REDEFINING CORPORATE GOVERNANCE

September 2017

BAILLIE GIFFORD

This document provides a short overview of how we think about and approach corporate governance and stewardship at Baillie Gifford. Further information is available at www.bailliegifford.com , or by contacting CorporateGovernance@bailliegifford.com

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000 www.bailliegifford.com

WHAT DO WE MEAN BY CORPORATE GOVERNANCE?

Corporate governance is the combination of a number of different aspects relating to the control, oversight and management of a company. Despite extensive regulation and the creation of a number of national-level corporate governance codes, companies still have broad discretion over how they choose to be incorporated, governed and operated. As long-term investors we pay close attention to these variables, taking particular interest in the following areas of a company's business:

- The capital structure, articles of incorporation, and the country or countries of incorporation and listing
- The treatment and protection of minority shareholders
- The alignment of interests between management, strategic shareholders and other investors
- The make up and effectiveness of the board of directors, the quality and performance of management, and the remuneration of key employees
- The corporate culture and approach to sustainable business, and the management of relationships with customers, employees, suppliers, regulators and the wider community

We focus on corporate governance not because of an interest in shareholder rights *per se*, but because we believe that governance really matters with respect to long-term investment performance. Our ongoing assessment of corporate governance issues may change our view on buying, selling or resizing our clients' holdings. It also determines how we choose to vote at company meetings and how we engage with management, the two principal levers we have for influencing change.

This combination of ongoing company monitoring and research, and 'active ownership' through voting and engagement, is what we think of as stewardship.

WHAT DO WE CONSIDER TO BE ‘BEST PRACTICE’ IN CORPORATE GOVERNANCE?

Just as there is no universally ‘right’ way to invest in the stock market, or to manage a pension fund, there is no ‘one-size-fits-all’ approach to corporate governance that should always be followed. We are open minded about the different ways to govern and manage a company, and we are pragmatic about the significant differences in both expectations and actions that exist across different countries. For example, we don’t have a fixed view with regards to the composition of a company’s board of directors. Effective boards can and do take many forms, and some of the least effective boards conform to the full range of widely accepted corporate governance ‘norms’.

For this reason, we are sceptical of the usefulness of rigid policies and checklists when analysing, engaging and voting on corporate governance issues. Just as our investment research is bottom-up, we prefer to take a case-by-case view on governance, focusing on what works in practice:

- Are we respected as minority holders?
- Are we consulted by management?
- Is executive compensation consistent with performance?

Ultimately, we want to be in a position where we can trust management to take a long-term view and to look after our clients’ interests as minority shareholders.

HOW DO WE EMBED CORPORATE GOVERNANCE CONSIDERATIONS IN OUR INVESTMENT PROCESS?

Our long-only, active approach to investment is based on identifying and holding high quality growth businesses that enjoy sustainable competitive advantages in their marketplace. To do this we look beyond current financial performance, undertaking proprietary research to build up an in-depth knowledge of an individual company and a view on their long-term prospects. This focus on bottom-up research also applies to our work on corporate governance and stewardship.

As a firm we are also very comfortable with our various investment strategies taking different approaches to reach the same goal of properly assessing and weighing up corporate governance considerations in the investment process. The general principles which follow are, however, valid across all of our investment teams.

RESEARCH & ENGAGEMENT

Corporate governance is not a separate side issue, it is central to our investment process. All of our investment staff share the responsibility for identifying, analysing and monitoring corporate governance issues with our current and potential holdings. Our investment staff spend a very significant amount of time assessing the quality, integrity, motivation and culture of management teams, and then acting on their convictions. The work of our Corporate Governance Team supports this, and is therefore complimentary to the work undertaken by our investment teams rather than separate.

Our investors and the Corporate Governance Team have regular meetings with management and board members to monitor performance, and to identify and understand issues. If we have reservations about a company's approach, we prefer to encourage change privately through engagement with management rather than divestment.

We will always review the merits of proposals on a case-by-case basis rather than following restrictive checklists.

VOTING

Thoughtful voting of our clients' holdings is an integral part of our commitment to stewardship. How we vote is an important part of the long-term investment process, and for this reason we always strongly prefer to be given this responsibility by our clients. Unlike many of our peers, we do not outsource the responsibility for voting to third-party suppliers. Our dedicated Corporate Governance Team oversees our voting analysis and execution in conjunction with our investment managers.

We will always review the merits of proposals on a case-by-case basis rather than following restrictive checklists. Checklists, often by necessity, revert to focusing on rights and inputs rather than outcomes. For example, it is easier to draw up a rule dictating how many other company boards a director can be on than to determine whether their performance as an independent director is effective. A formulaic approach to governance can often lead to recommendations that just don't make sense in an investment context – attempting to vote a successful founder CEO off the board because they are also company chairman for example.

WHAT IS ESG, AND IS IT THE SAME AS CORPORATE GOVERNANCE?

ESG stands for ‘Environmental, Social and Governance’. It has emerged as an industry shorthand for a very broad range of issues relating to how a company is governed and its impact on society. Whilst it is now a widely accepted term, we prefer to focus on corporate governance and stewardship as all-embracing concepts which already factor in a company’s performance on environmental and social issues – a business with an unacceptable environmental record, for example, is a poorly governed one that should be a priority for engagement, and if necessary, voting action.

WHAT ABOUT FIXED INCOME INVESTMENTS?

Corporate governance is also highly relevant to our fixed income investments. When investing in corporate bonds, for example, it is particularly important to undertake pre-buy research on material governance and sustainability issues, given the limited engagement levers for debt investors. We assess the risks to a company’s creditworthiness by considering governance matters such as the effectiveness of the board, and its approach to risk management.

STEWARDSHIP

Our commitment to responsible stewardship of our clients’ holdings is as old as our firm. Our clients trust us to oversee and manage their investments, and stewardship of their holdings is a core part of this commitment. As long term investors, we believe that our approach to voting and engagement supports investment performance. When the aim is to invest in a company for many years, ongoing oversight of the business is just as important as the initial investment decision.

But we also believe that we have a wider stewardship role to play in encouraging responsible, long-term capitalism. A company’s approach to governance issues can have a very material impact on society, and we should be using our influence to encourage sustainable practices. More broadly, our business is based on our ability to invest in stable and functional public markets. It is therefore ultimately in our own interests to ensure that the business sector enjoys ongoing public support and political, legal and regulatory backing in the key economies around the world. This will only happen if companies are seen to be operating with integrity and in a way that respects the interests of stakeholders.

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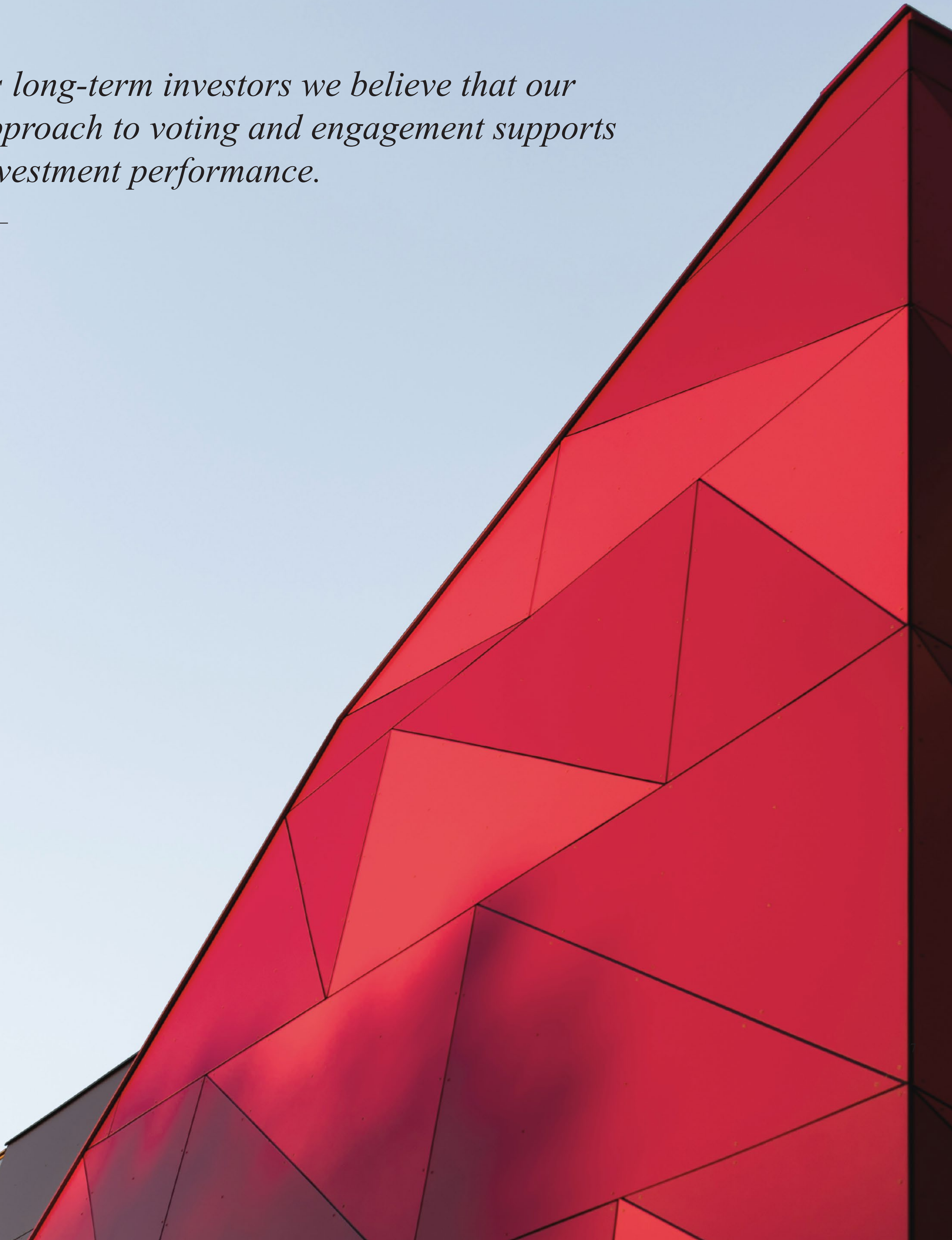

CURIOUS ABOUT THE WORLD

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