Sustainability Guidance for Enterprises: How to stay ahead of the game

Authors:

- ***Alisa Gessler, Scientific Collaborator, E4S – HEC UNIL***
- ***Michel Jaccard, Founder and Partner, id est avocats***
- ***Manon Schlaepfer, Assistant of Prof. Jean-Luc Chenaux, UNIL***

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There is growing pressure on start-ups and SMEs to integrate ESG considerations into their governance and business activities. As of today, binding Swiss regulations on corporate sustainability disclosure and due diligence only target Swiss *large* companies. However, there are benefits to implementing best practices, independently of company size. In an extremely complex and quickly evolving field, this guidance aims to provide a break-down for SMEs to better understand why keeping up with sustainability developments may be necessary for business opportunities in a shifting economy, and how to implement best practices relating to sustainability.

As of today, non-financial reporting is often the first step towards sustainable governance, as it occupies a predominant place among the contractual tools or legal measures aimed at improving the sustainability of a business. Therefore, we first explain the scope of novel Swiss, European and international reporting requirements and their impact on SMEs. We further highlight that the two main sets of sustainability reporting standards are both built around the recommendations of the global Taskforces on Climate- and Nature-related Financial Disclosures (TCFD and TNFD). We suggest that SMEs familiarize themselves with those recommendations, thus prioritizing corporate sustainability information on Governance, Strategy, Risk Management and Metrics & Targets.

Moving from data gathering to action and impact, we highlight some of the tools and service providers that can help SMEs implement sustainability more generally in their management. In particular, we recommend some best-practice clauses, i.e. sustainability- oriented clauses that SMEs can include in their corporate documents to plant the seed for long- term corporate governance practices aligned with their strategy and commitments.

TRICKLE DOWN EFFECT OF SUSTAINABILITY REPORTING STANDARDS: WHY SHOULD SWISS SMEs CARE?

It is reasonable to expect that international regulatory frameworks will evolve and, over time, lead to binding reporting norms for start-ups and SMEs. Non-EU countries such as the UK or Brazil have announced the regulatory incorporation of IFRS' sustainability standards. In parallel, the European Sustainable Reporting Standards (ESRS) were finally adopted in October 2023.[1] While these standards usually apply to large companies, their extension to smaller firms is discussed. In the EU, listed SMEs will be required to report sustainability-related information from financial year 2026 (with the possibility of an additional two-year opt-out). Swiss start-ups and SMEs will be particularly impacted by these European requirements, because of the close economic ties with European countries.[2]

Meanwhile, the Swiss Federal Council has clarified its intentions to align national regulation with international developments. This includes the future expansion of the scope for compulsory sustainability reports to companies with more than 250 employees, and accepting EU reports and other OECD aligned reports as equivalent.[3] A trickle down effect of reporting requirements is underway, since these reporting obligations also require information on value chains. Against this backdrop, the Federal Council has been asked to draw up a report highlighting the possible direct and indirect effects of the new European and international ESG directives on Swiss SMEs.[4] SMEs can uphold their competitive advantage by staying ahead of the game.

Attracting investors and contractors

Investors and contractors are increasingly interested in companies that integrate ESG considerations into corporate governance. Swiss financial institutions and large corporations with branches or activities in Europe will increasingly request sustainability data from their supply chain partners, to fulfill their own due diligence obligations according to EU law. Some investors or large corporations already subject their investment or their contractual relationship to the fulfillment of a sustainability questionnaire, sustainability objectives, or other sustainability requirements. Not only can a company's ESG integration be critical to the investment decision, but even filling out a sustainability questionnaire may require the collection of ESG data or the implementation of ESG processes. Some business partners contractually require ESG guarantees, e.g. in form of a Code of Conduct, from their investees and suppliers to comply with their own ESG-related obligations.

1 https://efrag.org/news/public-453/EFRAG-welcomes-the-final-adoption-of-the-ESRS-by-the-European-Institutions
2 https://www.bazg.admin.ch/bazg/de/home/themen/schweizerische-aussenhandelsstatistik/daten/handelspartner.html
3 https://www.admin.ch/gov/de/start/dokumentation/medienmitteilungen.msg-id-97782.html
4 Postulat 23.4062, available at: https://www.parlament.ch/fr/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20234062

Meeting shareholders' and stakeholders' expectations and promoting the development of a positive corporate reputation

Incorporating sustainable practices into an organization represents a proactive approach for businesses grappling with evolving legislation, shifts in natural resource availability, heightened customer expectations for sustainability, a growing demand for socially responsible employers, and a rising emphasis on ESG or sustainability criteria in investment decisions. The integration of sustainability into business practices serves as a strategic move, effectively future-proofing a business. This makes it a prudent choice for owners and managers committed to ensuring the longevity of their enterprise in the face of a dynamic and ever-changing global landscape.

To enhance sustainability, businesses should commence by comprehensively assessing their operational sustainability – a measure of how effectively they address environmental, social, and governance issues. Establishing a baseline is pivotal, as it forms the foundation for implementing targeted improvements over time. Various tools, including the Levo Framework, offer valuable resources for businesses seeking to undertake this transformative journey.

Shareholders and stakeholders more generally might expect and require that a firm adopts good governance practices relating to transparency, social engagement, ethical conduct, and so on. By integrating ESG considerations into corporate governance, a company shows its shareholders and stakeholders that sustainability matters and commits to take these considerations seriously. Incorporating ESG considerations into the corporate governance further helps to reduce companies' risks and promotes the development of a positive corporate reputation. It contributes to building trust with shareholders and stakeholders more generally.

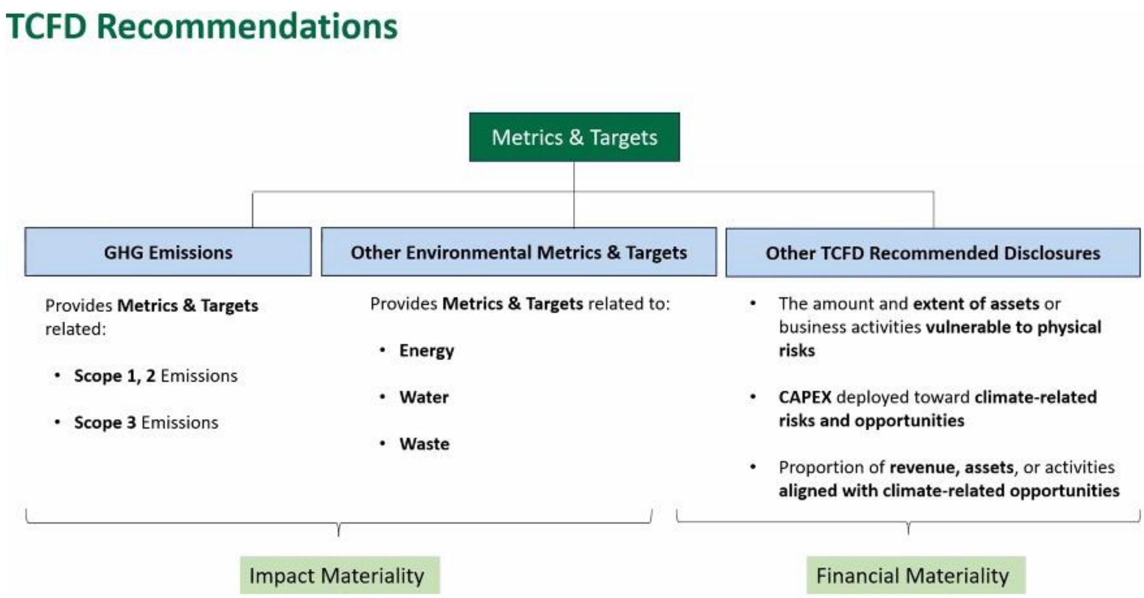
DATA HARMONIZATION AROUND CLIMATE AND NATURE ASPECTS: WHICH DATA SHOULD SMEs START COLLECTING?

Here are some ideas to start your sustainability journey:

1) **Familiarize yourself with the TCFD and the TNFD, think about local commitments and global due diligence.** Both above-mentioned sustainability reporting standards, ISSB/IFRS and ESRS, are structured around the recommendations of the Taskforces on Climate- and Nature-related Financial Disclosures (TCFD & TNFD). Besides, regulators around the world are increasing due diligence requirements to shed light on complex value chains. Thus, the best way to get prepared for potential data requests is to foresee which information might be needed from suppliers and look at well-established frameworks to start gathering the respective data.

   a) The TCFD recommendations (referenced as minimal expectation in the Swiss Climate Ordinance[5]) recommend climate-related disclosures, namely regarding:

   - Governance (Board Oversight and Management),
   - Strategy (Climate Risk & Opportunities, Impact and Resilience),
   - Risk Management (Identification, Management and Integration), and
   - Metrics and Targets, with a focus on transition plans (see Figure below).



Source: *Enfinit/Pelt 8 2023*

5 https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-91859.html

b) TNFD Recommendations

The TNFD is structured like the TCFD as it focuses on governance, strategy, risk management and targets. It highlights not only nature risks to business, but also non-financial business impacts on nature (so-called double materiality, see Figure above).[6] Instead of shying away from the complexity of nature, it is crucial to keep in mind that climate change is only one driver of nature loss, in addition to invasive species, changes in land and sea use, pollution and direct exploitation of natural resources. Taking climate change measures, without considering nature more holistically, can backfire. We suggest initially focusing on the natural aspects most interlinked with climate (e.g. forests and oceans as carbon sinks) and those closely associated with your business model.

6 And is thereby compatible with both financial materiality under IFRS as well as double materiality under ESRS.

FROM REPORTING BURDEN TO POSITIVE CHANGE: HOW CAN SMEs PLANT THE SEED VIA EXISTING TOOLS AND SIMPLE LEGAL CLAUSES?

Rather than thinking about impact measurement and sustainability reporting in terms of bureaucratic burden, firms should use the opportunity to reflect on business strategy and governance. Several public and private tools and initiatives exist to support companies in that endeavor. We further suggest simple legal phrases to include in a firm's articles of association or shareholder agreement.

a) Supportive tools, such as ENCORE which was developed together with the UN and SECO, help understand specific sectors' exposure to nature.

b) The Swiss Climate Foundation supports SMEs in developing sustainable solutions. B-lab certifies businesses on their way towards more sustainability, and developed a program dedicated for SMEs called the Swiss Triple Impact. The Levo Framework, for instance, is composed of an Operational Sustainability Assessment (OSA), and an External Impact Chart (EIC). Levo allows to evaluate the alignment of a business' operations with recognized sustainability standards through the OSA, and helps companies comprehend the effects of their products and services on customers, users, society, and the planet, whether through direct or indirect impacts. Finally, Levo also supports enterprises in aligning their activities with the UN Sustainable Development Goals (SDGs) and establish indicators for future success. Other tools, like Pelt 8, facilitate sustainability reporting through a platform which allows to collect sustainability-related data in an easy and traceable way. The Alliance for Sustainable Enterprises proposed the creation of a new status of "sustainable enterprise", based on a concrete and measurable commitment on the part of companies that would choose to adopt it.[7] This proposal was announced to the Federal Council in September 2023 and is currently examined.[8,9] Furthermore, the Toolbox 2030 provides sustainability guidance for cantons and companies.

c) Last but not least, SMEs can align with supply chain partners' increasing due diligence requirements by putting systems in place, which help to prevent human rights violations. Start by engaging all employees and discussing responsibilities and escalation pathways, e.g. by thinking through a potential violation case, such as underpaid migrant workers along your supply chain, e.g. following the guidance of Focusright.

[7] NERI-CASTRACANE ET AL., Legal Status for Sustainable Enterprise in Switzerland – White Paper from the Legal Experts Group, Alliance for Sustainable Enterprises, December 2023. https://www.alliance-sustainable-enterprises.ch/_files/ugd/fa1267_c073ec8c72a948af9c4995de67af6290.pdf
[8] 23.454 | Introduire un statut juridique facultatif "Entreprise Durable" pour les PME suisses | Objet | Le Parlement suisse (parlament.ch)
[9] https://www.parlament.ch/en/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20230454

Enterprise for Society Center (E4S)
Odyssea, EPFL Station 5, CH-1015 Lausanne, Switzerland
info@e4s.center

INTEGRATING A VISION FOR SUSTAINABILITY INTO THE CONSTITUTIONAL AND OTHER LEGAL DOCUMENTS OF THE COMPANY

A. *Articles of Association*

An amendment to the **Articles of Association** may include a specific corporate purpose for your company and describe concrete actions the company is committed to. The corporate purpose ("raison d'être") provides a framework for implementing the strategy and allocating resources in a consistent manner and inherently integrates the ESG components (BK-CHENAUX/BLANC, § 15 N 127).

In other words, shareholders can state in the Articles of Association how the company is to create sustainable value within the planetary boundaries while respecting the interests of its investors and other stakeholders (BK-CHENAUX/BLANC, § 15 N 127 s.).

This corporate purpose shall serve as a compass in the company's risk policy and the directors' decision process. It clarifies the board's fiduciary duties with regard to the company's ESG objectives.[10] The *sustainability* report may describe how the company implements this corporate purpose and the resources allocated (BK-CHENAUX/BLANC, § 15 N 155).

Option 1

Purpose. The corporate purpose of the Company is to [insert as appropriate]. Through its business and operations, the Company shall strive for a material positive impact on society and environment.

NB:

- The "material positive impact on society" can also be a specific environmental, social or governance objective freely determined by the parties (e.g. 10% reduction of GHG emissions by 2030).
- The objective of the clause is to include the company's obligation or aspiration to meet a particular ESG standard when meeting the other objectives of the company. It can also specify how this obligation or aspiration is related to the company's existing objectives and stakeholders (is it primary, equal or subsidiary to existing objectives and stakeholders?).

Source of inspiration: Chancery Lane Project, Arlo's Clause - ESG Aligned Company Articles (Link).

[10] NERI-CASTRACANE ET AL., Legal Status for Sustainable Enterprise in Switzerland – White Paper from the Legal Experts Group, Alliance for Sustainable Enterprises, December 2023, https://www.alliance-sustainable-enterprises.ch/_files/ugd/fa1267_c073ec8c72a948af9c4995de67af6290.pdf, pp. 12-13.

Option 2

Purpose. The company's objects are to carry on business as a general commercial company and, through its business and operations, to reduce or eliminate any process or activity within its control that releases GHGs and make every effort to achieve the goals of the Paris Agreement by implementing continuous, measured reductions in GHG emissions consistent with a maximum effort to achieve or exceed a fair share of the global 50% reduction in CO_2 by 2030.

NB:

- This clause requires company directors to commit to ensuring that the business and activities of the company are in accordance with the climate goals outlined in the Paris Agreement as set out in the clause. Directors commit to prioritize this climate ambition in decision-making and corporate governance processes.
- Practically, this clause requires the directors to set net zero and other climate-aligned targets, measure the company's carbon emissions footprint, and have a plan to achieve those targets and reduce emissions and offsets.

Source of inspiration: Chancery Lane Project, Pasfield's Clause, Paris-Aligned Company Articles.

B. Shareholder Agreement

The **Shareholder Agreement** might describe the sustainability values and vision shared by the company's owners, and detail the governance required to promote such values and support the vision.

1. Purpose

Option 1

Purpose. The Company, by pursuing its purpose, shall, through its business and operations, strive for a material positive impact on the society and the environment.

NB:

- This clause may simply restate the purpose clause of the Articles of Association or, in the absence of such clause, clearly state the intent of the shareholders regarding the way the business of the company shall be conducted.
- It also helps clarify the fiduciary duties of the board of directors, by stating that the best interests of the company extend beyond the mere maximization of value for the shareholders.

<u>**Option 2**</u>

Company Values. The Shareholders acknowledge that the Company's purpose and mission, as specified in the Articles of Association, shall be supported by (i) responsible business practices, (ii) the creation of short, mid and long term value for relevant stakeholders and (iii) a transition to sustainable economic activities in line with the United Nations' Principles for Responsible Investment (collectively, the **Company Values**).

Sustainability. The Board shall manage the business of the Company in a manner which supports achieving the goals set forth in the UNFCCC Paris Agreement and the United Nations Sustainable Development Goals (2030 Agenda for Sustainable Development) (the **Sustainability Goals**).

Source: id est avocats

NB:

- This clause commits the company to ethical operations, creating value for various stakeholders, and aligning business activities with the UN's Principles for Responsible Investment.
- It also helps clarify the fiduciary duties of the board of directors, by stating that the best interests of the company extend beyond the mere maximization of value for the shareholders.

2. Non-Financial Reporting / Information Rights Clause

<u>**Option 1**</u>

Non-Financial Reporting. The Board will regularly share with the Shareholders any non-financial reporting information, such as ESG and climate related information, in line with the Mission, the Sustainability Goals or as imposed by the law, and will consider any reasonable requests by the Shareholders to expand such Non-Financial Reporting, in particular with a view to satisfy such Shareholders' reporting and disclosure requirements.

Source: id est avocats

NB:

- The proposed clause could be expanded to include the definition of specific ESG metrics that should be included in the reports, such as carbon footprint data, diversity and inclusion statistics, or community impact assessments, and provide for a regular, predictable schedule for ESG reporting (e.g., quarterly, bi-annually) to offer consistent and timely information to shareholders. Other possible additions could include a requirement for third-party verification or auditing of the ESG data to ensure accuracy and reliability, the reaching out to a broader range of stakeholders (not just shareholders) on ESG issues, reflecting a more inclusive approach, and the establishment a mechanism for shareholders and other stakeholders to provide feedback on the non-financial reporting process and content.
- The clause can further specify the exact date by which the information must be available (e.g. each year by the 31st of December).

Option 2

Annual Reporting. The Company shall further (i) produce an annual report with respect to its performance as evaluated against the ESG reporting framework it has adopted (the **ESG Report**) within 90 days after the end of each fiscal year of the Company following the adoption of the ESG reporting framework and (ii) comply with reasonable requests from its shareholders with respect to such shareholders' ESG data collection efforts. The ESG Report shall include, at a minimum, (i) a description of the relevant objective targets and metrics; (ii) an objective assessment of the Company's success in meeting such targets; and (iii) the Company's proposed actions to further achieve the applicable targets over the next one-year period.

Source: *id est avocats*

3. Decision-making Process

Option 1

Decision-making. In its decision-making process, the Board shall take into account the Company's purpose, the short and long term interests of the Company, its subsidiaries and their suppliers, to create a positive material impact on society and the environment as well as the impact of their actions towards the relevant stakeholders, such as (i) their employees and their workforce, (ii) their customers, (iii) the regions and communities in which they are active and (iv) the environment.

Source: id est avocats

NB:

- This clause requires the board of directors to consider the long-term interests of the Company and its stakeholders and the impact of its decisions on the environment and stakeholders alongside the financial stakes when making decisions. It however does not require the board of directors to prioritize ESG issues over financial issues in decision-making.
- When making decisions, the board of directors is thus required to inform itself on the long-term interest of the Company and the impacts of its decisions on the stakeholders (by reviewing reports, engaging with stakeholders, etc.). The clause raises the Board's awareness of long-term interest of the company and stakeholders and reflects the acknowledgment of the company's impact beyond financial metrics.
- The proposed clause could be further expanded to (i) broaden the stakeholder engagement to include more groups, such as suppliers, investors, industry partners, and governmental bodies, (ii) define clear metrics to measure the social impact of decisions, such as employee satisfaction, community development initiatives, or customer welfare enhancements, (iii) establish mechanisms for receiving and integrating feedback from relevant stakeholders into the decision-making process and (iv) uphold high ethical standards in decision-making, ensuring that actions are not only legal but also ethically sound.

Option 2

Decision-making. The Company shall procure that [major shareholders] (each, an **Anchor Shareholder**) be granted (i) a[n observer] seat at the Board[, and as such be invited to all Board meetings and receive all the information available to the Board] and (ii) an option, to be exercised at each Anchor Shareholder's discretion, to assign to the Company or the other shareholders all of its shares in the Company, at the price originally paid by such Anchor Shareholder for such shares, in case the Company breaches any of its ESG obligations or covenants.

Furthermore, in the decision-making process, the Board shall give due consideration to ESG issues, even if such considerations may in some cases diverge from short-term financial gains. While maintaining the financial viability and interests of shareholders, the Board actively seeks opportunities to enhance the Company's positive impact on the environment, society and governance practices, recognizing the importance of long-term sustainability and stakeholder value.
Source: *id est avocats*

NB:

- This clause prioritizes the long-term interest of the company over its short term interest, as it explicitly requires the board of directors to move away from the short-term interest if they do not align with the company's long-term interest. When faced with a decision, the Board shall choose the solution that is in the company's long-term interest, provided that it does not jeopardize the company's financial viability.
- The clause also offers the right to major shareholders to divest their shares in the company (put option) should the Company breach its ESG or sustainability obligations (mission drift); in the absence of such right (and the liquidity offered by publicly listed companies), these shareholders could be left supporting a company which is found in breach of its legal obligations regarding ESG without a proper remedy available.
- The clause could be further expanded to (i) establish a transparent and objective process to identify and confirm breaches of ESG obligations, ensuring fairness and accountability, (ii) introduce incentives for the Board and management to achieve ESG targets, aligning their interests with long-term sustainability goals, (iii) implement external audits or assessments of the Company's ESG performance to provide an independent perspective or (iv) invest in training and development programs for the Board and employees on ESG issues, ensuring informed and effective decision-making.

Enterprise for Society Center (E4S)
Odyssea, EPFL Station 5, CH-1015 Lausanne, Switzerland
info@e4s.center