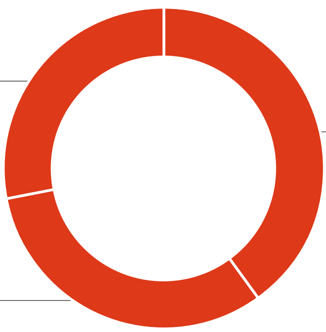
ESG Has Become a Success Factor for IPOs

It is important that companies outline their strategy and ambitions with respect to sustainability as well as they embed ESG aspects in their equity story and that the respective processes and reporting are in place once the company is listed. In this way, information asymmetries can be reduced and that might have a positive impact on company valuation.

Sustainable finance refers to the process of considering environmental, social and governance (ESG) aspects when making (investment) decisions. Especially given the rapid progression of climate change, the topic is gaining momentum among public investors. The motivation behind most "sustainable investing" is primarily financial performance – that is to say, optimizing the risk-return profile.

Main Implicit Motivations for Sustainable Investments
(in % of AuM)



Source: Swiss Sustainable Investment Market Study 2022; Swiss Sustainable Finance; University of Zurich, page 10.

Financial-performance-minded investors want to understand ESG aspects as they may have an impact on the valuation of companies.

ESG-related developments may offer companies new opportunities and the potential to gain a competitive advantage. Examples include:
- Revenue growth through new sustainable products and services;
- Cost savings by using less resource-intensive, sustainable technologies;
- Access to key talent and improved employee retention through fair working conditions.

At the same time, investors are aware that ESG-related developments are likely to expose a company to additional risks (business risks, legal and compliance risks, litigation risks, reputational risks etc.). Out of the world's 250 largest companies by revenue, 64% say that climate change and 49% say that social elements are risks to their business.[1]

[1] KPMG, 2022, Survey of Sustainability Reporting: Big Shifts, Small Steps (October 2022).

ESG Has Become an Integral Part of the IPO Process

It is crucial that companies include their ESG strategy and performance as part of their equity story, reporting and other disclosure documentation. Above all, it is important to illustrate well which ESG aspects are material to the company and to the industry the company is operating in. This includes both ESG aspects that affect a company's business as well as ESG elements arising from a company's operations. These two directions of sustainability form the core of the "double-materiality" concept.

During an IPO and especially during roadshows, company representatives constantly engage with current and future shareholders and stakeholders. In addition to the already established dialog between company management, financial analysts and investment managers, a separate stewardship on ESG aspects needs to be established. This continuous dialog helps the various stakeholders to better understand the company and which ESG aspects are material. Likewise, it can help the company to identify (potential) ESG issues.

Finally, ESG stewardship, dialogs and disclosures reduce information asymmetries and gaps, and may have a positive impact on valuation and volatility.

ESG Regulatory Landscape in Switzerland

Sustainability requirements are (still) lightly regulated in Swiss law compared to other jurisdictions, in particular the EU. In recent years, however, the Swiss legislature has enacted several ESG provisions to catch up with international developments and requirements under EU legislation, and will continue to do so in the future. The Investor Relations Handbook (see chapter 10; pages 132–169) of SIX Swiss Exchange provides a detailed overview of all ESG-related provisions applicable to Swiss listed companies.

Most notably, new statutory provisions on the reporting of environmental, social and employee matters, human rights and anti-corruption measures, which are part of the Swiss Code of Obligations (CO), entered into force on 1 January 2022. Swiss listed companies exceeding certain size criteria are required to create their first reporting in 2024 for the 2023 financial year.

ESG Recommendations by the Swiss Code of Best Practice

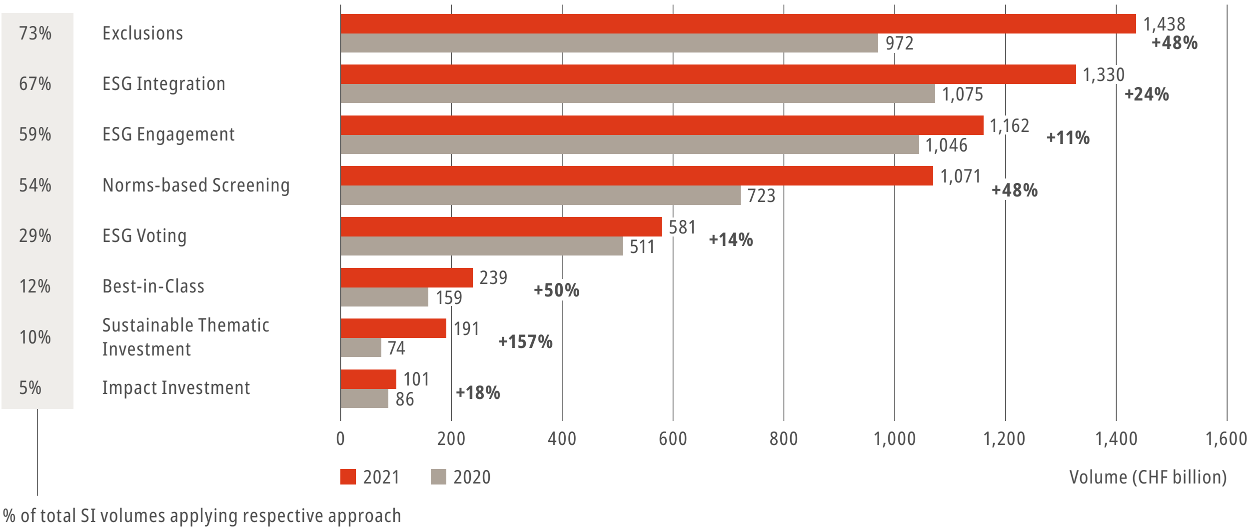
The Swiss Code of Best Practice, issued by economiesuisse, presents a so-called "best practice recommendation" without any legal obligations to follow such recommendations. The Swiss Code of Best Practice addresses larger Swiss companies and companies that are listed on a Swiss stock exchange.

In terms of ESG, the Swiss Code of Best Practice emphasizes the shareholders' right to comment on issues regarding ESG. It further promotes increased interaction between companies and its investors and suggests that the Board of Directors seeks a dialog with shareholders and key stakeholders on important matters. More concretely, the Swiss Code of Best Practice promotes that variable compensation is linked to specific ESG/sustainability targets and that the compensation system also provides for malus provisions. However, it does not make any recommendations on transparency and/or disclosure with respect to ESG and/or sustainability matters. Generally, it is fair to say that larger Swiss and/or stock exchange listed companies follow the overall recommendations of the Swiss Code of Best Practice – and of course, there are always situations and/or aspects where a deviation and different application is required. In such cases, it is advisable to put forward a good argument as to why the company opted for another approach, so that shareholders and stakeholders understand the reasoning.

Investors' Sustainability Investment Approaches

"Sustainable investments" have achieved substantial growth in recent years. The most common investment approach is "exclusion", i.e. certain equity issuers are excluded from the potential investment universe as they

Development of Sustainable Investment Approaches
(in CHF billion) (n=81)



Source: Swiss Sustainable Investment Market Study 2022; Swiss Sustainable Finance; University of Zurich, page 7.

are not considered sustainable or do not meet certain criteria. The second most common investment approach is “integration” (integration of ESG in the investment process) and “engagement” (active shareholder dialog with management on ESG matters).

Proxy Advisors’ View

Proxy advisory firms provide institutional investors with research and data, as well as recommendations on management and shareholder proxy proposals that are voted on at annual and special shareholders’ meetings. Also, with respect to ESG considerations – as for any other matters - large US proxy advisory firms, such as Glass Lewis and Institutional Shareholder Services (ISS), view that fulfilling the fiduciary and contractual responsibilities vis-à-vis their clients is the foundation of their business. Subsequently, proxy advisory firms provide voting recommendations to institutional investors for the companies that they own shares in, also for ESG matters.

In Switzerland, Ethos follows an engagement approach (see also Ethos’ Engagement Policy). Ethos considers that engaging in a long-term constructive dialog with listed companies on ESG topics of material importance is part of effective stewardship. Through continuous monitoring and engagement, Ethos aims to raise the Board of Directors’ and management’s awareness of investors’ concerns, convey suggestions for improvement and check for progress made.

Outlook and Conclusions

Today, it is becoming more and more important that companies outline their strategy and ambitions with respect to sustainability as well as ESG aspects in their equity story, and that the respective processes and reporting are in place once the company is listed, so that the company can provide regular updates on the progress. ESG disclosures in the equity story reduce information asymmetries and subsequently might have a positive impact on the company valuation at the time of going public and thereafter. Finally, it is unlikely that the Swiss regulator and soft law makers will rest, given the international ESG trends and developments. Therefore, Swiss companies may expect further and more extensive Swiss and foreign ESG regulation to cope with.

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