Long-Term Sustainability Calls For Greatness In Risk Management.

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Beth Krasna, current and former Non-Executive Independent Director at CEPF, Swiss Federal Institutes of Technology, COOP, BCV, Banque Cantonale Vaudoise, Fondation en faveur de l'art chorégraphique, and former CEO of Albert Inc., Sécheron and Valtronic, shared her key leadership lessons in my latest "Leading Through Disruption" interview. Subscribe here to receive future interviews.

Lauterbach: When did you first become aware of the term "ESG," and when did you start working with it in a boardroom?

Krasna: ESG evolved out of Corporate Social Responsibility (CSR). Some companies went the CSR path early on and became best in class; others joined as intelligent followers, and the rest have simply complied with regulatory requirements. In 2004, Kofi Annan of the United Nations coined the term ESG - "Environment, Social, and Governance." By 2005 CSR started to morph into ESG.

I chaired an ESG and Innovation Committee on the board of Banque Cantonale Vaudoise, the fifth-largest Swiss bank. A few years later, all pension and retirement funds in the bank portfolio got aligned around ESG criteria. Sometimes it takes a while for things to mature. Having an ongoing dialogue between the board and the CEO early on helped us concretize how we wanted to address the question. In 2012, I started promoting ESG as a critical issue for boards.

Lauterbach: What triggered European companies to pay attention to ESG?

Krasna: ESG started with the "G," or the governance part. In 2001, Swissair, an iconic European airline, was grounded. Its assets dramatically lost value, creating a watershed governance moment beyond Switzerland. All the board members were independently quite capable, but they did not manage Swissair best as a group. Around the same time, the European Union became interested in governance and its links to CSR, setting standards, and passing legislation.

Other geographies had their moments of truth when it came to ESG. Australia had to cope with climate disasters and actively promoted regulation to address the CO2 challenge. The US had Enron, and they had their share of climate disasters, such as fires in California. Still, it will take time to embed ESG into governance practices across the globe.

Lauterbach: So the movement in Europe really started with governance. Still, Europe is not done with corporate scandals. Wirecard, Carillion, and Credit Suisse are the most recent examples. Do you think European countries are heading into major corporate governance reforms?

Krasna: Everything in the world is increasingly interconnected. European regulators are watching the US closely, with recent bankruptcies in the banking sector, including Silicon Valley Bank and First Republic. Credit Suisse, being absorbed by UBS, becomes a mega-bank compared to the GDP of Switzerland. Regulators might act upon the size issue.

In my capacity as president of Ethos, we've been speaking up at the AGMs of Credit Suisse since 2005. Since 2017, we've criticized the board and the management and asked to separate the retail and wealth management bank from the investment branch, which was taking many risks and had a cowboy mentality. We put it to a vote multiple times. When the bank crashed, the press was all over us for interviews. It's easy to look at it with hindsight. A difficult question remains — as Ethos president, I want to know how to increase our impact. How do you secure a followership when it comes to difficult decisions? We saw the disaster coming, and we could not prevent it. The underlying issue at Credit Suisse was cultural, driven by short-terminism, which the management and the company board needed help to sort out.

Lauterbach: Part of a solution would be reorganizing the process and aligning the communications side with a broader shareholder base. What else would you recommend for boards to be great stewards of governance?

Krasna: ESG can and should be related to risk management. Long-term sustainability calls for greatness in risk management.

Lauterbach: Where is the most pressure to focus on ESG coming from? Young hires? Shareholders?

Krasna: Activists like Ethos pay close attention to what is important to businesses' stakeholders. Brand reputation is extremely important. Addressing ESG is not about avoiding a PR disaster, such as the use of child labor, or human rights issues, or environmental catastrophes. It's about promoting something better than your competition does, which attracts the best talent.

Lauterbach: Do you think that investors are pushing for more sustainable capitalism in the entire system while addressing ESG?

Krasna: Not all investors are on board with the movement. Pension funds, however, opt for the long-term while investing in particularly strong ESG vehicles. Sustainable finance is a real movement. It is surfacing because everything is interlinked, be it global trade, environmental disasters, climate change, or refugee migration. If I look at Nestlé as an example, they address water, agriculture, and decent work conditions on their ESG roadmap. They operate in emerging economies, and their choice of focus areas makes perfect sense to them.

Lauterbach: Where do you get data to measure ESG?

Krasna: Ethos has 25 years of data for Swiss companies. We can see trends. Our bottleneck is the format of annual reports. While we try to automate a lot of analyses, we must calculate with a particular error rate. European Union insists on a standard format for an annual report to enable automation.

Lauterbach: How do you balance externalities while measuring ESG?

Krasna: We include positive impact in our ESG scores. Take a solar panel company that is relying on semiconductors in its manufacturing process, which requires a lot of water. Clearly, they burden the environment. Then, consider the positive impact of their products, which balances out the necessary evil. A company using data centers might recycle the heat for a town next door. Circular concepts of using the externalities in a positive way can enable a positive ESG rating.

Lauterbach: Should we link AI to the ESG discussion, or should it be considered somewhere else, let's say, in the Innovation and Technology committees?

Krasna: At Ethos, we've already extended ESG with "D" for "digitalization." It is not just about using AI in product development, manufacturing, or the supply chain. It also has to do with cybersecurity. Does a company possess insurance against a cyber incident? Does it have redundancy in data, and what storage strategy does it apply? What role does a board play in case of a successful denial-of-service or ransomware attack? Instead of running around like a chicken without a head trying to get a specialist on the board, more board members should be trained. Awareness leads to asking relevant questions.

Lauterbach: Unfortunately, sometimes you require a scandal to move the needle. The United States is leading the pack with cybersecurity regulations. Boards pay attention. It started in 2014 with the exposure of 40 million credit and debit card accounts, along with the personal information of 70 million customers of Target. The incident caused Target Corp.'s chairman, president, and CEO to resign. What would enable change in European corporate governance systems?

Krasna: At Ethos, we asked publicly traded companies to answer a questionnaire containing over 200 positions. We sent it to 48 companies. In the first year, only 12 responded. Out of a score of 100, the best one got 12. We took what they published in their annual report for those still needing to answer the questionnaire. We published our findings. In the second year, we had 16 companies delivering answers to our questions. By posting the results and our expectations, we helped move the needle. When you see disasters happening right, left, and center, you start pushing for conversations.

Lauterbach: What is your advice for boards and companies on focusing your roadmap around “Social” impact?

Krasna: “S” starts with diversity at the management level, as it enhances discussions and facilitates better decisions. Boards look into the talent pipeline to the next level down from the C-Suite. Then, there is an external view on what constitutes “S,” including community work, philanthropic programs, and what kind of initiatives your company supports. In a cantonal bank, the impact of “S” showed in absolutely everything that moved in the community, be it sports, culture, or associations. They funded and supported a third to 50 percent of all the requests coming to them. It was about small amounts in absolute numbers, but they were involved in the life of the canton. I saw companies matching employees’ donations for causes people cared about, such as supporting victims of natural disasters. Finally, companies help organize things their people want to contribute to. It could be cleaning up the sides of the river, for example. If a company isn't doing anything, the board may need to ask questions about its culture.

Lauterbach: What would be your message to CEOs regarding how to approach ESG?

Krasna: Tracking progress and understanding impact is crucial. Measuring your CO2 footprint and trying to be carbon-neutral by 2050, at the very latest, is an excellent start. Developing a plan and checking progress on how to get there is an excellent idea. Addressing waste management and trying to become a circular economy with your products is another area. If you are a service company and use lots of electricity, ask where you buy it and whether you use renewables. The pay scales are essential on the social side, so there's no sense of unfairness. With automation and machine learning coming in, think about your retraining roadmaps. Finally, always addressing good governance practices and strengthening compliance is essential.

Lauterbach: Do you believe in the finality of growth for businesses?

Krasna: Some areas grow quickly but need additional funding and imply high risk, like startups, especially in the tech sector. And some things are very stable, profitable, and pay good dividends. A cantonal bank doesn't go into investment banking and trading. They de-risk everything but can afford to increase the employees' pay in line with inflation. The compulsion for growth is nothing on their menu, but they must pay attention to new technologies to stay relevant. Think Kodak, with all the patents that never moved into mobile phones. They paid the price for complacency.