SWIPRA CORPORATE GOVERNANCE SERVICES & DIALOGUE

Newsletter 11/2024

SWIPRA Governance Survey 2024

Aligning Governance Practices with Strategic Ambitions pay

Zurich, 28th November 2024 – The 2024 SWIPRA Governance Survey underscores the importance of aligning governance practices with emerging challenges and stakeholder expectations. Enhancing transparency on board development, aligning on an understanding of sustainability report voting, considering reputation risks in compensation decisions, and broadening stakeholder engagement are key to driving long-term value creation and build a stronger reputation.

Board elections continue to stand out as the most important AGM agenda item. But shareholders still have very limited understanding of how boards assess themselves and their performance, how they develop their composition over time and how they align it with their company's strategy. Improving this understanding would increase a board's credibility and allow shareholders to better understand a board's work and its strategic ambitions.

The newly introduced votes on sustainability reports had a positive impact on disclosure quality but shareholders need a better understanding of the vote's objectives to make this say on sustainability meaningful. The currently high AGM approval levels are not reflecting shareholders judgement of companies' sustainability efforts and achievements.

In shareholder votes on remuneration reports, Switzerland leads Europe in shareholder opposition, driven mainly by comparably high pay levels and insufficient pay-for-performance transparency. Poor peer group selection, performance assessment transparency or incentive structures are particularly critical issues. The survey further shows that high executive pay not only has a negative spillover to corporate reputation but also adversely impacts the credibility of boards and in particular of the executives receiving these compensation packages.

Next Events

Outlook AGM Season 2025
Webinar
January 2025

Swiss AGM Season 2025
Webinar
June 2025

Finally, the views regarding the governmental push to align Swiss sustainability disclosures with EU standards are split. Swiss companies and shareholders prefer to not align, contrary to non-Swiss shareholders. Their reasons seem clear, that this may provide easier comparability, not taking into consideration other aspects.

Board of Directors: Enhancing Transparency and Functionality

Board elections remain the most important and impactful agenda item in terms of value creation according to both, shareholders and companies alike. Gaps persist in the understanding of how board composition aligns with strategic goals or how board functionality is regularly reviewed and improved through board assessments. Only 34% of the shareholders indicate that they have a good understanding of a board's succession process. A majority of them (53%) is particularly missing information on how a board's skills and experiences are aligned with the company's strategic challenges in order to enhance long-term value. An issue on which boards themselves need to develop a better understanding.

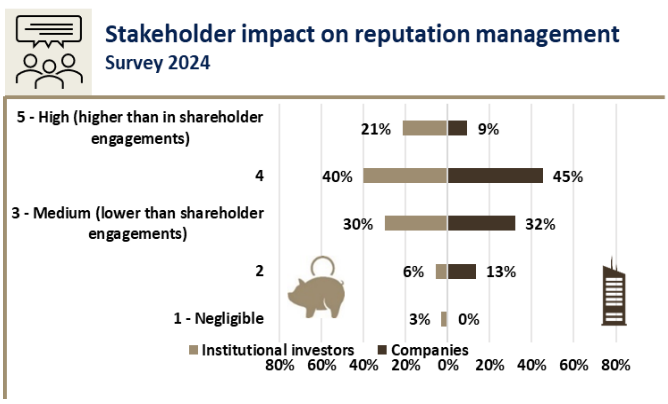
Greater transparency around board management and composition is thus essential for building trust in boards. Rigorous and regular board assessments are deemed (very) important by over 90% of companies and shareholders. Yet only 33% of shareholders are aware from current disclosures of whether a company has conducted such an assessment and less than 10% have a general understanding of the consequences of such assessments.

To address these gaps, companies should prioritize additional disclosures on whether their boards conduct regular assessments, how they improve their organization over time, and how the board composition aligns with strategic ambitions and challenges. Engagements between shareholders and the board, which 51% of companies have already established on a regular basis, offer a primary channel to discuss such information. According to shareholders, discussions about the board have been the second most important topic in their engagement efforts during the run up to the 2024 AGMs.

Stakeholders: Unlocking Long-Term Value through Broader Engagement

The dialogue with key stakeholders other than shareholders is largely driven by management, with boards limiting their direct engagements, mainly due to time limitations of board members, to their shareholder. Discussions with other critical stakeholders such as regulators (conducted by 25% of companies), communities (18%), and NGOs (3%) are limited.

Yet while 52% of shareholders and 31% of issuers see very little or even a negligible impact of stakeholder engagements (other than shareholders) on a company's short-term value generation, 39% of shareholders and 43% of companies perceive the long-term value impact of such engagements to be at least as high as for shareholder engagements.



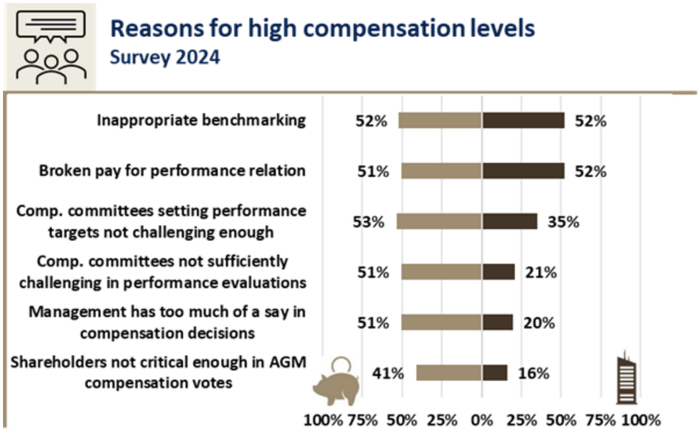
According to more than half of shareholders and issuers, this long-term value impact of stakeholder engagements originates from its influence on decisions related to reputational management and, to a lesser degree, from its impact on strategic decisions.

Boards should thus consider institutionalizing regular and structured interactions with diverse stakeholders that are key for long-term strategic success. By prioritizing these broader relationships and integrating stakeholder feedback into strategic planning, companies can strengthen their reputation and adapt effectively to evolving societal expectations. Expanding the scope of engagement to include all relevant stakeholders will ensure that boards are better prepared to address reputational risks and capitalize on long-term opportunities.

Compensation: Addressing Reputational Risks and Disclosure Gaps

Switzerland continues to record the highest levels of shareholder opposition on compensation reports in Europe. This shareholder discontent mainly stems from high compensation packages relative to EU peers (57% of shareholders) and insufficient pay-for-performance transparency (43% of shareholders). Not surprisingly, compensation-related issues were the main engagement topic for issuers and shareholders alike in the run up to the 2024 AGM season.

76% of shareholders consider executive pay levels in Switzerland to be (too) high. The key reasons identified by companies and shareholders for these pay levels are inappropriate benchmarking and broken pay for performance relations. Shareholders especially raise the point that compensation committees are not setting sufficiently stretching targets and are not challenging enough in their performance assessments, opinions that are not shared by issuers.



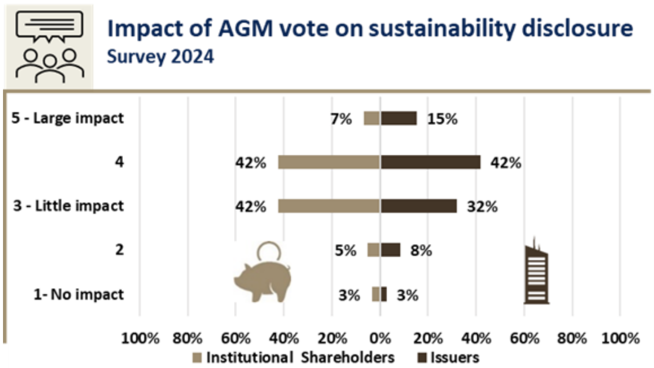
Market participants also believe that high compensation packages have negative reputational spillovers to the company and the involved people. Shareholders specifically also point out the negative impact on the public perception if the pay differential between executives and employees gets too large.

The latter point is closely related to long-term incentives (LTI), usually the largest share in an executive's compensation package. In most LTIs, executives often not only benefit from increasing share prices, a mechanism that is aligned with shareholder gains, but also receive additional shares (multipliers at vesting) in case the company is doing well, benefiting disproportionately. Interestingly, only 48% of issuers and 52% of shareholders are of the opinion that this additional upside is needed, while 64% and 75%, respectively, consider the downside possibility of an LTI losing all its value (very) important.

Companies should prioritize improving disclosures on pay-for-performance linkages, detailing performance metrics and outcomes. The structure of long-term incentives, specifically the possibility of a disproportional vesting, needs to be re-evaluated by shareholders and companies alike to sustainably align compensation with corporate performance. These steps, alongside reinforcing governance mechanisms such as clear performance safeguards, will mitigate reputational risks and build confidence in companies and their shareholders among other stakeholders.

Shareholders: Strengthening Sustainability Reporting Practices

The introduction of the "say on sustainability" vote in the 2024 Swiss AGM Season considerably impacted issuers' AGM preparations: 45% indicated that this vote required the highest effort in the preparations towards the 2024 AGM.



This effort seems to have paid off. 49% of the shareholders stated that this vote had a large or rather large positive impact on the quality of the sustainability reports and the voting outcome at the 2024 AGM seems to support this with an average approval rate of the sustainability report amongst the largest 100 companies of above 97% (SWIPRA AGM Analysis 2024).

These high approval rates are at first sight astonishing: only 17% of shareholders believe that Swiss companies are further advanced than their non-Swiss peers with respect to sustainability and only 29% believe that they have a high level of transparency. More than half of the shareholders indicated that the high votes are due to a missing best practice with respect to this vote. Consequently, according to 50% of the shareholders, the voting outcome only reflects whether the legally required information has been published by companies, but not whether they agree with sustainability-related achievements or targets. Current approval levels are thus not to be mistaken for an "all clear" signal.

To enhance its effectiveness, the goal of this say on sustainability vote, which is not yet clear to almost half of the shareholders, needs to be better understood. Fostering alignment on the intended signal of this vote will eventually make it a meaningful tool.

Regulatory Alignment: Weighing EU Disclosure Requirements

The Swiss Federal Council's plan to align local sustainability disclosure requirements with EU standards triggered split opinions. Amongst companies, in particular smaller ones, a majority is against such a regulatory alignment of disclosure requirements. On the shareholder side, opinions are almost evenly split, with non-Swiss based shareholders preferring an alignment while Swiss shareholders rather oppose it.

The challenges posed by current sustainability reporting requirements mainly concern data availability and quality amongst shareholders and high administrative cost originating from this data collection amongst companies.

About the survey

In collaboration with researchers from the University of Zurich, all companies in the Swiss Performance Index SPI® and institutional shareholders from Switzerland and abroad were invited to take part in the twelfth SWIPRA survey on corporate governance in Switzerland. During the survey period (August to November 2024), 91 representatives of companies listed on the SIX Swiss Exchange, representing around 81% of the market capitalization of the Swiss Performance Index, and 89 institutional asset managers and asset owners from Switzerland and abroad took part. The participating investors, around a third of whom are based abroad, represent at least 34.8% (source: ThinkingAhead Institute) of the equity investments under management of the 100 largest asset managers and the majority hold substantial stakes in Swiss companies.

About SWIPRA Services

SWIPRA Services provides **corporate governance and corporate social responsibility services** for listed companies and their boards of directors. We provide our clients with hands-on advice that takes into consideration relevant stakeholder opinions with aim of increasing the value of the company in the long term, based on principles of value-based management and empirically relevant criteria. www.swipra.ch

SWIPRA Services is working with a high-profile think tank to further develop corporate governance and CSR in Switzerland.

Contact

Barbara A. Heller, Managing Partner, T: +41 (0) 55 242 60 00, E: barbara.heller@swipra.ch