

BAILLIE GIFFORD

BCSSS BG Long-Term Global Growth Equity

Report for the quarter ended
30 June 2017



Having recently completed a three week trip to Asia, this is an opportune time to provide a brief overview of some of the progress being made on governance and stewardship in the region.

The purpose of the trip was to speak to clients about our own governance and stewardship activities as well as engaging with the wider industry. We spoke at industry events and conferences in Japan, Taiwan and South Korea to asset owners, asset managers and consultants.

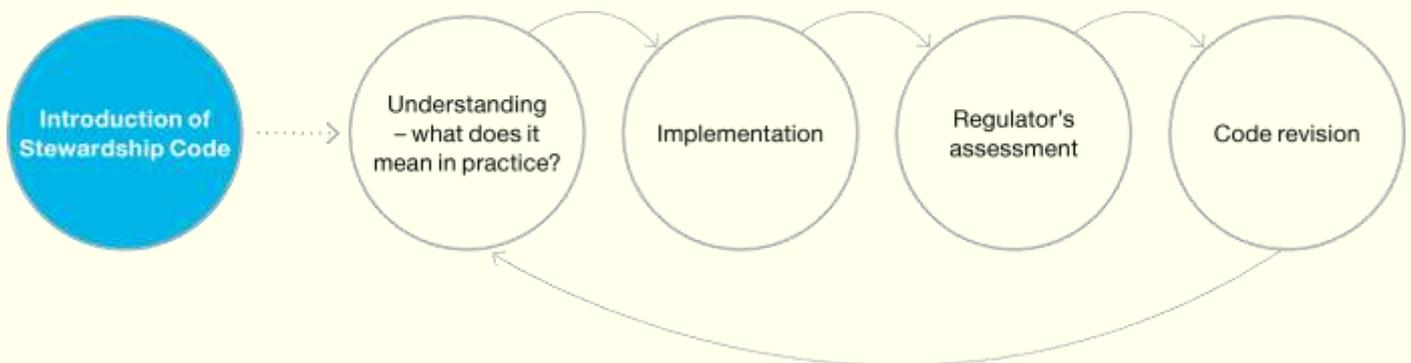
Essentially we were discussing our views on the value of stewardship, with the goal of helping all market participants build their understanding of what ‘stewardship’ means and how to implement the principles of the various stewardship codes now prevalent in the area. It was education for them, and for us.

It is worth remembering that the first stewardship code was only introduced in the UK in 2010. Of course, the term has been used in the context of nature and the environment, economics, property and theology, so it isn’t ‘new’. However, its introduction to mainstream investment management language has happened quickly so it is not surprising that it isn’t always well understood.

Stewardship should really be thought of as a journey – the introduction of a Stewardship Code is simply step one. The industry then needs to understand what stewardship means, start to implement it, and understand the benefits (primarily qualitative). The loop completes and starts its second rotation with a regulatory review, assessment and potentially code revision. We have had regulatory assessment in the UK.

In 2007, when we first visited Japanese companies with corporate governance as an explicit agenda item, there was no expression for ‘corporate governance’. There have been many developments since that time. We now have corporate governance and stewardship codes, and we have begun to see board restructuring and diversification. In addition, many more companies have introduced return on equity (ROE) targets and have formulated capital strategies. More companies are also producing documentation in English. Progress is being made but, if we are to see real advances, we need culture change. That will take time. For many companies, developments will come when management are replaced and with board turnover – generation change. A lot has happened since 2007, and if we see the same focus on governance structures, professionalisation of key corporate positions such as chief financial officers and independent non-executive directors, and efficient use of capital, the Japanese market will be better positioned for continued growth. I don’t think it’s too controversial to say we won’t see mind-sets alter until we have generation change within senior management and corporate boards.

There are many different reasons for a country to introduce a stewardship code. In the UK the regulators were responding to the criticism about the role institutional investors played in the lead up to the financial crisis. Consequently, the aim was to increase oversight and time horizons, and to control risk. By contrast, in Japan it was about *increasing* companies’ tolerance to risk.



In Taiwan, the driver was ensuring that governance and stewardship standards are aligned with global best practice. The Stewardship Code was introduced in 2016 and so industry participants are very much at the start of the stewardship journey, although very keen to progress.

Unlike Taiwan, South Korea is a market where there are some governance challenges. Indeed chaebol reform was at the forefront of the South Korean presidential campaign in May 2017 following corruption scandals and the exposure of connections between corporates and politics. The pro-reform candidate, Moon Jae-in, was elected as president and time will show the speed and extent of reform. The Stewardship Code was introduced at the end of 2016. Clearly, South Korea is at the very start of the stewardship journey.

The political environment is important for the development of stewardship in Asia. Whether it is Prime Minister Abe in Japan promoting governance and stewardship reform as part of his ‘third arrow’ of corporate competitiveness reforms; a response to South Korea’s corporate governance challenges; or conforming to best practice, political will can help expedite regulatory changes. But it is not divorced from the cultural environment which can take longer to evolve. For real change in Japan we are probably waiting for generational change and in South Korea reform will be a tough task given the historical success of the chaebols and the role they played in the country’s rise as an industrial giant.

We are enthused by the broad spectrum of developments globally as we see this as a move towards moving into line with our own philosophy of long-term investment and good stewardship.

Politics has also been a feature in US ESG recently, with President Trump ending the speculation by announcing that the US would withdraw from the Paris Climate Accord. There have been more conversations about climate change and environmental matters in the US recently, and we feel that the conversations are continuing, despite the political environment.

This topic of conversation is likely to run, and we will continue to monitor the story. However, if you have any questions as to how we are thinking about the risks and opportunities associated with climate change in your portfolio please ask the question.



Taroko Gorge, Taiwan.

Voting Activity

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	19	Companies	6	Companies	2
Resolutions	239	Resolutions	18	Resolutions	4

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In Japan, progress is being made but, if we are to see real advances, we need culture change. That will take time. For many companies, developments will come with management and board turnover

The drivers of stewardship in Taiwan and South Korea were very different. Taiwan aimed to incorporate 'best practice' into governance, while the introduction in South Korea came amid corporate and political governance challenges

Firmwide Company Engagement

Engagement Type	Company
AGM or EGM Proposals	Intuitive Surgical Inc., Kering S.A., Rocket Internet SE , Tesla Motors Inc.

Notes on company engagements highlighted in blue can be found in this report. Notes on other company engagements are available on request.

Company	Engagement Report
Rocket Internet SE	<p>Rocket Internet is a venture capital firm specialising in the incubation of start-ups. Ahead of the company's Annual General Meeting, we had a call with the CFO to discuss amendments proposed to Rocket's stock option plan. Our conversation focused on granting the Board more flexibility to alter the terms of the plan in exceptional circumstances. We understand that this type of discretion is standard practice and can be used to attract and retain talent. However, we believe that in return there should be a commitment to disclose its utilisation to shareholders. We therefore explained that we would support the amendments if there was such a commitment. The company confirmed later that this would occur.</p>
Tesla Motors Inc.	<p>Ahead of the 2017 annual meeting, we had a conference call with the CFO Deepak Ahuja and General Counsel Todd Maron to discuss the proxy agenda, and in particular the shareholder proposal requesting the declassification of the board of directors. While a declassified board is often perceived as best practice and in the interests of shareholders, we disagreed with the proposal's sponsor that it is the right time to initiate this change. We think it is important to consider Tesla's governance practices within the broader context of its stage of development and how it can support the delivery of its long-term strategy. Firstly, we believe Elon Musk's substantial personal investment in Tesla provides good alignment with shareholders' interests and his long-term ambitions for the company will benefit all stakeholders. Secondly, the existing Board has overseen a strong track record of delivery, often at times of significant operational challenges. It has also facilitated several key decisions which we believe will contribute to Tesla's long-term success, including the recent acquisition of SolarCity. The classified Board structure has enabled this process by allowing the company to avoid distractions and focus on its strategic objectives. Furthermore, we have been encouraged by the company's openness to engagement and have had consistent communication with regard to the Board's efforts to develop its governance practices. In the long-term the company has acknowledged that its Board composition will evolve as the business matures. This will include the transition to a declassified structure and a refreshment of its directors. However, during an ongoing period of rapid development at the company we are satisfied that the existing Board structure remains appropriate and therefore opposed the shareholder resolution. The proposal was defeated with approximately 70% of shareholders voting against it.</p>

Votes Cast in Favour

Company	Meeting Details	Resolution(s)	Voting Rationale
Netflix Inc	Annual 06/06/17	10	We supported a shareholder proposal regarding majority voting for director elections, in line with our Global Proxy Voting Guidelines.
Netflix Inc	Annual 06/06/17	5	We supported a shareholder proposal regarding proxy access, in line with our Global Proxy Voting Guidelines.
Netflix Inc	Annual 06/06/17	6	We supported a shareholder proposal regarding sustainability reporting, in line with our Global Proxy Voting Guidelines.
Companies		Voting Rationale	
AIA Group, ASM Lithography, Amazon.com, Atlas Copco A, Facebook, Hermes International, Illumina, Intuitive Surgical, Juno Therapeutics Inc, Kering, L'Oreal, NVIDIA, Netflix Inc, Rocket Internet SE, Salesforce.com, Seattle Genetics, Tencent, Under Armour Inc Class A, Workday Inc		We voted in favour of routine proposals at the aforementioned meeting(s).	

Votes Cast Against

Company	Meeting Details	Resolution(s)	Voting Rationale
Kering	MIX 27/04/17	E.16-E.18	We opposed three resolutions which sought authority to issue equity because the potential dilution levels are not in the interests of shareholders.
Kering	MIX 27/04/17	O.10	We opposed the remuneration of the Vice-CEO due to concerns regarding the payment of extraordinary awards.
Netflix Inc	Annual 06/06/17	8	We opposed a shareholder proposal to declassify the board as we are satisfied that the current board structure is appropriate.
Rocket Internet SE	AGM 02/06/17	9, 10	We opposed two resolutions which sought authority to issue equity because the potential dilution levels are not in the interests of shareholders.
Companies		Voting Rationale	
Amazon.com, Facebook, Netflix Inc, Salesforce.com		We opposed a shareholder proposal which is too prescriptive.	

Votes Abstained

Company	Meeting Details	Resolution(s)	Voting Rationale
Kering	MIX 27/04/17	E.13, E.15	We abstained on two resolutions which sought authority to issue equity because the potential dilution levels are not in the interests of shareholders.
Kering	MIX 27/04/17	O.8	We abstained on the Remuneration Policy due to concerns regarding the alignment between pay and performance. We will be continuing our engagement with the company.

Voting

Report for the quarter ended 30 June 2017

Company	Meeting Details	Resolution(s)	Voting Rationale
L'Oreal	MIX 20/04/17	E.11	We abstained on the resolution which sought authority to issue equity because the potential dilution levels are not in the interests of shareholders.

Votes Withheld

We did not withhold on any resolutions during the period.

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