

*Governance – that is to say, management, people, their values, time horizons, relationships and attitudes – is integral to the decisions companies make.*

These decisions influence not just environmental and social performance but capital allocation, remuneration structures, relationships with external stakeholders and attitudes towards minority shareholders.

Whilst each of these ‘pillars’ should not be considered in isolation or without the understanding of the relevant governance structures, we will explore the social and environmental performance of two holdings within your portfolio here.



When assessing any (potential) investment from a corporate governance perspective, we look for areas of material risk to the business. For the clothes retailer Inditex, the garment supply chain and sustainability thereof is a considerable risk, given the reputational damage associated with any failure. Failures could range from the use of child labour, factory collapse or the use of water and toxic chemicals.

More than two years ago, the press was awash with news of the horrific garment factory collapse in Bangladesh which killed more than 1100 workers. Following this incident, scrutiny of the garment supply chain has increased. As part of a much broader sector review, our Corporate Governance team has been engaging with Inditex management on the company’s supply chain policies.

One element of this wider project was to visit Bangladesh and Burma to see first hand the inner workings of these garment factories and the challenges that exist for the clothing brands. Inditex is especially attractive as its supply chain is predominantly based in Northern Europe; the close proximity to HQ allows management to exercise tight control. As such, the company has little exposure to Bangladesh but, despite this, management have been very responsive and have maintained an open dialogue with us on the subject.

Our initial broad discussions with Inditex management indicated that their disclosures with regards to their supply chain policies and management could be more specific and detailed. The company provides a lot of information; the difficulty was reconciling the detail and extracting a clear picture of how the company manages the challenges associated with the supply chain on a day-to-day basis.

Subsequent conversations, with the Head of Corporate Responsibility and the management team, have been wide ranging. We have discussed broad industry issues, such as the increased number of factory fires, and reviewed specific elements of the company’s ongoing efforts to improve its social and environmental performance.

Inditex is a global retailer and it recognises its responsibility to be at the forefront of improving standards in the supply chain. This is important for the long-term sustainability of the business and all decisions taken by management are made with the long-term view in mind. We are confident that Inditex’s vertically integrated supply chain incorporates all of the necessary relevant controls, audit procedures and improvement plans. Inditex’s supply chain is without doubt one of the company’s greatest strengths.

Inditex has been held in the portfolio for five years and over that time we have strived to build a good relationship with the company. Our efforts are rewarded with the opportunity to have these types of in-depth conversations on supply chains and to discuss the hard work undertaken by management in an effort to remain at the forefront of the industry.

Tesla has been in the portfolio for half that time and, whilst we are taking great strides forward in our engagement with management, it is still early days. After all, we expect Tesla to be a holding in the portfolio for many years to come.

Tesla CEO Elon Musk’s ultimate ambition is to move energy consumption away from fossil fuels towards renewable energy. To achieve this ambition, the focus so far has been on electric vehicles, storage batteries and solar power. Tesla is obviously directly involved with the first two and it is the battery technology and the depth of intellectual property which have provided a competitive advantage. We recently toured the Tesla factory to gain a greater insight into the batteries which have significantly improved the range for electric cars and are poised to upset the traditional utility companies.



Whilst Zara remains the most well-known, other brands in the Inditex portfolio include Bershka, Pull & Bear and Lefties, a budget clothing retailer.

Cars go past a Lefties store in central Madrid, 12 March 2014.  
© JUAN MEDINA/Reuters/Corbis



Guest poses with the Powerwall unit after Elon Musk, CEO of Tesla unveiled suit of batteries for homes, businesses, and utilities at Tesla Design Studio, 30 April 2015 in Hawthorne, California.

© Getty Images North America

Stationary battery demand has so far astonished the Tesla management team and in the long run could be a larger and more profitable business than automotive. Consequently, they are working out how to scale much faster than they had anticipated. Management’s internal projections for demand are far, far in excess of anything any external analyst has envisaged. Commercial and utility projects are likely to be the main source of the initial demand.

President Obama’s announcement of the revised Clean Power Plan (CPP) in August supports Tesla’s projections. One of the CPP’s aims is to cut carbon emissions from the power sector by 32% by 2030, compared with 2005 levels. Carbon pollution reduction goals have been set out for power plants and must be complied with by 2022. Hundreds of companies and investors have voiced their support for the CPP. Additionally, the Environmental Protection Agency has announced draft rules to reduce methane emissions from the oil and gas industry, in line with President Obama’s Climate Action Plan to cut methane emissions from the sector by 40%–45% from 2012 levels by 2025.

Inditex and Tesla operate in very different industries but they are similar in many ways. Most importantly, they are both leaders in their respective fields. However, we have discussed only the social and environmental merits of these companies and, as highlighted at the beginning of this article, it is important not to consider each in isolation. Both these companies have a place in your concentrated portfolio, not because of social or environmental merits but because of the long-term opportunities available to them, their strong competitive advantages and our confidence in the management’s ability to execute.

Should you wish further information on our corporate governance policies and procedures, please visit our website or speak to your Baillie Gifford representative.

**Voting Activity**

Votes Cast in Favour		Votes Cast Against		Votes Abstained/Withheld	
Companies	4	Companies	1	Companies	None
Resolutions	66	Resolutions	1	Resolutions	None

Governance is integral to the decisions that companies make and it impacts many aspects of social and environmental performance

Scrutiny of the garment supply chain has increased and our engagement with Inditex continues

Tesla's battery technology has improved the range for electric vehicles and is poised to upset traditional utility companies. The environmental benefits could be considerable

**Firmwide Company Engagement**

Engagement Type	Company
Corporate Governance	Hermes International, L'Oreal
AGM or EGM Proposals	Burberry Group

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

**Votes Cast in Favour**

Companies	Voting Rationale
Burberry, HDFC Corp, Inditex, Whole Foods Market	We voted in favour of routine proposals at the aforementioned meeting(s).

**Votes Cast Against**

Companies	Voting Rationale
Whole Foods Market	We opposed a shareholder proposal which is too prescriptive.

**Votes Abstained**

We did not abstain on any resolutions during the period.

**Votes Withheld**

We did not withhold on any resolutions during the period.