# Responsible Global Equity Income

## Stewardship Report

For the year ended March 2023

BAILLIE GIFFORD | Investment managers

## Risk factors

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

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### Potential for profit and loss

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### Stock examples

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# Highlights of the year

### Investment decisions

We took new holdings in four companies we believe can compound earnings and dividends over the long term and have strong environmental, social and governance (ESG) credentials: L'Oréal, Coloplast, Cognex and Intuit. We sold out of positions in some companies, including C.H. Robinson, in part due to corporate governance-related concerns.

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### Constructive engagement

Over the year, we engaged with 37 holdings to encourage management to accelerate change and improve governance and sustainability performance.

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### Learning from academia and experts

The Responsible Global Equity Income (RGEI) Team engaged with non-profit organisations and other third-parties to inform our engagements and deepened our partnership with the Smart Freight Centre.

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### Progress on climate

Following last year's Net Zero Asset Managers initiative commitment, there was a marked increase in portfolio alignment with the Paris Agreement's goals this year, from 40 per cent to 51 per cent. We also published our inaugural Task Force on Climate-related Financial Disclosures report.

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### Focus on company culture

A key component of our investment and ESG analysis is seeking to understand company culture and how it influences employee motivation.

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### Resolutions and voting

We voted on 821 resolutions across our portfolio holdings. On 52 occasions, we voted in opposition to management's recommendation, where we felt the company's position fell short of our expectations.

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# Introduction

*After the remarkable ascent of environmental, social and governance (ESG) investing over the past few years, it has become a contentious subject and the focus of tougher regulation.*

With myriad investment approaches increasingly using the term, it is perhaps no wonder regulatory bodies began to intervene. The flexibility of its meaning and consequential broad application – an ingredient in the field's rapid growth – has been the foundation of many of the criticisms and misunderstandings about ESG. Some have even proclaimed 'the end of ESG'. However, for those with long-term investment horizons, integrating ESG factors should, in theory, not be especially noteworthy, as, "considering long-term factors when valuing a company isn't ESG investing; it's investing"[1]. Responsible Global Equity Income subscribes to this school of thought, and in this year's Stewardship Report we hope to demonstrate to you why.

ESG considerations are vital lenses through which we calibrate our understanding and conviction in whether companies can compound earnings and dividends over decades. Considering a company's sustainability and governance profile is, in our view, part of our fiduciary duty. We own, and are searching for, companies with genuinely sustainable business models that respect, and in many cases benefit stakeholders. Companies that we believe will grow our clients' capital and income sustainability over decades. These matters are, consequently, integral to our investment decision-making.

Regardless of the debates, there have been some significant developments in the past year. The International Panel on Climate Change released the synthesis of its sixth report. Although it outlines the rapidly closing window to effect change, it also asserts that we have the solutions, tools, technology and finance available – to limit warming and deliver necessary emissions reductions.

What may come to be seen as the most significant development of 2022, however, could be the passing of the Inflation Reduction Act in the United States, comprising $369bn of funding for the energy transition and heralds a new era of global competition in clean technology. For our part, the Responsible Global Equity Income portfolio has progressed this year towards its net zero alignment commitment, announced last year. We are pleased to share more in *Climate change: an update on portfolio progress* on pages 21–23.

COP15, or the 2015 UN Biodiversity Conference, ended with a historic agreement, the Kunming-Montreal Global Biodiversity Framework. It sets out four goals, with 23 targets to be reached by 2030, marking a crucial step towards halting nature loss. This year, we reviewed the Taskforce on Nature-related Financial Disclosures (TNFD) beta frameworks and participated in a pilot led by the United Nations Environment Programme's Finance Initiative (UNEP-FI). You can read more on page 18.

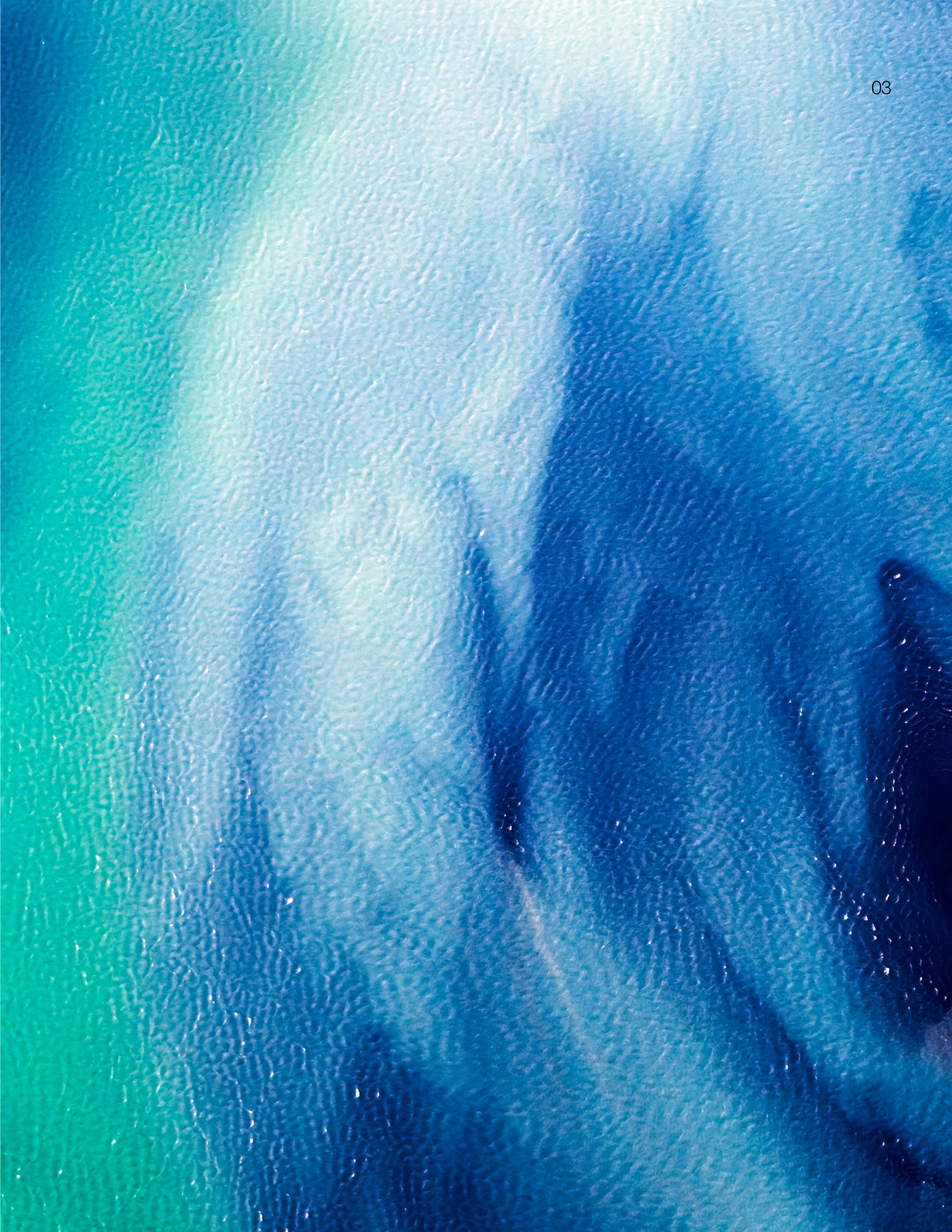
As a strategy, we have deepened our relationship with the Smart Freight Centre, a non-profit focused on reducing greenhouse gas emissions from freight transportation. We also furthered our approach in seeking independent, expert insights to inform our research better. We believe doing so is not only differentiated, but also improves our chances of reaching positive engagement outcomes for clients. You can read more on this year's activities in *Constructive engagement: alternative insight from independent experts* and of our wider engagement activities across pages 9–18.

We put significant effort into seeking to understand company culture. What makes somewhere a 'good' place to work? How do the organisational structures and incentives used to motivate employees increase the likelihood of a company overachieving over the long term? As the world of work increasingly changes, thinking about these issues and how they affect our investment cases becomes ever more critical. You can read about our thinking in *Finding the best companies: a study in employee motivation* on pages 24–25.

The report concludes with a summary of our voting activities; outlining our approach and highlighting a selection of instances where we have escalated our positions on various issues or voted against management. You can read more in *Voting: taking a thoughtful approach* on pages 26–27.

We hope you find this year's Stewardship Report an informative read.

[1]Edmans, Alex. 2022. The End of ESG. Financial Management. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4221990.



# Our approach to investment: allocating capital responsibly

*As investors, we seek companies that can compound their earnings and dividends at attractive growth rates for many years to come. Many of our clients also want these investment objectives to be met with a portfolio that excludes certain types of business and sets a high bar for inclusion in terms of ESG factors.*

We are confident Responsible Global Equity Income (RGEI), which is part of our Global Income Growth Strategy, can meet these needs for three reasons:

### 1. Finding sustainable long-term growth

We have a long and successful track record of identifying companies that can deliver both sustainable real growth and resilient dividends in our Global Income Growth Strategy.

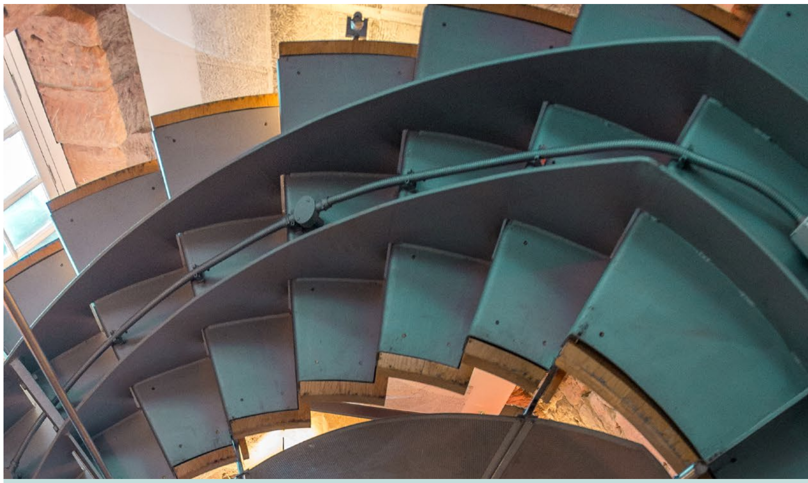
### 2. Fully integrating ESG considerations

Sustainability considerations are fully embedded into our stock picking process through our Impact – Ambition – Trust (IAT) assessments, which draw on the dedicated input of our ESG analyst. No new holding is purchased without one and following assessment we exclude companies we believe: cause significant net harm to the environment, society and wider stakeholders; do not acknowledge their impacts; exhibit poor corporate governance or have a management team we cannot sufficiently trust.

To provide additional comfort for clients, we apply two further types of exclusion to the portfolio: companies that sell certain harmful products and those we consider operate outside the ten principles of the United Nations Global Compact. Furthermore, our ESG analyst holds a right of veto.

### 3. Responsible ownership, stewardship and engagement

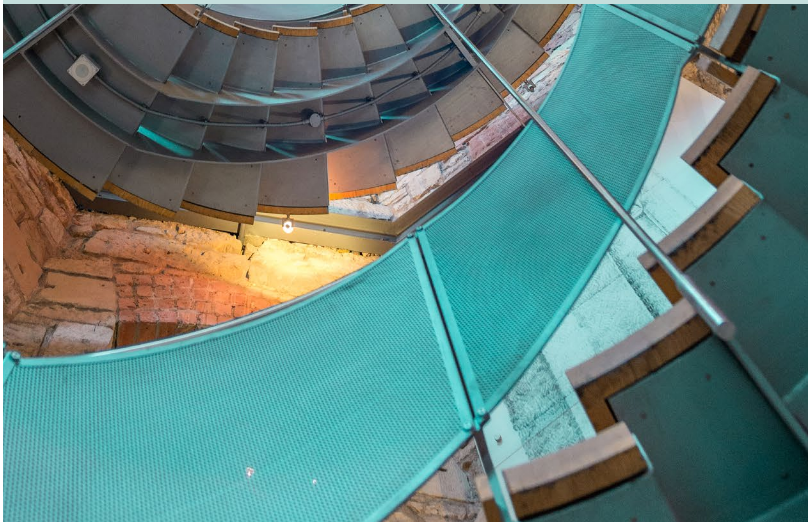
Many sustainability matters are complex, multi-dimensional and challenging for individual companies to overcome alone. Therefore, we engage with our holdings in a constructive, targeted way to help them address material sustainability challenges and support them on their journey.



## Impact – Ambition – Trust

Our proprietary, forward-looking sustainability assessment *Impact - Ambition – Trust* is core to RGEI's investment process. The purpose of this assessment is to judge the:

- **Impact (operations)**, positive or negative, of a company's operations on the environment, society and wider stakeholders;
- **Impact (products)**, positive or negative, of a company's products on the environment, society and wider stakeholders;
- **Ambition** a company has to either address, if negative, or further, if positive, these impacts;
- **Trust** we have in the company's management team and the board to deliver on our expectations around sustainability and governance matters.



# New investments

In previous Stewardship Reports, we have spoken of our IAT assessment. It provides a thoughtful, consistent and replicable framework that fully integrates ESG considerations into our investment process. In the past year, we took new holdings in four companies: **L'Oréal, Coloplast, Intuit** and **Cognex**. All four scored well on our IAT process, and we believe all four have strong sustainability credentials and prospects for long-term growth in their earnings and dividends. Over the following pages, we share a selection of short summaries of these IAT assessments.



## L'Oréal

A global leader in the beauty industry, L'Oréal requires little introduction. Over the years ahead, we expect the company to continue compounding its revenue and earnings ever-higher, underpinned by market growth, market share gains and steady margin improvement. L'Oréal does not require a great deal of capital investment to grow earnings, which means the company can afford to pay a growing and resilient dividend. We invested last year at what we believed was an attractive valuation and expect it to be a longstanding holding for the portfolio.

**Impact – operations:** neutral

L'Oréal has a significant carbon footprint across numerous areas, with its operations contributing to pollution, water use, waste generation, chemical use and the extraction of natural materials. We believe the company has a strong track record in working to reduce its contributions to these impacts through its use of lifecycle assessments, alongside innovating new technology for improved outcomes. However, the nature of its industry means there currently remains an inherent environmental impact. We recognise the importance of responsible marketing and advertising practices in the beauty industry. While we believe L'Oréal currently behaves responsibly in this regard, we see this as an important area for our continued monitoring. Historically, L'Oréal has been subject to allegations of a problematic working culture, with concerns about excessive hours and gender discrimination. Consequently, we undertook extensive research into this area, speaking with 17 former employees. What we heard left us confident that L'Oréal's culture has adapted significantly for the better in recent years and, while not perfect, produces unparalleled levels of dedication and passion from employees.

**Impact – products:** neutral

L'Oréal provides an extensive product range that benefits consumers daily. The nature of these products, however, means that we consider these benefits not to be overly significant to the environment, society and wider stakeholders.

**Ambition:** leader

The company's 'L'Oréal for the Future' strategy contains comprehensive, ambitious goals in the material areas of climate, packaging and green chemistry. Notably, it also navigates the company towards 'regenerative' business practices. Of most note, though, is L'Oréal's ambition and willingness to bring its entire industry with it. Examples of initiatives it has helped establish include the Responsible Mica Initiative, the Sustainable Packaging Initiative for Cosmetics (SPICE) and developing the Sustainable Product Optimisation Tool (SPOT) to assess the environmental/social impact of cosmetic products across the design, production and packaging stages.

**Trust:** full

We are longstanding admirers of management, and the company's anchor shareholder, the Bettencourt-Meyers family, increases our trust that management will remain focused on long-term success. The company has also been at the vanguard of its industry regarding sustainability performance and innovation for over a decade, delivering on goals and providing us confidence that the company is committed to responsible operations and appropriate treatment of its stakeholders.

## Coloplast

Coloplast makes essential products for patients with chronic ostomy and continence needs. As its new products come to market in the years ahead, and as the company continues to expand its reach in the USA (where it is currently under-represented), we expect to see its revenues, profits and dividends compounding higher. We also expect its profits and dividends to prove resilient across economic cycles.

**Impact – operations:** neutral

Our interactions found an uncompromising approach to continuous product improvement focused on end-user satisfaction. We also see a strong focus on cultivating a positive company culture. The company's strategic push on data and digital tools means we hope to see more evidence of a focus on managing cybersecurity risk.

**Impact – products:** developing

Coloplast's products help customers manage intimate healthcare conditions reliably and discretely, enabling them to confidently return to a more normal way of life without anxiety about their medical conditions. We note historic litigation against the company relating to the safety of a transvaginal mesh product, but we believe the company has responded honourably and appropriately. We also believe Coloplast will continue to be a leader in its segments, driving forward innovation seeking to address unmet medical needs and improve the standard of care for patients.

**Ambition:** leader

The company has ambitious, wide-ranging sustainability targets, and demonstrates evidence of initiative and considered analysis of how best these should be achieved. For instance, it has a limit that only 5 per cent of the products may be shipped by air freight and has ambitious scope 3 emission reduction targets. Its products undergo lifecycle assessments to help the company learn how to further minimise the environmental impact of their manufacture, use and disposal.

**Trust:** high

The company demonstrates a strong track record of managing its material sustainability impacts, and governance of this strategy involves executive-level oversight. The Louis-Hansen family's position as a strategic shareholder gives us confidence that the company is managed for the long term. We have taken confidence from several conversations across various levels of management that Coloplast invests in and nurtures its company culture.

## Intuit

Intuit earns revenue from its online accounting service for small businesses and online consumer tax service. Over the next several years, Intuit's online services will add more functionality. As the company collects more customer data, it will be in an ever-stronger position to develop these services into a compelling financial platform for small businesses and households. In turn, we expect the business to attract more customers, who are likely to spend more money on Intuit's services. We expect this to lead to strong revenue and profit growth at Intuit for years to come. We believe Intuit's dividend will be resilient through periods of economic stress, thanks to the cash-generative nature of the business and a healthy balance sheet.

**Impact – operations:** neutral

Intuit's operational impact on the environment and society is minor as an accounting software business. Data privacy and cybersecurity are key risks, but systems and oversight appear robust. We note Intuit's Prosperity Hubs seek to generate jobs in underserved regions – and an external review found they had helped generate $102m in economic activity. The company's past marketing practices, for which it received a federal fine, somewhat offset these positives and is an area where we will be doing further work.

**Impact – products:** developing

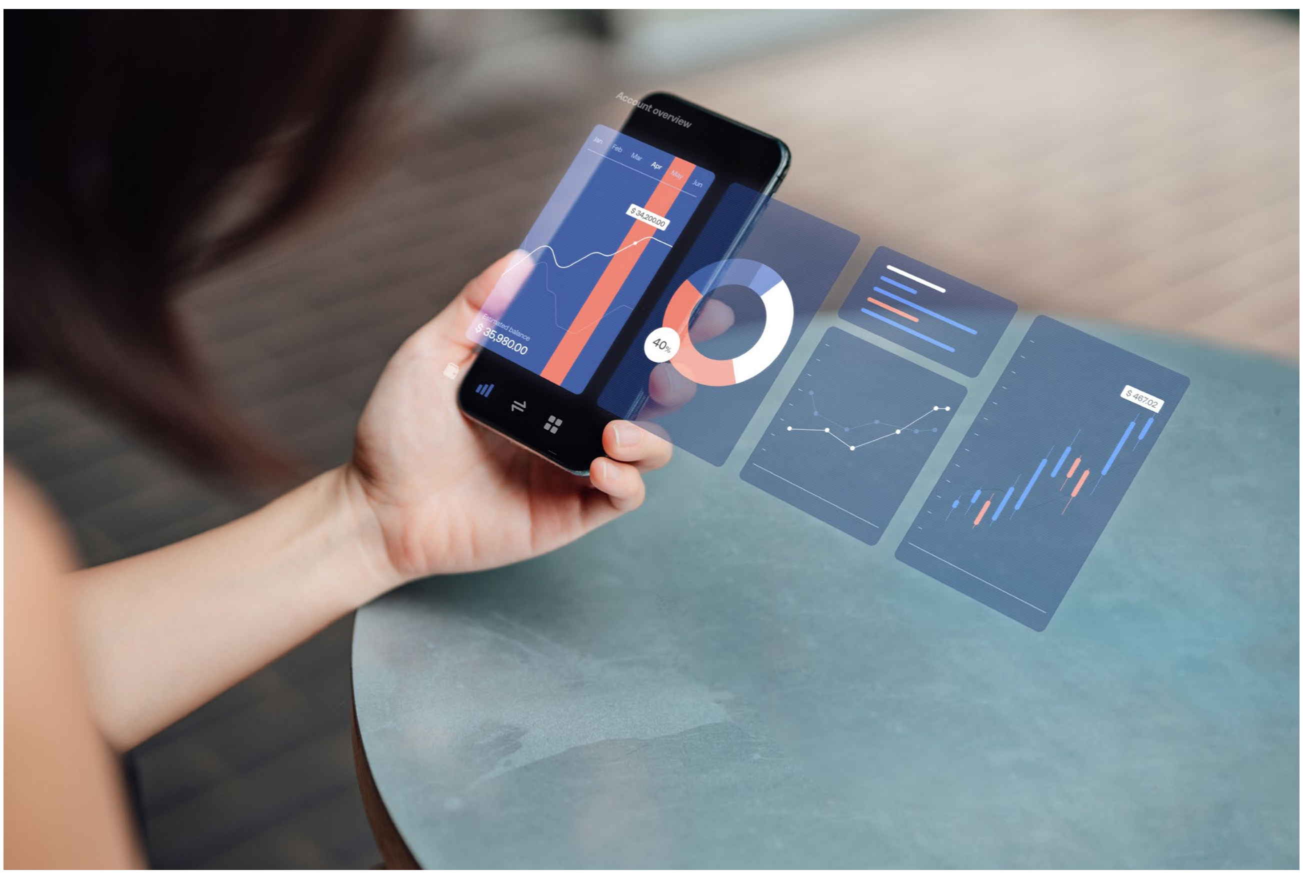
Intuit's product suite makes bureaucratic tasks straightforward, freeing entrepreneurial resource for other productive uses. The company's 'Climate Action Marketplace' demonstrates it using its influence to support small-and medium-sized enterprises – who often lack the expertise and resources – to take steps to reduce their carbon footprints.

**Ambition:** leader

Intuit became carbon neutral in 2015 and has since adopted system-wide targets (such as an ambition to remove 50x its 2018 carbon footprint by 2030). Prosperity Hubs have ambitions to create 10,000 jobs in underserved communities by 2024.

**Trust:** high

Before purchase, several conversations with the top tier of management and sustainability leads emphasised the company's 'obsession' with its customers. Both company management and the board possess strong teams of experienced individuals, and we believe the board is committed to dividend growth.



## Cognex

Cognex is a leader in machine vision technologies, helping solve some of the most challenging problems in automation. The company has a differentiated culture that has been attractive to engineers. We think its leadership in this growing industry will translate into substantial revenue and profit growth over the coming years, which will translate into strong dividend growth.

**Impact – operations:** neutral

We believe Cognex's operational environmental impact to be modest. Its contract manufacturing model and a fire at its sole inventory storage facility in Indonesia led the company to work towards adding other locations, reducing the risk of supply chain disruption. Before investment, we spoke with numerous former employees, and our discussions confirmed that Cognex's company culture is highly distinctive, leading to a highly motivated workforce. We believe this will benefit the company and its voluntary attrition rate sits significantly below its industry average.

**Impact – products:** developing

Some of the benefits of machine vision in manufacturing include: product quality improvements and assurance process simplifications; reduced Occupational Health and Safety risk for human employees; less incidence of production faults/defects through early detection; lower emissions intensity of manufacturing, among others. In sum, Cognex's products will improve resource efficiency and enable greater automation in an increasingly wide range of industrial contexts.

**Ambition:** follower

The company has only recently begun to report and disclose sustainability matters, yet we do not believe that this signifies the company has historically ignored such issues. The company acknowledges its disclosures are behind the curve. But we believe its reporting and strategy setting approach will improve how it tackles its key material sustainability issues. We intend to engage with the company in the coming years, working with management to share our views on best practice.

**Trust:** neutral

We recognise strengths in the company's distinctive culture but acknowledge some areas of concern. The company is professionalising its board and other corporate governance structures as it enters a new chapter following the departure of its founder. Given these ongoing changes and the lack of historical disclosure from which to gauge the company's delivery on previous ESG goals and commitments, we are currently withholding judgement. However, expect to see improvements in our assessment over the duration of our investment.

# Divestments

Partially funding these new investments were several sales. Noteworthy among these was our sale of C.H. Robinson.

Further sales over the year included: Hiscox, National Instruments, Silicon Motion, Cullen/Frost Bankers and Linea Directa. All had performed well in their respective IAT assessments and, we believe, had continued to operate responsibly throughout our ownership. Divestment primarily reflected investment considerations rather than any concerns about ESG performance. We also divested from Haleon following its demerger from GSK.

We believe these investment decisions are consistent with a responsible investment philosophy and have improved our portfolio's earnings and dividend growth sustainability.

## C.H. Robinson

The North American truck broking company, which helps buyers of freight reliably get their goods to market, has faced an increasingly competitive market. That has led to margin pressure. Over the year, we took the opportunity to meet with the company in Minnesota. Following up on our engagement with the company in 2019, where we discussed the company's work on carbon emissions optimisation for customer orders, and how it considered its role in supporting its customers in decarbonising their shipping routes, we also requested a demonstration of its new digital platform 'Emissions IQ'. We left unenthused about the platform, the company's investments in technology and, more generally, the outlook for the company. Furthermore, an activist investor appointing several directors to the board damaged our trust in the company's governance and our confidence that decisions would be taken with a long-term mindset.

# Constructive engagement: alternative insight from independent experts

Building lasting, positive relationships with management at portfolio holdings is an essential aspect of our engagement approach. As long-term, active investors, we are in the privileged position of allocating capital, time and support to companies helping to drive positive outcomes around the world. Similarly, we recognise a responsibility to, where necessary, challenge those who we believe can do more and escalate our engagement should we not see improvement. The whole Responsible Global Equity Income (RGEI) Team is involved in the stewardship of our holdings. Engaging with companies in a supportive manner on the issues that matter and voting thoughtfully are our most effective levers through which we can support management to deliver long-term, sustainable investment performance. Our engagement activities are underpinned by Baillie Gifford's Stewardship Principles, which you can read more about on our website at: https://www.bailliegifford.com/en/uk/individual-investors/about-us/esg/

## Baillie Gifford's Stewardship Principles:

- Prioritisation of long-term value creation
- A constructive and purposeful board
- Long-term focused remuneration with stretching targets
- Fair treatment of stakeholders
- Sustainable business practices

Another key tenet of RGEI's approach is seeking alternative sources of insight in our ESG-related research to help inform how we engage with holdings. Baillie Gifford has a long and proud history of partnering with academic and other subject-matter experts. Doing this provides us with insights that inform better investment decisions, thereby enhancing outcomes for our clients.

In our ESG research, the RGEI Team seeks to inform and calibrate our assessment of a company's material sustainability risks and opportunities, as well as the relative ambition in mitigating and capitalising on these, through engaging and forging relationships with subject matter, independent experts and non-governmental organisations (NGOs). We also often undertake research seeking to understand company culture – particularly those we hope to better understand – by interviewing individuals with first-hand experience.

Over the following pages, we share a selection of examples from the portfolio over the year to 31 March, alongside a selection of our wider engagement activities with holdings worldwide.

## 1 **Microsoft:** engaging with Ranking Digital Rights, a leading NGO, before engaging with the company on data privacy and artificial intelligence (AI).

**Assessing**

Fair treatment of stakeholders

Outcomes

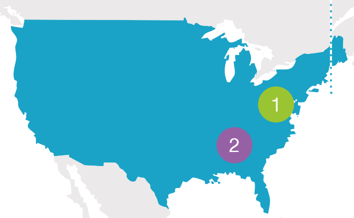
Collaboration

Voting

**Objective:** We engaged with Microsoft to understand its approach to data privacy and ethical AI, as we believe these to be ESG risks that could significantly impact Microsoft's long-term business prospects. Before our engagement, we spoke with leading experts internally and Ranking Digital Rights externally to discuss and learn what best practice is.

**Discussion:** We joined an engagement call with the Chief of Responsible AI at Microsoft, Natasha Crampton, that provided insights into the rules, processes and teams that determine AI-related decisions at Microsoft. As a subset of data privacy, this helps us understand human rights issues in development and data storage. It also offered examples of Microsoft's advocacy in regulating this space. However, while it provided evidence of independent analysis of human rights risks at Microsoft, we were not fully reassured on its management of conflicts of interest between short-term business gains and data privacy concerns.

**Outcome:** Microsoft is demonstrating a lot of leadership in the data privacy and human rights arena – its reporting, governance structures, expertise and examples of turning down government requests in order to protect customers strongly indicates a company taking its responsibility seriously. However, given how dynamic these ESG risks are, we will continue to monitor the company's approach. With Microsoft's recent investment in OpenAI and the rapid advancement of large language models, we foresee this as only the beginning of our engagement with the company on these matters. Our research and findings in this area also led us to support a shareholder resolution on the topic at the most recent company AGM.




## 2 **United Parcel Service:** leveraging our partnership with the Smart Freight Centre to escalate our engagement with UPS on its climate strategy.

**Assessing; Influencing**

Prioritisation of long-term value creation

Sustainable business practices

Collaboration

Voting

Portfolio positioning

**Objective:** This year, we stepped up our engagement with United Parcel Service on the company's climate strategy – the key sustainability challenge identified by our IAT assessment. In the run-up, we engaged with leading experts at the Smart Freight Centre to discuss our concerns surrounding the company's ground-fleet decarbonisation strategy and its lack of focus on electrification. We believe the company will increasingly feel pressure from some of its larger customers to set more robust decarbonisation targets. UPS may increasingly find itself at a competitive disadvantage if it does not demonstrate increased ambition.

**Discussion:** Over the past year, we raised this issue with UPS's chief executive officer (CEO) and sustainability leads multiple times. We sought assurances that UPS's '25 per cent renewable electricity by 2025' target will be met, querying what we perceive to be leisurely progress. We also wanted to learn more about the company's renewable natural gas (RNG) 2025 strategy for ground-fleet decarbonisation owing to methane-related issues, the possibility of growing demand from stationary sources and our belief that electrification will be the long-term solution. We outlined our wish to see a post-2025 ground-fleet decarbonisation strategy and the company adopt a 1.5C aligned climate strategy. Recently, UPS's two main data centres (its two facilities which consume the most electricity) have switched to 100 per cent renewable electricity. A dozen facilities also have self-installed solar power. This is a source of reassurance, but we continue to monitor progress.

**Outcome:** Our conversations with the company provided some confidence that it recognises electric vehicles as the long-term solution to ground-fleet decarbonisation. These will feature more prominently in the company's post-2025 ground-fleet strategy. Since our discussions, the company has begun reporting on the number of electrified vehicles in its fleet. We would not claim to have reached a point of satisfaction, so we look forward to continued engagement with the company on this issue. Over the year, we reduced our holding in the company partly owing to these concerns. We intend to escalate, as appropriate, should we not see timely improvements and, at 2022's AGM, supported a shareholder proposal requesting the company adopt a verified science-based climate target.



## 3 **TSMC:** speaking with Taiwanese academics to better understand the company's decarbonisation challenge, owing to the carbon intensity of Taiwan's grid and the direction of its energy policy.

**Assessing**

Sustainable business practices

Outcomes

Collaboration

**Objective:** We spoke with numerous researchers and academics from Taiwanese think-tanks and NGOs to understand the challenge TSMC faces in decarbonising its operations. The island relies heavily on imported fossil fuels, and nuclear power is due to be phased out by 2025. In 2021, renewables contributed just under 6 per cent to its energy mix and their expansion has been sluggish. Issues have included, but are not limited to, constrained land availability for solar and supply chain and permitting issues for wind. Given the direction of the current energy policy, Taiwan's grid will likely remain carbon-intensive for some time. Approximately 62 per cent of TSMC's reported carbon emissions come from its electricity use and much of its manufacturing takes place in Taiwan; if the company is to decarbonise, much depends on Taiwan's success in decarbonising. This is not just a moral imperative or environmental concern – some of TSMC's customers have ambitious scope 3 emissions[2] reduction targets. If TSMC cannot manufacture greener semiconductor chips, the company may increasingly find itself at a competitive disadvantage to those that can. We wanted to hear from the company about how it was addressing this challenge.

**Discussion:** In two meetings with the company this year, one with the Chief Finance Officer (CFO), we raised our awareness of the company's challenges in decarbonising its operations in Taiwan. The company recently improved its target, aiming to achieve 40 per cent of electricity consumption to come from renewable sources by 2030. The company has signed the world's largest purchase power agreement with renewable energy company Ørsted. Our estimates suggest that, even accounting for its contribution, meeting its 2030 goal will be a challenge. But there are several other examples of the company ambitiously pursuing renewable purchasing. For instance, it has been purchasing almost 98 per cent of Taiwan's renewable energy certificates (T-RECs), is self-installing renewables on new fabrication plants and supporting suppliers to purchase renewable power. We encouraged the company in its ambitions to get ahead of the curve on these issues. We have expressed our full support as long-term shareholders for the company incurring the short-term costs needed to ensure the long-term sustainability of its energy supply.

**Outcome:** Despite the constraints facing TSMC, given the nature of Taiwan's electricity grid and the direction of its energy policy, we believe the company is showing genuine ambition to decarbonise and take confidence that the company's commitment to greening its electricity supply is sincere.

2. We define scope 1, 2 and 3 emissions on page 16. Scope 3 emissions include those resulting from purchased goods and services, capital goods, employee commuting, business travel, fuel and energy-related activities, and waste generated in operations.

## 4 **Fastenal:** sharing the result of investigative research into its workplace culture with the company.

**Assessing; Influencing**

Fair treatment of stakeholders

Engagement

**Objective:** As detailed on page 24, in *Finding the best companies: a study in company culture and employee motivation*, this year, we have furthered our work to understand company culture and employee motivation by adopting both new tools and investigative research. One of these tools, Culture500, applies AI processing to Glassdoor employee reviews to rank companies across nine culture dimensions. On assessing portfolio companies' Culture500 scores, Fastenal's poor ranking in two cultural dimensions led us to undertake a wide-ranging investigative study, interviewing eleven former employees. We engaged with the company, sharing our report with senior management, to discuss its findings.

**Discussion:** A broad discussion with the CEO covered the company's approach to diversity and inclusion, its human resources structures, employee benefits and its approach to hiring and promotion. It was encouraging to hear that the company was improving practices, such as implementing a whistle-blower hotline and the company's recognition of the importance of diversity in its talent pipeline. We were further encouraged to hear that the company will relay our work to its new Vice President of Human Resources.

**Outcome:** Fastenal's decentralised structure and highly competitive culture have been important factors in the company's success, but they also contributed to some stakeholders feeling a sense of unfairness. While we do not believe the company's approach and human resources structures pose a material risk, we do recognise Fastenal's culture to be a potentially challenging one for some stakeholders and will continue to monitor the company's progress in professionalising its processes and structures.

## 5 **Procter & Gamble:** engaging to understand the company's ambition on sustainable palm oil sourcing.

**Assessing**

Sustainable business practices

Engagement

**Objective:** This year, we undertook a thematic audit to identify best practice, assess current holding performance and key requests for improved performance with regard to sustainable palm oil across the portfolio. We gleaned insight from conversations with attendees at Roundtable for Sustainable Palm Oil's (RSPO) European Sustainable Palm Oil Dialogue, engagement with experts at Global Canopy, a leading NGO working to address commodity-driven tropical deforestation, and WWF. In a meeting with Procter & Gamble (P&G), we discussed our assessment of its commitments and RSPO palm oil sourcing levels.

**Discussion:** At the company's headquarters in Cincinnati, we queried what appeared to be lagging progress towards P&G's sustainable palm oil sourcing commitments from its Processing and Trading division. This is largely due to there being less availability of sustainable palm kernel oil, compared to the more widely available sustainable palm oil (where P&G's Consumer Goods division has achieved 100 per cent RSPO sourcing). P&G is working to stimulate greater supply of sustainable palm kernel oil. More generally, P&G's palm oil sourcing strategy adheres to many of the features our research led us to believe are 'best practice'. These include field and desk auditing, third-party auditing and plantation inspections, grievance mechanisms with disclosures and cessation of agreements with suppliers found to contravene company policies. P&G's independent smallholders programme is a further initiative we are encouraged by and one we hope to see achieve significant impact.

**Outcome:** At a high level, it was positive to hear P&G is strategically prioritising environmental sustainability issues. On palm oil specifically, we were encouraged to hear further details of how P&G operationalises its various commitments. As legislation, such as the EU's deforestation law, comes into force these matters will only increase in importance and so we will continue to encourage leading ambition from P&G.



## 6 **SAP:** assessing its cybersecurity approach after learning from our interaction with national cybersecurity agencies.

**Assessing**

Sustainable business practices

A constructive and purposeful board

Outcomes

Collaboration

**Objective:** We engaged with SAP's Chief Security Officer (CSO), Tim McKnight, and the SAP Chief Trust Officer, Elena Kvochko, about cybersecurity and SAP's governance of this material ESG risk. Before the meeting, the team conducted research into 'best practice' via internal teach-ins with Baillie Gifford's own CSO and external communication with the National Cyber Security Centre (NCSC) in the UK and the Cybersecurity and Infrastructure Security Agency (CISA) in the US, via an email exchange and reviewing published resources.

**Discussion:** We learnt that Tim McKnight and his centralised security team meet monthly, report on security issues to the board every two weeks, quarterly to the Audit Committee and annually to the Technology Committee. McKnight reports directly to the CEO, as is industry best practice. Below McKnight, every business division has a Business Information Security Officer (ISO) responsible for risks in the business but operating within SAP's standard cybersecurity planning and processes.

**Outcome:** The answers and insights provided by the SAP CSO and Chief Trust Officer offered reassurance that SAP appears to have a thorough cybersecurity process and policy in place, competent cybersecurity leadership and strong cybersecurity governance. It covers all the best-practice areas outlined by NCSC and CISA, most impressively, the board of directors and management oversee cybersecurity issues and auditing. Their rhetoric was demonstrative of a culture of continual improvement and learning. And they have examples where cybersecurity has been prioritised over short-term business 'wins' (customer acquisition or product roll-out).

## 7 Albemarle Corporation

**Assessing; Influencing**

Sustainable business practices

Milestones

Outcomes

Engagement

**Objective:** Building on our longstanding engagement with the company, we had numerous engagements with Albemarle this past year, including email exchanges, video calls and in-person meetings with members of management and ESG leadership. We also participated in the annual Albemarle Sustainability Webcast, the only asset manager to be invited as a questioner. In a call in late 2022, we sought an update on progress towards the Initiative for Responsible Mining Assurance (IRMA) third-party certification in its La Negra site and encouraged the company to roll its assessment framework out to other operational sites. In our early engagements with the company, we had encouraged it to adopt third-party verification standards. We also wanted to encourage the company to set scope 3 emissions reduction targets, building on the publication of its first estimates in 2022's Sustainability Report. Finally, we hoped to learn how it was investing to not exceed its carbon intensity target given the higher carbon intensity of resource extraction in its Australian operations, which will constitute much of the company's future growth.

**Discussion:** Albemarle have already started IRMA assessments at two further operational sites. Furthermore, as its King's Mountain site becomes operational, the company intends to use its learnings to target IRMA 100 – the highest level of certification. On the setting of scope 3 emissions reduction targets, we were pleased to hear that the company intends to set these and implement a responsible sourcing strategy, with a secondary focus on human rights, to help achieve them. With regards to the company's lithium carbon-intensity neutral growth ambition, the primary levers it is pulling are purchasing renewable power (reducing its scope 2 footprint by a third) and efficiency gains. The company is also exploring renewable power purchasing agreements and own power generation, as well as engaging in industry-wide collaborations in clean technology.

**Outcome:** The company's prioritisation of sustainability since our first engagement several years ago, we believe, is noteworthy. We are pleased to see the company's continued progress in its aspiration to world-class standards in mitigating the environmental impact of its operations. We believe this will give the company an important competitive advantage in the long term, as customers look to ensure their lithium is responsibly sourced. As a next step, we intend to follow up with the company to learn more about its efforts to manage its impacts on the hydrology of the Salar de Atacama following our own extensive research speaking with expert, independent hydrogeologists with knowledge of the region.


## 8 B3 S.A. - Brasil, Bolsa, Balcão

**Assessing; Influencing**

Sustainable business practices

Outcomes

**Objective:** Over the course of the year, across several engagements, we met with the CEO, CFO and CSO to learn more about how sustainability and ESG link to B3's current and future strategy. In addition, and although not a material concern, we wanted to understand why B3 had used 2021 as a baseline for its scope 2 emissions target – an outlier year where these emissions were significantly higher than usual, owing to droughts in Brazil causing the country's grid's carbon intensity to spike due to hydroelectric power being integral to the country's electricity production.

**Discussion:** B3 shared its perspectives on how it considers its position of influence, as a stock exchange, in promoting good ESG practices. B3 was an early leader in thinking about and taking action for sustainability from an exchange perspective and continues to believe there is an opportunity for ESG-related benchmarks and indexes as well as wider carbon markets. Gender inequity continues to be a priority for B3. It has committed to creating a diversity index for the Brazilian market to seek to incentivise listed companies to incorporate gender diversity into their senior leadership. We encouraged B3 to review its scope 2 emissions target, given our belief that it would not lead to meaningful emissions reductions.

**Outcome:** Our engagements have provided a useful perspective on how ESG fits with the strategic priorities of the organisation. In early 2023, the company committed to an improved scope 2 emissions target.



## 9 GSK

**Fact-finding**

Fair treatment of stakeholders

Different geographies

**Objective:** Recognising the important need for the world to increase access to health care and medicine in low-and middle-income countries (LMICs), we had a meeting with GSK's Chief Global Health Officer and President, Vaccines and Global Health to discuss the company's work in the area.

**Discussion:** With 'Affordability and Accessibility' a key pillar in the company's ESG strategy, we were encouraged to hear of board-level commitment and oversight of GSK's strategy, performance and contributions in this most vital of areas. GSK recognise that, from a purely commercial point of view, its work in this pillar is not a key driver of growth. However, it is fundamental to their overall strategy and the best employee retention tool available to the company. To this end, it was encouraging to hear of the company's commitment of £1bn investment into its global health research and development engine over the coming years. Also notable was the company's recognition that access to healthcare and medicine in LMICs is a 'partnership game'. The enabling infrastructure and capacity requirements for increased accessibility must be strengthened in LMICs for healthcare products to reach those markets in the first place – but also for them to be delivered in an effective manner.

**Outcome:** We believe GSK recognises its responsibility and position of influence with regards to improving LMICs access to, and affordability of, health care and medicine – and believe the company is acting on this. We look forward to future conversations with the company, alongside others, as part of a prospective firm-wide project to support and help our holdings drive innovation and positive change in LMICs' health.

## 10 ANTA Sports

**Assessing; Influencing**

Sustainable business practices

Milestones

Outcomes

**Objective:** As part of our continued engagement with ANTA, we had several calls over the course of the year to monitor progress towards its commitments to develop its supplier audit framework, become members of the Sustainable Apparel Coalition and roll-out Higg Index auditing modules. We also wanted to encourage more disclosure and ambition on raw material traceability and the company's climate strategy.

**Discussion:** ANTA confirmed that the company has adopted the Higg Index alongside becoming members of the Sustainable Apparel Coalition, meaning collaborative work is underway to train ANTA's supply chain. Initial data collection will focus on suppliers familiar with the requested data types, but those less familiar will receive training in 2023. Concerning raw material sourcing and traceability, most notably cotton, ANTA has mapped its tier 1 and 2 suppliers to factory names and locations – the company has also contacted tier 3 suppliers. On third-party auditing, ANTA communicated that it was increasingly looking to supersede its current process by adopting an independent third-party approach. ANTA also updated us on its work to set a new climate target, aligned with and verified by the Science-Based Targets initiative. The company remains committed to ensuring there is no forced labour in its supply chain.

**Outcome:** The company remains on track with the commitments it previously made to us. We strongly encouraged ANTA to seek to roll out independent third-party auditing by the end of 2023. We will monitor the company's traceability progress and encourage ambition and disclosure of its findings.

## 11 Greencoat UK Wind

**Fact-finding**

Sustainable business practices

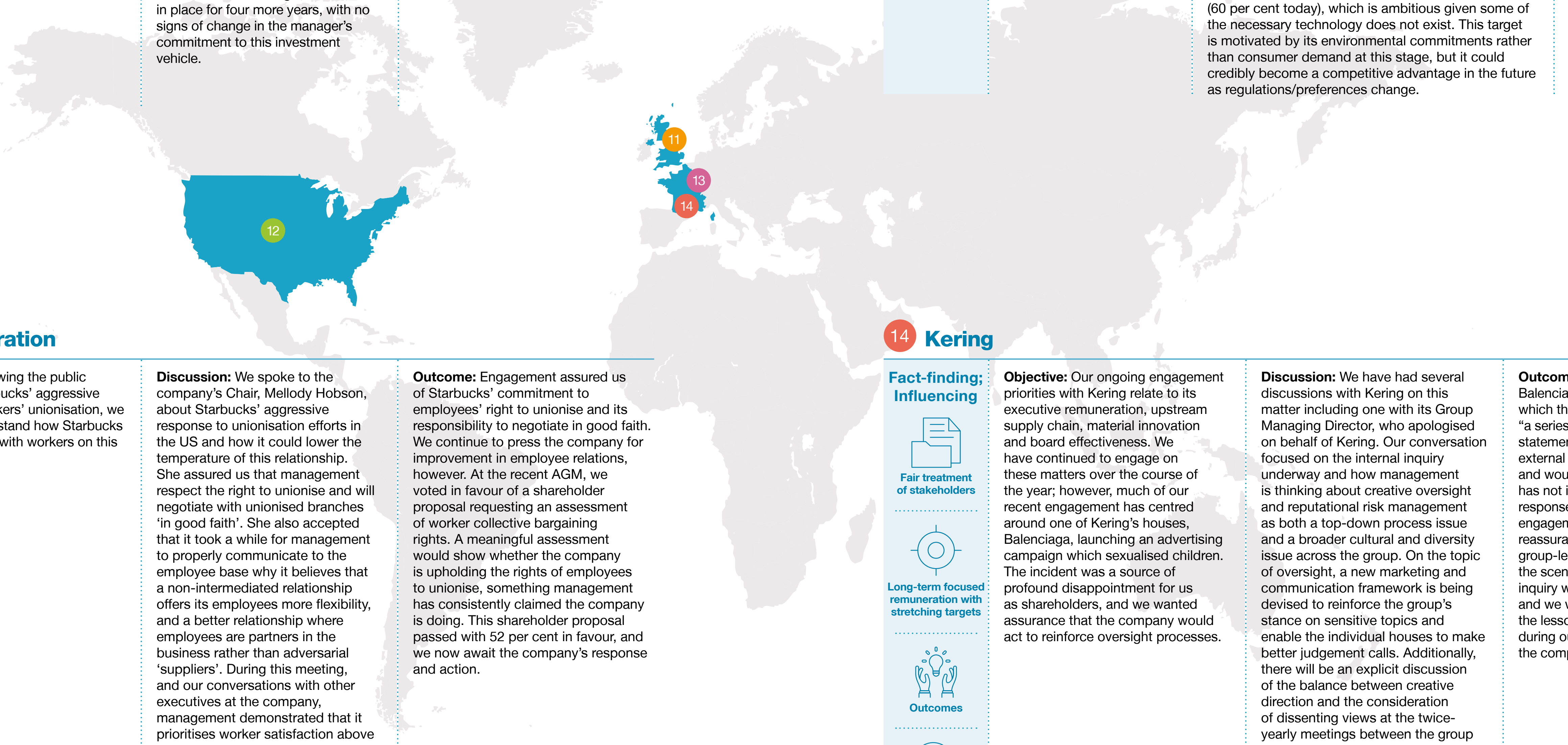
A constructive and purposeful board

Engagement

**Objective:** Having participated in a firm-wide, United Nations Environment Finance Initiative (UNEP-FI) led pilot of the TNFD framework for financial institutions, focusing on offshore-windfarms, we took the chance to engage with Greencoat UK Wind on biodiversity matters. In a further meeting, we were formally introduced to the incoming chair, Lucinda Riches, to query the board's provisions for an eventual manager exit (in light of Schroders' acquisition).

**Discussion:** We explored the manager's work to manage biodiversity risks across all sites, learning of its habitat management plans at all of its onshore assets, and its consideration of environmental and social factors in every investment. Peatland restoration is a particular focus, post-construction at sites where this is necessary, given peat's role as a carbon sink. In our call with Lucinda Riches, we learnt succession planning for an internal replacement is underway and take comfort from the fact the current managers will remain in place for four more years, with no signs of change in the manager's commitment to this investment vehicle.

**Outcome:** Broadly, involvement in the pilot proved valuable in learning of some of the techniques, tools, and datasets used to assess nature-based risks. Greencoat UK Wind's ownership and management exposure to offshore assets is growing, and so it was encouraging to hear of management's integration of biodiversity considerations in investment decision-making. We welcome the board's efforts in preparing for an eventual manager exit, including its succession plan for an internal replacement.




## 12 Starbucks Corporation

**Assessing**

Sustainable business practices

Fair treatment of stakeholders

A constructive and purposeful board

Voting

Engagement

**Objective:** Following the public criticism of Starbucks' aggressive response to workers' unionisation, we wanted to understand how Starbucks plans to engage with workers on this matter.

**Discussion:** We spoke to the company's Chair, Mellody Hobson, about Starbucks' aggressive response to unionisation efforts in the US and how it could lower the temperature of this relationship. She assured us that management respect the right to unionise and will negotiate with unionised branches 'in good faith'. She also accepted that it took a while for management to properly communicate to the employee base why it believes that a non-intermediated relationship offers its employees more flexibility, and a better relationship where employees are partners in the business rather than adversarial 'suppliers'. During this meeting, and our conversations with other executives at the company, management demonstrated that it prioritises worker satisfaction above many other considerations. The company recognises that motivated and supported employees are crucial to the service it provides and the sustainability of its business in the long term.

**Outcome:** Engagement assured us of Starbucks' commitment to employees' right to unionise and its responsibility to negotiate in good faith. We continue to press the company for improvement in employee relations, however. At the recent AGM, we voted in favour of a shareholder proposal requesting an assessment of worker collective bargaining rights. A meaningful assessment would show whether the company is upholding the rights of employees to unionise, something management has consistently claimed the company is doing. This shareholder proposal passed with 52 per cent in favour, and we now await the company's response and action.



## 13 L'Oréal

**Fact-finding; Assessing**

Sustainable business practices

Engagement

**Objective:** We met with L'Oréal to discuss management changes and how they have affected its sustainability strategy.

**Discussion:** L'Oréal reiterated the strength of its commitment to sustainability and corporate responsibility, which the CFO espoused confidently and in-depth rather than handing over to his ESG-focused Investor Relations colleague. This focus has not changed under the new CEO, and we note that he has also brought more emphasis on 'purpose' from his experience on the branding/marketing side of the business. This can be risky, but the company seems focused on authenticity and not overpromising – something to watch. We also spoke about the company's current sustainability challenges. These include reformulating its products to switch petrochemical inputs to 'bio-based' or derived from abundant minerals – targeting 95 per cent by 2030 (60 per cent today), which is ambitious given some of the necessary technology does not exist. This target is motivated by its environmental commitments rather than consumer demand at this stage, but it could credibly become a competitive advantage in the future as regulations/preferences change.

**Outcome:** This was a reassuring meeting with CFO Christophe Babule and the team, and we were pleased with the continued commitment to sustainability.

## 14 Kering

**Fact-finding; Influencing**

Fair treatment of stakeholders

Long-term focused remuneration with stretching targets

Outcomes

Engagement

**Objective:** Our ongoing engagement priorities with Kering relate to its executive remuneration, upstream supply chain, material innovation and board effectiveness. We have continued to engage on these matters over the course of the year; however, much of our recent engagement has centred around one of Kering's houses, Balenciaga, launching an advertising campaign which sexualised children. The incident was a source of profound disappointment for us as shareholders, and we wanted assurance that the company would act to reinforce oversight processes.

**Discussion:** We have had several discussions with Kering on this matter including one with its Group Managing Director, who apologised on behalf of Kering. Our conversation focused on the internal inquiry underway and how management is thinking about creative oversight and reputational risk management as both a top-down process issue and a broader cultural and diversity issue across the group. On the topic of oversight, a new marketing and communication framework is being devised to reinforce the group's stance on sensitive topics and enable the individual houses to make better judgement calls. Additionally, there will be an explicit discussion of the balance between creative direction and the consideration of dissenting views at the twice-yearly meetings between the group management and the management of brands. Diversity among creative teams themselves is important, but Kering also recognises that nurturing a culture that embraces challenge is equally so.

**Outcome:** Following our meetings, Balenciaga issued a public apology in which the house took responsibility for "a series of grievous errors", with the statement also outlining that internal and external investigations were underway and would lead to changes. Kering itself has not issued a public statement in response to the controversy, but our engagements have provided some reassurance as to the considerable group-level work taking place behind the scenes. The findings of the external inquiry were published in February 2023 and we will continue to follow up on the lessons learned from this incident during our regular engagements with the company.

# Further engagements undertaken throughout the year

Including the examples in the previous section, throughout the year we engaged with management at 37 companies to encourage an accelerated rate of progress on issues related to long-term business sustainability. The further engagements are listed below:

| | Company | Engagement theme/s |
|---|---|---|
| 15 | **Admiral Group** | A constructive and purposeful board |
| 16 | **Amadeus IT Group** | Long-term focused remuneration with stretching targets |
| 17 | **Analog Devices** | Long-term focused remuneration with stretching targets |
| 18 | **Arthur J. Gallagher & Co** | A constructive and purposeful board; sustainable business practices; long-term focused remuneration with stretching targets |
| 19 | **Atlas Copco** | A constructive and purposeful board |
| 20 | **AVI Limited** | A constructive and purposeful board |
| 21 | **C.H. Robinson Worldwide** | Sustainable business practices |
| 22 | **carsales.com** | A constructive and purposeful board; long-term focused remuneration with stretching targets |
| 23 | **Cisco Systems** | Long-term focused remuneration with stretching targets |
| 24 | **Dolby Laboratories** | Long-term focused remuneration with stretching targets; sustainable business practices |
| 25 | **Edenred** | Long-term focused remuneration with stretching targets |
| 26 | **Experian** | Sustainable business practices |
| 27 | **Hargreaves Lansdown** | A constructive and purposeful board; prioritisation of long-term value creation |
| 28 | **Intuit** | Long-term focused remuneration with stretching targets |
| 29 | **Kuehne + Nagel International** | Long-term focused remuneration with stretching targets |
| 30 | **National Instruments Corporation** | Sustainable business practices |
| 31 | **Nestlé** | Fair treatment of stakeholders; sustainable business practices |
| 32 | **PepsiCo** | Long-term focused remuneration with stretching targets |
| 33 | **Sonic Healthcare Limited** | Long-term focused remuneration with stretching targets |
| 34 | **TCI Co** | Sustainable business practices |
| 35 | **Valmet Oyj** | Long-term focused remuneration with stretching targets |
| 36 | **Want Want China Holdings Limited** | Sustainable business practices |
| 37 | **Watsco** | Sustainable business practices |

# Responsible Global Equity Income: in the field

*The team organised a volunteering day at Aberlour Options, McNally House, in Glenrothes, not far from Edinburgh. Aberlour is a leading children's charity providing a range of services, support and advice for vulnerable children, young people and families in Scotland.*

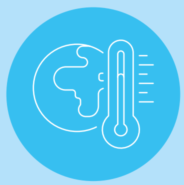
The charity works to supports families affected by disability, drugs and alcohol, behaviour problems and emotional difficulties. They do this by providing parenting development services, community support, respite care, befriending, residential care and offering a range of other young people, child and family support services. The team spent the day brightening up McNally House's garden, enjoyed by its residents, painting fences and giving the garden a refresh.

# Climate change: an update on portfolio progress

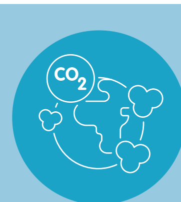
*The Responsible Global Equity Income Strategy has considered climate change in its investment process since its inception. We recognise climate as an increasingly tangible investment risk and seek to invest our clients' capital in a way that supports the Paris Agreement's goals.*

## This year's highlights include:

An updated climate audit of Responsible Global Equity Income's portfolio holdings, showing increased portfolio alignment with net zero year-over-year.



Escalation of our engagement with some of the portfolio's largest contributors to its carbon footprint.




Deepening our partnership with a leading NGO, the Smart Freight Centre, which is working to support the decarbonisation of the freight and logistics industry.

The publication of Responsible Global Equity Income's inaugural Task Force on Climate-Related Financial Disclosure's (TCFD) report, accessible on our website at bailliegifford.com

## Portfolio progress on net zero alignment

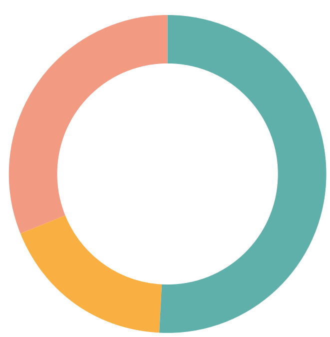
Our firmwide climate audit records Baillie Gifford's assessment of company alignment with limiting global warming to less than 1.5C this century. Its framework, we believe, sets a high bar. The minimum standard to be considered 'Leading' requires not just a target to net zero by 2050 but comprehensive disclosures and targets for net zero by 2050 across all material scopes of the Greenhouse Gas Protocol, with appropriate interim targets. We also look for strategic alignment, increasingly expressed through capital allocation, decision-making, the company's wider narrative and use of its position of influence within its value chain.

Our assessment currently has seven assessment categories ranging from no disclosure, through to targets that demonstrate well-above average ambition. We organise these seven categories into three groups to provide an indication of company preparedness: Leading, Preparing and Lagging.

Findings from the audit last year showed that approximately 40 per cent of Responsible Global Equity Income's portfolio, by capital weight, were 'Leading' and 1.5C scenario aligned. This year, the portfolio's climate audit shows that just over 51 per cent by capital weight is 'Leading' and aligned with a 1.5C scenario. This has been a consequence of portfolio activity and company progress. We believe this shows meaningful year-over-year progress towards our net zero alignment commitment.

## Target assessment

A company's ambition and targets to reduce their direct and value chain emissions in line with the Paris Agreement.



% market value USD

| | |
|---|---|
| Leading | 51 |
| Preparing | 18 |
| Lagging | 31 |

Based on a representative portfolio. Data as at 31 March 2023.

**Leading**
Companies committed to reductions in line with their fair share of a science-based 1.5C-aligned pathway, with appropriate demonstrations of targets, intent and strategic coherence.

**Preparing**
Companies with disclosure and narrative that suggests they are preparing to set 1.5C-aligned targets in the near furture.

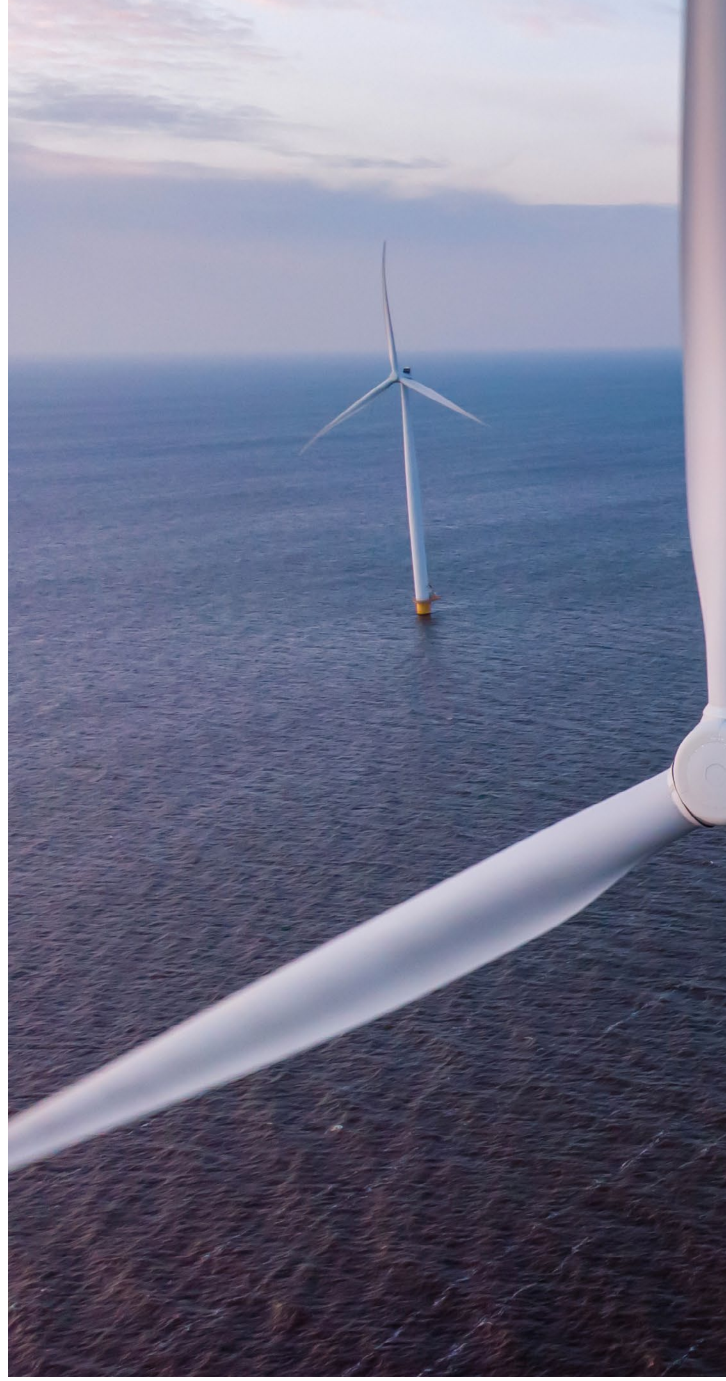
**Lagging**
Companies lacking sufficient disclosure or suitably robust targets, where the pathway to improvement is currently uncertain.

## Our net zero alignment commitment

We are committed to investing in a way that is aligned with a scenario that limits global temperature increases to 1.5C. We believe the most important contribution here will be made by the companies we invest in implementing plans to align their business with a 1.5C scenario, including investing in and supporting climate solutions. Encouraging our holdings to be ambitious in this regard is likely to be where we can have the greatest influence. We also believe that we should focus our influence on those companies that are likely to have the biggest impact on the climate.

We therefore commit that:

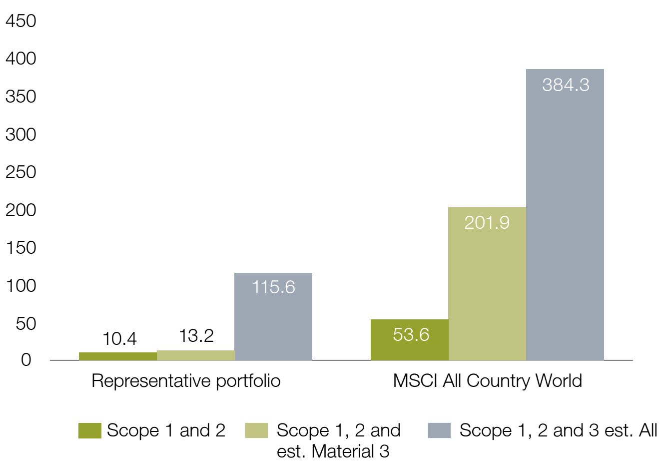
1. By 2030, more than 90 per cent by number of our climate-material holdings will be aligned with a 1.5C scenario. All holdings will be so-aligned by 2040. New buys will have an extra two years to meet the commitment.
2. Between now and 2030, we will report annually on i) the progress of our holdings in aligning with a 1.5C scenario, and ii) our engagement with these companies.



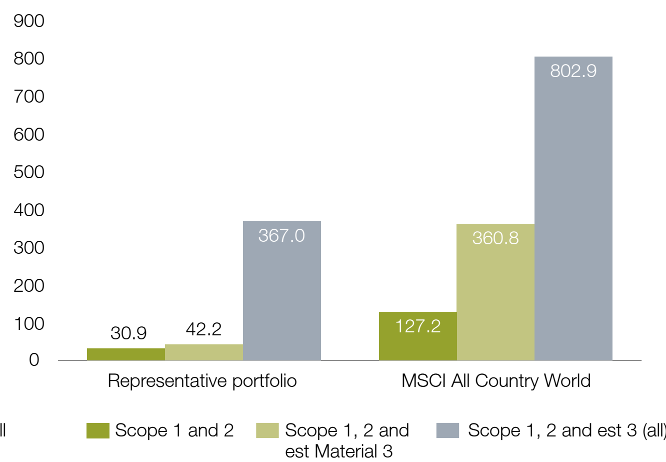
### Emissions at the portfolio level

We recognise that carbon footprinting and emissions intensity analysis is imperfect – indeed, it is only telling us where the portfolio is, not where it is going – this is one of the reasons behind our climate audit. Nonetheless, below we disclose a carbon footprint analysis of the portfolio. Financed emissions data compares the total carbon emissions of the portfolio with its benchmark, the MSCI All Countries World Index (ACWI), per $1m invested. The weighted average carbon intensity (WACI) is the sum product of the portfolio constituent weights and intensities. These intensity measures allow comparison of emissions across companies of different sizes and other industries.

**Portfolio Carbon Footprint (Financed Emissions tonnes of carbon dioxide equivalent ($tCO_2e$) per $m)**




**Portfolio Emissions Intensity (WACI/Revenue ($m))**




Source: MSCI. USD.

Based on a representative portfolio. As at 31 March 2023. All data is pulled from MSCI, Sustainalytics, ISS and BoardEx, via the FactSet platform. It is fact checked by our ESG analysts and is considered correct at the time of publishing.

## Climate solutions providers: the other half of the story

The climate audit was helpful for comparing company carbon emission targets and strategy alignment with a 1.5C scenario. These are important and relevant inputs to a responsible investment strategy, but we believe it is only half the story. In addition to those companies leading the way, we recognise that the low-carbon transition presents a real opportunity for other companies to provide climate change solutions. As long-term investors, we are excited about the potential for climate-solution providers to accelerate the energy transition as they scale – creating a ripple effect that companies focused on their own operational emission reductions are less likely to do. This year, we would like to profile Greencoat UK Wind.

## Greencoat UK Wind

Greencoat UK Wind is a renewable infrastructure fund that invests in a portfolio of UK-based operational wind farms. The UK's development of its wind power industry, mainly offshore, has been described as one of its biggest infrastructural successes. Between 2009 and 2020, wind power's contribution to electricity generation in the UK increased by 715 per cent. Greencoat UK Wind has played a significant part in this success story, acting as a conduit to capital and increasing levels of investment in the UK wind industry. In 2022, its wind farms generated 4,362 gigawatt hour (GWh) of renewable energy across 45 onshore and offshore wind farms. Collectively, its assets are capable of powering over 1.8 million British homes, approximately one in fourteen. Annually, Greencoat estimates its assets help avoid 2 million tonnes of $CO_2$ emissions through the displacement of thermal generation.

## Engagement with climate material holdings over the year

A bottom-up assessment of material carbon-emission risks across our holdings demonstrates United Parcel Service and TSMC as the holdings that contribute most significantly to the portfolio's overall scope 1 and 2 footprints. Both also have significant scope 3 footprints. This is partly a reflection of the companies' sheer size (they are both prominent global leaders in their industry), and partly a reflection of the nature of their operations (moving parcels around the world and producing semiconductors). This is one of the reasons we escalated our engagement with both companies this year. We sought alternative insights to inform our understanding of both companies' decarbonisation opportunities and challenges and calibrate what we should consider reasonable ambition better. The case studies for this research and engagement are outlined on pages 10 and 11.

### Summary

We recognise that as long-term, responsible investors, we are obliged to use all available levers to encourage our holdings to increase their ambition when it comes to tackling their emissions footprints and scaling products and services which avoid emissions. Ultimately this will help ensure the long-term sustainability of their business models and improve the odds that the long-term earnings growth and shareholder returns we expect from these companies will meet our expectations. We have come a long way this year and will continue to press holdings for increased ambition on climate action.

# Finding the best companies: a study in company culture and employee motivation

*As a team, and as part of Baillie Gifford, we strongly believe in the importance of culture and employee motivation to drive long-term company growth and outperformance. This is, perhaps, most obvious – and best codified – in our company's Shared Beliefs, explicitly striving to be an engaging and progressive workplace for those who work here. We apply the same logic to the companies in which we invest.*

As the so-called 'Great Resignation' increasingly hit the headlines last year, we set out to identify what attributes of a company and its culture foster a highly motivated workforce. In doing so, we hoped to arrive at ways to measure and discern these attributes, to improve our chances of finding and investing in genuinely great companies worldwide.

An increasing body of work demonstrates that companies with highly engaged workforces show higher employee retention, greater customer satisfaction and better revenue growth when compared to companies with more disengaged workforces. For example, according to Edmans (2012), companies listed in the '100 Best Companies to Work for in America' generated 2.3–3.8 per cent higher stock returns per year than their peers between 1984 and 2011. Expanding the review period to 1984–2020 sees 2–2.7 per cent excess market returns (Boustanifar and Dae Kang, 2020). Putting aside these academic studies it seems evident to us, as investors thinking about the long-term societal changes which might impact our holdings, that job satisfaction and employee engagement are becoming increasingly important. A generation of workers is entering the labour force for whom 'a job for life' and 'a good pension' are not leading motivators. A sense of purpose and an ability to make a real contribution will be crucial for firms to continue attracting young talent.

Corporate culture is the trickiest intangible we seek to assess when investing in a company. But given its increasing importance to employees, the RGEI Team initiated a research project last year attempting to identify the requirements and signs of high employee motivation.

This endeavour, alongside making us aware of several helpful new frameworks and tools, resulted in us arriving at the following eight characteristics of companies which are particularly attractive to employees:

**Purpose**

If corporate PowerPoint slides are anything to go by, the importance of purpose to businesses worldwide is ubiquitous. The idea that people want to have a reason, beyond simply their next pay cheque, to work for, indeed, devote their life's energy to, has undoubtedly been widely recognised (or co-opted, as critics of 'purpose-washing' might argue). When authentic, however, it is a key element of employee motivation. Some leaders, like Starbucks founder Howard Schultz, point to purpose and pride in one's work as the most important ingredient to their company's success: "If people relate to the company they work for, if they form an emotional tie to it and buy into its dreams, they will pour their heart into making it better."

**Agency**

Agency requires a combination of autonomy, authority and the resources to achieve one's work without unnecessary hoop-jumping. Agency fosters motivation by fully engaging employees in their work and increases satisfaction through a sense of ownership in the result. And, here, things tie back to a sense of purpose: feeling one's work is purposeful, and that one's work has demonstrably contributed to that purpose, can be a source of profound motivation.

**Impossibility**

Read almost any business book, and there will almost always be a heady cocktail of risk, pressure, survival and achieving what was perceived, at one stage, to be an impossibility lacing its pages. The prospect of achieving the impossible can be incredibly motivating. It can stem from breaking new ground or succeeding in an area an individual did not know they had the required skills to achieve in.

### Belonging

In *The Culture Code*, Daniel Coyle describes a key element of highly successful groups as 'belonging'. The groups he interviews regularly describe themselves as a family, and individuals feel a part of a whole. One way that belonging appears to be fostered at successful organisations is simply by listening. When leaders regularly ask for and listen to the ideas of their employees, it can engender a sense of 'we're all in this together'. As well as listening, embedding a sense of belonging requires transparency to help employees feel responsible and involved.

### Fun

Many a biography of successful organisations also references fun. Phil Knight said of his Nike team, "We were always laughing. Sometimes, after a really cathartic guffaw, I'd look around the table and feel overcome by emotion. Camaraderie, loyalty, gratitude. Even love. Surely love." And Sam Walton said of Wal-Mart, "I know most companies don't have cheers, and most board chairmen probably wouldn't lead them even if they did. But then most companies don't have persimmon-seed-spitting contests… Most companies also don't have a gospel group called the Singing Truck Drivers, or a management singing group called Jimmy Walker and the Accountants. My feeling is that just because we work so hard, we don't have to go around with long faces all the time, taking ourselves seriously, pretending we're lost in thought over weighty problems."

### Recognition

Former Senior Vice President of People Operations at Google, Laszlo Bock, says, "Public recognition is one of the most effective and most underutilised management tools." Similarly, a Boston Consulting Group survey of 200,000 job seekers from 189 countries in 2014 found that an employer or manager showing appreciation for their work is the number one attribute for a new job. Whether this is a source of motivation or job satisfaction isn't clear. However, its importance for employees has been corroborated by a US-based employee engagement study conducted by Quantum Workplace that found employees are 2.7 times more likely to be highly engaged when they are confident they will be recognised for contributing to organisational success.

### Reward

A lot of work has been done by companies, not to mention consultants and investors, to identify the best possible remuneration packages – ones that align an employee to the firm and its financial success, ones that attract talent and encourage retention, ones that reward for a whole slew of desired goals. Indeed, each year for every holding in Responsible Global Equity Income's portfolio we judge whether we believe a company's remuneration policies align with our expectations.

### Support

Taking care of employees is another ingredient of successful businesses and one that seems to go beyond individual motivation. When management teams put extra effort into making sure employees are looked after – by treating employees benevolently, it trickles down into how employees treat each other and other stakeholders. Taking care of employees isn't just about giving attractive benefits, creating good working conditions or helping employees learn new skills. It's also about creating a safe environment to make mistakes and speak up. MIT Sloan's Culture500, an AI natural language processing system, review of Glassdoor scores found that its 'Culture Champions' scored highest in honest discussions.

This work and the awareness of various means and tools it has provided us with, has already shown worth. Our investment in Cognex, the machine vision company, was partly supported by our research suggesting that the company possesses a unique and enduring corporate culture, leading to the company's ability to retain and attract talent in a competitive industry. Over the coming year, we will continue thinking about how we might incorporate this work into our evaluation process for portfolio holdings.

# Voting: taking a thoughtful approach

*We view exercising the voting rights attached to clients' holdings to be fundamental and a core part of our overall stewardship responsibilities. Our voting decisions are concentrated on what we believe is ultimately in our clients' best interests.*

Whenever voting, we ask the motivating question: "In the long term, is this likely to strengthen or weaken the sustainability of the company's future earnings and returns to shareholders?" We emphasise the first four words: we are delighted to support shareholder resolutions that incur short-term costs if we believe they are likely to strengthen a company's sustainability in the long term. We have little interest in resolutions that will incur short-term costs with potentially no tangible long-term gain.

In this endeavour, we are fortunate to be supported by Baillie Gifford's dedicated, in-house voting team. It reviews all resolutions and provides independent input and guidance to inform our voting decisions. Ultimately, however, all decisions are instructed by the managers: we do not outsource any stewardship or voting activities. Our fundamental approach to stockpicking thus extends to our voting approach. While we consult proxy advisory reports, they make a minor contribution to our process. All voting decisions are made case-by-case by the investment team, informed by our dedicated on-team ESG analyst, and Baillie Gifford's in-house voting team. The managers' final voting decision will be based on our combined analysis and views.

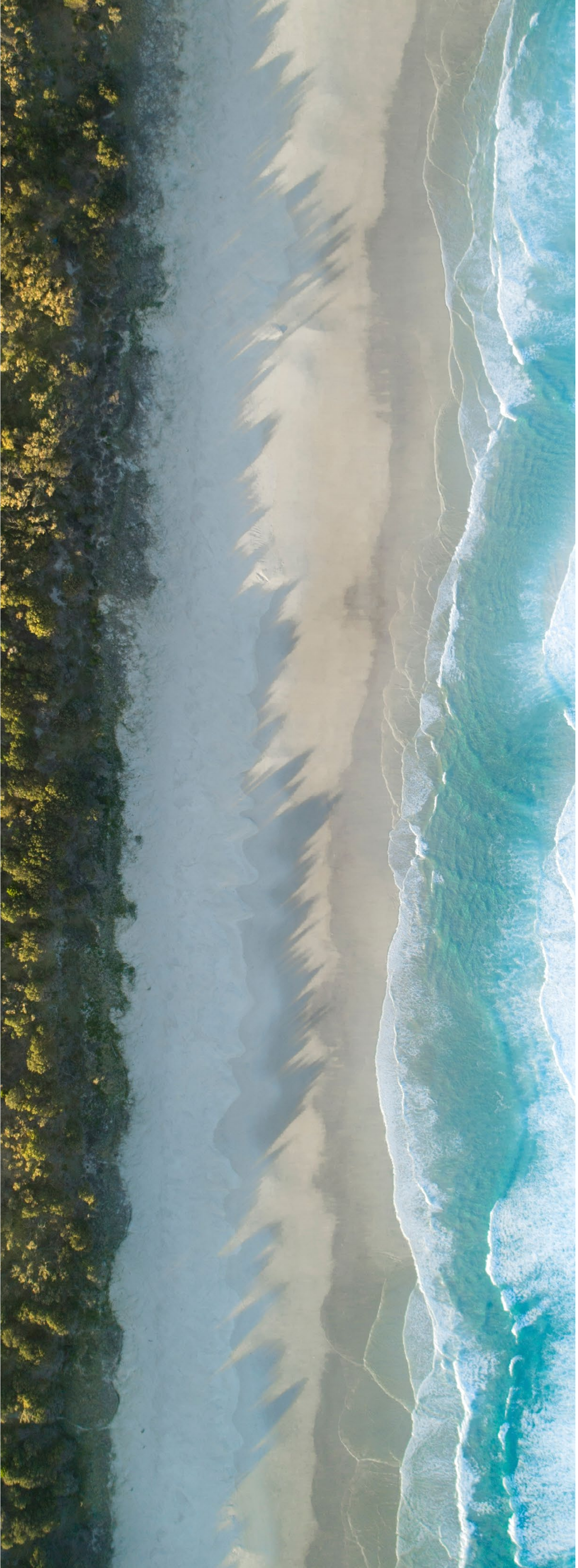
Our investment research and underlying philosophy and process place significant focus on gauging the extent to which we feel a company is showing ambition about its most material ESG issues and its management of stakeholders. We place equal, if not greater, emphasis on understanding how much we can trust company management to deliver on these ambitions and wider stakeholder expectations. Therefore, it is no great surprise to us that our voting data reveals that we often vote in support of management teams that score highly in our assessment of their ambition and trust. After all, we invest in a concentrated portfolio of companies where we know and respect the management teams. Our support for their leadership relates to our support for their long-term vision. This is by no means where we default to.

In instances where additional information on a resolution might help us reach more informed voting conclusions, we will engage with the company before submitting our vote to solicit this. If, after this dialogue, we decide to vote against a company's management, we will always seek to convey a rationale for this vote. Often, this approach enables an ongoing conversation with the company, where we ultimately work to encourage and support them in implementing remediating actions. As long-term shareholders, we believe this approach supports our desire to build long-term relationships with our holdings and deliver long-term value to our clients.

As well as voting on resolutions submitted by management, we will also vote on all resolutions proposed by shareholders. We analyse these in the same manner as management proposals, opposing if we are comfortable that management and the board are actively and effectively addressing the issue raised in the proposal.

| **Voting** | **Number** | **Percentage (%)** |
|---|---|---|
| For | 759 | 92.5 |
| Against | 52 | 6.3 |
| Abstain, withhold or no vote | 10 | 1.2 |
| Total number of ballots | 821 | 100 |

Based on a representative portfolio. Data from 1 April 2022 to 31 March 2023.





Given that we voted on 821 resolutions, including voting 52 against, we summarise some of the more notable votes cast during the past year below.

## Notable votes cast against management proposals

### Procter & Gamble

We opposed the reappointment of the external auditor due to concerns that the auditor's length of tenure could negatively impact their ability to act independently. Procter & Gamble's audit firm has been unchanged since 1890, and we believe it is best practice for the auditor to be rotated regularly as this works to ensure independent oversight of the company's audit process and internal financial controls.

### Analog Devices

We opposed executive compensation because we do not believe the performance conditions for the long-term incentive plan are sufficiently stretching, vesting below the median. Generally, we think, when performance is assessed relative to a benchmark, vesting of awards should only begin when performance is equal to or above that of the chosen benchmark.

### AVI

We opposed eight resolutions on non-executive director fees as the new fee framework incorporated a performance fee. We believe this is inappropriate as it could impact the independence of non-executives. Our considerations included the principle of assessing performance, the opacity of the mechanism for doing so, and whether non-executives can remain independent and continue to provide robust challenge to the executive with that in mind.

## Notable votes cast in favour of shareholder proposals

### Microsoft

We supported a shareholder resolution requesting an independent report on whether government use of its technology contributes to violating the company's human rights and ESG policies and principles. We believe shareholders would benefit from additional transparency around the considerations made by the company in evaluating the appropriateness of military contracts.

### Starbucks

We supported a shareholder proposal on freedom of association. In light of several recent high-profile controversies, shareholders would benefit from a more thorough examination of the compliance of the company's policies and practices with international fundamental rights.

### United Parcel Service

We supported a shareholder proposal calling on the company to adopt independently verified science-based greenhouse gas emissions reduction targets that, we believe, would provide shareholders with a clearer understanding of UPS's climate change approach and its progress in achieving climate-related targets.

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