorns" founded in Europe – startups that went on the be valued over USD 1 billion – relocated their headquarters abroad, with the vast majority moving to the US.[2]

These policies also negatively affect Conformity Assessment Bodies (CABs). As companies allocate more resources to meet regulatory requirements, without a guaranteed proportional increase in the consumption of their products or services, many struggle to maintain production levels. Ultimately, this can lead to the closure of numerous businesses, directly impacting CABs by reducing their client base. At first glance, it may seem that these new regulations would benefit the CABs market, as they increase revenue from conformity assessments of products and services against regulations or standards. However, when

[1] Draghi's Report: A force for reform - https://geopolitique.eu/en/2024/09/09/the-draghi-report-a-force-for-reform/
[2] The future of European Competitiveness, Part A / A Competitiveness Strategy for Europe, https://commission.europa.eu/

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regulatory pressure becomes excessive, the market suffers (SMEs close, and large companies relocate to more favourable territories), and this also impacts the CABs market by reducing the number of clients.

Given the up-mentioned current concerns, EUROLAB calls for deregulation and simplification of the ESG bureaucratic approach, instead of setting more regulatory constraints that on long term will impact the profit and financial sustainability of CABs that on a longer term will prefer to move their activities outside Europe. More regulation means the need for more resources for CABs to comply with all the requirements. These additional efforts related costs will be reflected in the higher increase of the price of the service/ product offered to the clients, leading to potential loss of the clients and the move of the industry outside of Europe. Also keeping in mind, that ESG covers a very important pillar including the economic sustainability of a company based on market competitiveness.

It is of high importance to build smart, operational and sustainable ESG strategies within the companies and to apply specific expertise to enhance different sustainable best practices. However, instead of diverting the resources towards the development of such strategies and innovation, companies are forced to devote their resources to bureaucratic compliance with little practical utility. This problem is particularly challenging in small and medium-sized enterprises (SMEs), which lack the capacity that large corporations have to efficiently meet regulatory requirements. A market that was originally dynamic, consisting of businesses of all sizes, becomes stifled when SMEs - the most vulnerable sector, are driven out by "the law of unintended consequences"-, leaves the market to lose certain economies of scale that are critical for highly specialised business ecosystems. This affects both the business landscapes and Conformity Assessment Bodies (CABs), as the reduction in the number of businesses directly impacts the volume of work for CABs.

Sustainability cannot be imposed through centralised regulations. Instead, it arises from the spontaneous interaction between private incentives, competition in open markets, and the responsible management of resources, grounded in the respect for property rights. This approach enables companies to effectively adapt to market demands and the specific realities of their sectors while fostering innovative solutions that promote long-term sustainability.

Regulatory frameworks such as ESG and CSRD (Corporate Sustainability Reporting Directive) impose disproportionate burdens on businesses, particularly small and medium-sized enterprises (SMEs), which lack the same resources as large corporations to adapt to increasing regulatory pressures and demands. This not only creates inequalities in the market but also leads to business closures, reduces competition, and limits the ability of Conformity Assessment Bodies (CABs) to operate efficiently.

Increasing the sustainability of products and services is vital for the future of the European society. Based on the above-mentioned aspects, it is important to note that a high degree of proportionality, when it comes to legislative demands and the impact they might have on the business, it is very important, while, of course, building up and investing resources on a strong culture of sustainability, rather than bureaucratic constraints.