

Baillie Gifford™

Executive Remuneration Principles



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Executive Remuneration Principles

Summary

This document presents the Baillie Gifford Executive Remuneration Principles (our 'Principles') with the aim of sharing our approach with our investee companies, clients and other stakeholders. Our Principles aim to support an evidence-based approach to executive remuneration. They outline a clear preference for simple incentive structures which prioritise equity ownership and longer pay duration. We do not advocate for a one-size-fits-all approach, but use the Principles as a robust framework to steer our investment research, engagement and voting activities as they relate to executive remuneration.

Introduction

Executive remuneration is a core component of a company's corporate governance. It is crucial for attracting, retaining, and incentivising key management personnel who lead our clients' holdings. We firmly believe a thoughtful, well-structured remuneration policy focuses executives on long-term value creation and aligns their interests with shareholders.

Principle 1: Executive remuneration plans should be radically simple.

Explanation

Current executive remuneration plans are too complex. We support the adoption of simple, easy to understand pay structures which emphasise long-term (ideally 5+ years) share price as the primary determinant of executives' rewards. Examples of how this can be achieved include grants of restricted shares or appropriately structured options. We do not believe prescriptive performance conditions always make an incentive plan more robust or effective.

Guidance

The appeal of pay for performance is obvious. However, research shows that performance-based shares are not the most effective means to incentivise management or align their interests with shareholders¹. In fact, they add complexity and risk to pay which is often offset by larger pay awards.

However, we are pragmatic and realise that most companies have a conventional pay structure with performance conditions. Where financial or operational targets are used, we expect that they are focused on the few fundamental business drivers which management can influence and where achievement will result in value creation for shareholders². Rather than trying to account for every eventuality, any residual imperfections should be addressed by management integrity, board oversight and our own due diligence.

The remuneration committee must, in advance, have considered the outcome on retention and motivation if the share price falls or performance conditions are not met. We do not welcome retrospective resetting or adjustment of targets or extension of plan duration.

¹Are Performance Shares Shareholder Friendly?

²Letting Go of Norm: How Executive Compensation Can Do Better Than "Best Practices"

Principle 2: Equity ownership and pay duration matter.

Explanation

We focus on evidence-based remuneration characteristics proven to incentivise management and align their rewards with long-term shareholders. We believe equity ownership and lengthening the time horizon of executive pay are superior to complex performance conditions, intricate pay structures and conventional three year long term incentive plans.

Guidance

Equity ownership and pay duration are important remuneration features for investment analysis. Higher levels of stock ownership and longer pay duration are positively associated with improved operating performance, innovation, and higher returns³. Helpfully, both metrics are agnostic to executive pay design and can be applied across markets, industries, and remuneration structures.

Equity ownership (the value of management's shareholding) is consistently shown to have a positive relationship with long-term shareholder value⁴. Pay duration measures the average length of total compensation, reflecting the vesting periods and time horizons of different pay components. It is forward-looking and found to be longer in firms with many positive attributes including more growth opportunities and long-term assets⁵. An interesting study from non-profit organisation Focusing Capital on the Long Term⁶ reports that the average duration of CEO remuneration in the MSCI ACWI is just 1.7 years⁷.

³ CEO Ownership, Stock Market Performance, and Managerial Discretion; Does a Long-Term Orientation Create Value? Evidence from a Regression Discontinuity; The Purposeful Company: Executive Remuneration Report

⁴ The Most Important Dimension of Alignment: Why Share Ownership Matters as Much as Pay

⁵ Duration of Executive Compensation

⁶ Of which Baillie Gifford is a member.

⁷ The Risk of Rewards: Tailoring Executive Pay for Long-Term Success

Principle 3: The quantum of remuneration should reflect management quality and long-term value created.**Explanation**

Executive remuneration should incentivise reward-seeking behaviour and provide genuine alignment with long-term shareholders. We are supportive of appropriate payouts when management create significant value but will oppose remuneration plans which fail to provide aligned pay for performance, including awards for long-term underperformance.

Guidance

In most cases, the quantum of executive pay must be competitive to attract and retain quality leadership. To assess whether the level of remuneration is reasonable, we consider several factors: we compare total pay to industry and market peers; we assess the value added by the CEO and the executive team (in some cases we may attribute higher value to the CEO-to-firm match, such as founders or exceptional leaders); and we prioritise long-term pay for performance over any individual year, by comparing total realisable pay over a 5-year period versus total shareholder return.

Principle 4: Executive remuneration should be tailored to each company's requirements.

Explanation

We believe the remuneration committee should exercise and demonstrate independent thought and judgement when determining how to incentivise executives. We expect them to resist pressure to adopt structures which conform to conventional expectations but bear minimal relevance to the company's long-term strategy.

Guidance

We encourage our holdings to be bold and implement bespoke incentive policies. We will support decisively company-specific remuneration plans even if this is contrary to current market expectations or practice. If a plan conforms to a predictable template, but does not appear to strengthen alignment, we will challenge the board to explain why it is the optimum model for the company.

Conclusion

This is a short summary of our research and wider work on remuneration and we would be delighted to discuss it further. Please do not hesitate to get in touch if you would like to talk about this in more detail.

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