



Engagement Topics 2019

For the engagement activities of the members of the **Responsible Shareholder Group (RSG)** the following topics were chosen in 2019:

Social

- o Human Rights Due Diligence
- o Presenteeism

Environment

- o Scope 3
- o Green Products and Services

Governance

- o Competencies in the Board
- o ESG Criteria in the Compensation System

Human Rights Due Diligence

Over the last few years, Human Rights Due Diligence (HRDD) has become a strategic topic for companies and their investors. Many companies are affected by human rights-related risks, particularly through their supply chains in emerging markets or their financing activities. The violation of human rights may cause severe risks for both companies and their investors, including reputational and financial damages, commercial losses and criminal sanctions.

At the international level, standards developed by the UN or the OECD are unanimously endorsed and are already being integrated by some leading companies in the field of Human Rights. Some countries, such as France, have issued laws on this topic and are binding national companies to HRDD specific requirements. In Switzerland, a popular initiative was launched in 2015, demanding greater responsibility for multinational corporations. The initiative would compel Swiss-based multinational companies to undertake human rights and environmental due diligence in all their business activities. A popular vote will take place in 2020 on these constitutional amendments.

According to the UN Guiding Principles on Business & Human Rights, HRDD is a way for enterprises to proactively manage potential and actual human rights risks in which they are involved. It consists of five core components:

1. Policy Commitment and Governance: a company needs to show its commitment to address the issue, to formulate ad-hoc policies and to adopt proper governance system.
2. Human Rights Impact Assessment: a company identifies and assesses actual or potential adverse human rights impacts that it may cause or contribute to, either through its own activities or through its products and services.
3. Actions to Mitigate and Avoid Impacts: after having considered the findings from impact assessments, a company takes appropriate action according to its involvement in the impact.
4. Monitoring and Reporting: a company communicates on how impacts are being addressed and shows stakeholders that adequate programs are in place.
5. Grievance and Remedy: a company implements grievance mechanisms so that appropriate remedies can be provided to affected stakeholders.

The dialogue initiated by Inrate with Swiss companies predominantly focuses on these five aspects of HRDD.

Presenteeism

The second social topic refers to the management of psychosocial risks at work, with a specific focus on presenteeism. Presenteeism refers to the behavior of attending work despite having health issues or other impairments, which would have legitimized an absence (Eberhard Ulich 2013, *Dorsch Psychologisches Wörterbuch*) - this is a psychosocial risk. These issues can be physical, psychosomatic and/or mental (for instance depression). Reasons for presenteeism might be e.g. sense of duty, consideration of colleagues, volume of work, fear of suffering any professional disadvantages, loyalty to the employer etc. (Eberhard Ulich and Miriam Nido 2014, *Präsentismus - auch ein Ergebnis persönlichkeitsförderlicher Arbeitsleistung?* In P. Sachse and E. Ulich (HRSG.), *Psychologie menschlichen Handelns: Wissen & Denken – Wollen & Tun. Beiträge zur Arbeitspsychologie, Band 7*).

Latest research studies show that psychosocial risks and the development of corporate performance indicators are significantly correlated. According to an OECD research report published in 2014, mental illnesses cost CHF 19 billion per year in Switzerland. Furthermore, approximately 40% of all disability pensions are caused by psychological impairments, and this number continues to grow. As a result of this development, the European Union as well as the State Secretariat for Economic Affairs (SECO) have placed "psychosocial risks at the workplace" at the center of their preventive activities. Between 50%-80% of the employees reported at least once per year having gone to work despite feeling ill (Fred Henneberger and Michael Gämperli 2014, *Präsentismus: Ein kurzer Überblick über die ökonomische Relevanz eines verbreiteten Phänomens*).

A large majority of recent studies conclude that the cost of presenteeism to companies is significantly higher than the cost of absenteeism. The cost ratio between absenteeism and presenteeism ranges from 1:3 up to 1:10. The higher costs of presenteeism can be attributed to the following:

- o Decreased performance due to health impairment
- o Additional sick leaves due to chronification of health impairment
- o Ill employees have an increased risk of making mistakes and of having an accident
- o Additional productivity losses due to contagion of business colleagues in case of infectious diseases

According to the Swiss Federal Statistical Office, 28.7% of men and women were affected by a mild or moderate or severe major depression in Switzerland during the 2012 health survey. In the following survey in 2017, the rate rose by 21% to 34.6%. There is an average of 10 years between the start of a depression and treatment (Niklas Baer et al. 2013, *Depressionen in der Schweizer Bevölkerung. Daten zur Epidemiologie. Behandlung und sozial-beruflichen Integration*). During this period of time many employees might continue to work without being aware that they are affected by a depression.

Given the high cost block caused by presenteeism, companies should have a strategy on how to deal with this topic.

Scope 3

Greenhouse gas emissions are divided into three "scopes" according to the most widely used international accounting instrument, the Greenhouse Gas (GHG) Protocol:



Scope 1 emissions are direct emissions from sources that are owned or controlled by the company (fuel combustion, company vehicles [without electric cars]).

Scope 2 emissions are indirect emissions from the generation of purchased energy (purchased electricity, heat and steam).

Scope 3 emissions include all other indirect emissions resulting from the company's value chain activities, but that are not owned or controlled by it. Scope 3 emissions come from upstream and downstream activities such as:

- third-party distribution and logistics
- leased assets, franchises and investments
- purchased goods and services
- contracted solid waste disposal and wastewater treatment, use and disposal of sold products.

In Switzerland, tracking scope 1 and scope 2 emissions are no longer a major challenge for companies. Most of them track, monitor and disclose these emissions in detail. Reporting on scope 3 emissions, on the contrary, is rare. Collecting and reporting on scope 3 emissions is challenging for most corporations, however their importance is substantial and growing. Between 1995 and 2015, global scopes 1, 2, and 3 emissions grew by 47%, respectively 78%, and 84%. In some sectors scope 3 emissions are by far larger than scope 1 and 2 emissions. For example, in the case of buildings (which includes the construction sector, real estate and housing), scope 3 emissions are twice as high as scope 1 emissions (Edgar G Hertwich and Richard Wood 2018, The growing importance of scope 3 greenhouse gas emissions from industry). The sector with the highest scope 3 emissions is the manufacturing industry.

For these reasons, reporting on scope 3 emissions is essential to fully understand the impact of a company on climate change. Without a complete GHG emissions disclosure that includes scope 3, investors may be misled. In addition, the progress of a country, investor or business addressing climate change and trying to contribute to the transition to a low carbon, may be hindered. Developing a scope 3 emissions inventory requires a joint effort between the company and its suppliers. This allows companies to better manage emissions-related risks and opportunities, to focus efforts where they can have the greatest impact and to efficiently reduce value chain GHG emissions.

Green Products and Services

Companies that do not adapt their business models to the challenges of sustainable development may face significant environmental risks. Sustainability challenges can turn into business opportunities if companies develop innovative products and solutions that directly address specific or global sustainability issues, such as climate change, energy efficiency or scarcity of natural resources. Among other characteristics, green products can save energy, be free of toxic compounds, be made of recycled or reused materials. Green services can help to reduce environmental impact through targeted technical and scientific expertise, for example in the financial industry or in the real estate sector. As customers have become increasingly sensitive to environmental issues, demand has increased significantly in recent years and the offer of "Green Products and Services" is increasingly becoming a strategic business issue and a competitive factor for many companies.

In the food industry, the supply of organic products, which comply with standards and ecolabels, meets an ever-increasing demand. Many investors today consider the offer of green products and services as a material ESG challenge that contributes to the financial value of a company. International initiatives, like the Sustainable Development Goals (SDGs), supported by a growing number of stakeholders, including investors, strongly encourage companies to offer green products and deliver green services.

Competencies in the Board

The board of directors plays a crucial role for a company's long-term success. The board acts as a sparring partner to the management board, sets and supervises the firm's strategy and long-term priorities, and provides critical advice to the management. As a result, investors ought to have a serious interest in appointing a board composed of skilled and experienced directors. Furthermore, diversity of employees is important so that corporate challenges are tackled with insights from various perspectives. Inrate identifies eight measurable competencies to evaluate board of directors and to identify potential know-how gaps:

- (1) Industry experience
- (2) CEO experience
- (3) International experience
- (4) Experience in emerging markets
- (5) Financial knowledge
- (6) M&A experience
- (7) Legal education
- (8) Experience in digitization

ESG Criteria in the Compensation System

For investors, sustainability is becoming increasingly important when considering their investment decisions. At the same time, companies are implementing comprehensive sustainability strategies. This is intended to take into account environmental, social and governance (ESG) impacts when making corporate decisions (e.g. reducing CO2 footprints, promoting employee health, increasing diversity at management level). An effective instrument for the implementation of such strategies is the design of remuneration systems. Incentives can influence the behavior of employees and in particular managers. The consideration of ESG criteria for bonuses in remuneration systems might have a potential leverage effect on the integration of sustainability in companies. An analysis by Inrate of 2320 companies in 2018 showed that 11.3% of the companies included ESG criteria in their remuneration systems. The analysis showed that the most used ESG criteria in management remuneration relates to employees: 6.9% of companies mention such criteria. In this context, occupational safety and health of employees, talent development, talent management, employee satisfaction and diversity are mentioned. 4.9% of companies mention environmental issues. They mention general environmental issues, energy savings, emission reduction and water. In the area of social affairs (4.7%), customer satisfaction, quality criteria, ethics and corporate values, as well as stakeholder commitment and social programs are included in the variable compensation. 3.1% of companies generally refer to a link between sustainability or CSR and remuneration systems.

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