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Corporate Governance Vs. Social Responsibility Of Swiss Companies

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CORPORATE GOVERNANCE VS. SOCIAL RESPONSIBILITY OF SWISS COMPANIES

Introductory Example

A fast-growing Swiss corporation is faced with the opportunity to secure a large and extremely lucrative project in a promising developing country. The project would involve the establishment of a foreign entity and thus mean another important step towards expansion and growth. The said developing country provides for low wage labor force, and the publicity of the project is well received. All in all, the project promises to be highly profitable.

Unfortunately, the project could also lead to environmental damage in the country in question. In addition, the working conditions are precarious and the workers are, in general, insufficiently protected by law. Furthermore, the country also has significant deficits in its human rights standards. Although the Swiss company would not violate local law in any way, this law certainly does not meet Swiss standards regarding human rights and employee protection. Consequently, the high profitability is contrasted by reputational risks as well as potential problems with customers and business partners who might no longer be able to identify with the company's business policy.

Subject Matter

Sustainability, diversity, and social and ecological responsibility are topics that are increasingly becoming relevant in operating activities of profit-oriented Swiss companies. This impact is often associated with high costs and, at least at first sight, does not primarily serve the financial interests of the company's shareholders. Accordingly, like in the introductory example, executive bodies are often confronted with the task of balancing the various interests against each other.

The codified Swiss corporate law does not explicitly state whether a company is to be managed exclusively in the interests of the shareholders (*Shareholder Value Approach*) or whether it should also serve other interest groups such as employees, suppliers, consumers and customers as well as society and the environment in general (*Stakeholder Value Approach and Corporate Social Responsibility*). Taking the Swiss stock corporation as an example, the question arises as to what extent the board of directors, as the executive body of the company, must take adequate Corporate Governance aspects into account and balance the various interest approaches. The following discussion of this "hot topic" is intended to show how this subject is to be dealt with from the perspective of Swiss corporate law.

Shareholder Value, Stakeholder Value and Corporate Social Responsibility

In general, the primary interests of shareholders do not coincide with the interests of other stakeholders. The crucial question is to whom a company should provide benefits and to whom it is obligated – only the shareholders (*Shareholder Value Approach*) or also the society at large as well as third parties who come into contact with the company (*Stakeholder Value Approach*).

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The Shareholder Value Approach should not be seen as directly opposed to the interests of other stakeholders. The focus on value enhancement for the benefit of shareholders can in fact lead to other stakeholders benefiting as well. Financially stable companies can grow and create more jobs and contribute to general prosperity by supplying the population with goods or services and through higher tax payments.

While the Shareholder Value Approach can thus indirectly serve the interests of other stakeholders, the Stakeholder Value Approach pursues a more direct promotion of the same. Implemented consistently, there would ultimately have to be a direct redistribution of entrepreneurial profit from the shareholders to other interest groups. One justification for such an approach can be seen in the fact that the state grants certain privileges to the corporation and its owners, such as limited liability or tax advantages for dividends compared to wage payments. By providing such advantages, the corporation is to be regarded in a certain sense as an institution of public interest and should, therefore, not serve exclusively the interests of shareholders.

The broad Stakeholder Value Approach can be further focused on the concept of Corporate Social Responsibility (CSR), which obliges companies to adhere to ethical standards, particularly in terms of respecting human rights and protecting the environment. Pursuing the CSR approach requires that companies not only conduct their business in a legally correct manner, but also in an ethically appropriate one. In this context, the ethical standards that are customary from a Swiss perspective in the areas of environmental protection, working conditions and human rights would also have to be observed in developing and emerging countries in particular, even if the respective local law offers less far-reaching protection in these areas. CSR therefore requires companies to be socially committed and to conduct their business activities in a way that complies with human rights and is environmentally friendly.

The General Regulations of Swiss Corporate Law

The question arises as to whether, from a Swiss legal perspective, there is any room at all for CSR-compliant action or even an obligation for such action. Swiss stock corporation law provides as a general guideline that the board of directors must "*safeguard the interests of the company in good faith*" (art. 717 of the Swiss Code of Obligations, CO). Legal doctrine largely interprets the relevant provisions in such a way that the board of directors must act in accordance with the primacy of long-term shareholder interests and is obliged to increase the value of the company in the long term and to generate profit. Accordingly, the shareholders, as risk bearers and providers of capital, are entitled to an operation that is profit-oriented. Therefore, Swiss stock corporation law provides that a company can only be transformed into a non-profit organization with the consent of all shareholders (art. 706 CO). The law is based on and emphasizes the principle of the profit motive of a stock corporation.

The provisions of Swiss corporate law and their interpretation in doctrine and practice are therefore consistent with the catchwords of Milton Friedman, the father of the Shareholder Value Approach: "*The business of business is business*" (in: *The New York Times*. 13. September 1970). Nevertheless, it would be short-sighted to conclude that the board of directors can rely solely on the Shareholder Value Approach in the context of Corporate Governance. In particular, due to constant social change, the perception of social responsibility is constantly increasing and gaining in importance. For instance, young talents, which are essential for the development and continuity of a company, may only be attracted if

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the company demonstrates exemplary social and environmentally responsible behavior. In addition, customers and business partners are also paying more and more attention to CSR aspects. These days, they expect that their business partners provide a certain level of diversity or sustainability. In many current cases, multinational operating Swiss companies are already forced to pursue a CSR approach. The violation of ethical standards can not only lead to reputational risks, but also to more concrete business disadvantages and shortage of business if consumers, business partners or foreign governments expect compliance with basic ethical rules and this expectation is not met. In this sense, the board of directors is well advised from a Corporate Governance point of view to promote an appropriate social and ecological commitment in order to safeguard long-term shareholder interests in the best way possible.

The Codification of CSR Obligations in Swiss Law

Although Swiss corporate law thus primarily stipulates the Shareholder Value Approach as a guideline for the board of directors, CSR principles have now also found their way into codified law. The legislator recognized a need for action, not least because of the politically highly debated popular initiative "*For responsible companies – to protect people and the environment*", which aimed to implement extensive due diligence and reporting obligations as well as extensive legal liability for Swiss companies for the actions of their subsidiaries and suppliers abroad on a constitutional level. Even though this initiative ultimately failed, new transparency and reporting requirements for certain companies were included in the CO. Large Swiss companies, in particular listed companies, are mainly affected. The new provisions are regulated in the accounting law and thus apply not only to stock corporations, but across all legal forms of companies.

The law contains provisions on transparency in non-financial matters (art. 964a – art. 964c CO), transparency in raw material companies (art. 964d – art. 964i CO) and due diligence and transparency in relation to minerals and metals from conflict-affected areas and child labor (art. 964j – art. 964l CO). The report on non-financial matters must account for environmental concerns (in particular CO_2 targets), social and employee concerns, compliance with human rights, and the fight against corruption. Affected companies active in the extraction of raw materials must prepare an annual report on payments to government bodies. The due diligence obligations regarding conflict minerals and child labor essentially consist of companies having to introduce a management system and define their supply chain policy in it. In addition, the highest management and executive body (in the case of a stock corporation, the board of directors) must submit an annual report on the fulfillment of the due diligence obligations.

After the new legislation granted the affected companies a transitional period of one year, they are now required to implement the new provisions for the first time in financial year 2023. These new regulations essentially force large Swiss companies to live up to CSR principles to a certain extent due to additional due diligence and transparency obligations. Accordingly, for large Swiss companies as well as companies operating in certain sensitive industries and regions, there are now specific legal obligations in connection with CSR.

In addition, it should be noted that CSR commitments also often follow a soft law approach. Ethically correct behavioral recommendations are issued in particular by NGOs, inter- and supranational organizations (*e.g.* UN Human Rights Council and EU Commission), and major business associations. Since such recommendations ultimately reflect the expectations of society and thus of consumers and

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service recipients, they can have an enormous economic impact. Unfulfilled customer expectations, in particular, can have a negative impact on the success of a company. Even though the significance and scope of such behavioral recommendations should by no means be underestimated, the soft law rules of conduct are neither legally binding nor enforceable. Unless certain CSR actions appear necessary in light of a long-term increase in the value of the company or are required by law, such as the transparency and reporting obligations mentioned above, the executive bodies are under no obligation to undertake them.

Liability of the Board of Directors in Connection with CSR Measures

Economic considerations, factual circumstances or, to some extent, the law require CSR-compliant corporate behavior in many cases. It should be noted, however, that the primacy of long-term shareholder interests and thus the predominance of the Shareholder Value Approach also restricts the board of directors' freedom of action with regard to CSR measures. In particular, there is a liability risk (art. 754 CO) if the board of directors undertakes CSR measures that are not commercially justifiable and could be seen as not acting in the interests of the shareholders. The executive bodies of a stock corporation can in principle only pursue CSR activities to the extent that these are covered by the purpose of the company on the one hand and by the purpose of increasing the value of the company in the long term on the other. It goes without saying that the question of which measures can increase the value of the company in the long term is a matter of entrepreneurial discretion. As such, it is neither legally regulated nor justiciable. The board of directors consequently has a very broad freedom of action. In the event of wrong decisions by the board of directors with regard to CSR activities, it is therefore more common in practice for directors to be dismissed than for liability actions to be brought against them. Liability is only a risk in those cases where the actions taken do not make any sense from a business perspective and exclusively pursue non-business interests. For example, donations for charitable purposes which are completely outside the relevant business activity or which are made without any public impact (e.g. anonymously) and thus promise neither a reputational gain nor other economic advantages cannot be reconciled with the legal duties of the board of directors.

If the board of directors intends to take measures that will reduce the value of the company or if there are significant doubts as to whether certain measures could increase the value of the company in the long term, the board of directors is well advised to submit the intended business actions to the general meeting of shareholders for approval. Approval by the general meeting may have the effect of a discharge resolution vis-à-vis the company and the shareholders (art. 758 CO). In principle, a discharge resolution precludes any claims for damages by the company or the shareholders against executive bodies. Hence, the motion for approval of the relevant business acts should be explicitly worded in such a way that the approval is simultaneously deemed to be a discharge resolution. In this way, the liability risk of the board of directors towards the company and the (approving) shareholders can be neutralized.

In situations where, from a Corporate Governance perspective, the undertaking of CSR measures appears to be appropriate, the board of directors will not face any liability risks. As an example, it is unobjectionable for executive bodies to refrain from carrying out an activity that is profitable in the short term if, at the same time, they assume in good faith that they are acting in the long-term interests of the company and ultimately increasing its value. Such refraining from certain activities is particularly appropriate when associated risks, such as liability claims, reputational damage, or the threat of regulation if the private sector fails to act, could outweigh the short-term gains.

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Conclusion

The board of directors of the emerging Swiss company in the introductory example is faced with the challenge of weighing the benefits of the project against its risks. At first glance, the intended business project promises to be highly lucrative and to increase the company value. On the face of it, the realization of the project thus appears to be in the interest of the shareholders.

On the other side, Swiss corporate law provides that the board of directors is obliged to increase the value of the company in the long run. Within the framework of adequate Corporate Governance, the board of directors will also have to address the disadvantages of the project, which relates in particular to CSR aspects. The long-term interests lay in a healthy reputation, in securing the next generation of employees, and in long-term business relationships with socially and environmentally conscious customers and business partners. These interests could outweigh the interest in (short-term) high profitability. If, from this point of view, the project would harm the company's value in the long term, the board of directors must decide against the project in the interests of adequate Corporate Governance, regardless of how the company positions itself in terms of CSR.

Finally, it is important to note that the law imposes additional CSR-related obligations on certain companies as of the 2023 financial year. In particular, major Swiss companies, above all stock listed companies, are legally required to report on the risks of their business activities in the areas of the environment, social concerns, employee concerns, human rights and anti-corruption, as well as on the measures taken against them, and thereby create transparency. Furthermore, companies with risks in the sensitive areas of child labor and the extraction of certain raw materials must comply with special and far-reaching due diligence and reporting obligations. Should these special provisions be applicable to the company from the introductory example, its board of directors must of course also take these aspects appropriately into account in its decision-making and ensure that the additional obligations are complied with.

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