Pacific Asset Management
*is proud to be a signatory of:*
PRI Principles for Responsible Investment

PACIFIC SUSTAINABLE MULTI-ASSET

# INVESTMENT OUTLOOK

2021: 2nd Quarter Insights

## INTRODUCTION

A key facet of sustainability focuses on the way in which companies are managed for the long term. Clearly generating profit is the principal objective of companies but this should not come at any cost. Good governance ensures that staff are not exploited, that boards are independent and that CEOs are incentivised correctly and held accountable for their conduct. Good governance ensures that companies don't commit fraud or take excessive risks. For us, this ultimately aligns both shareholders, management and staff, and produces more robust companies to invest in over the long term.

### WHAT IS GOVERNANCE?

**Firstly, it makes sense to define what corporate governance is, and how we assess whether a firm is practising 'good' or 'bad' governance.**

**At a high-level governance is simply the mechanisms through which a company is run well. Key topics and methods of corporate governance space can include pay, business ethics and tax transparency.**

**KEY ISSUES**

**CORPORATE GOVERNANCE**

> Board

> Pay

**CORPORATE BEHAVIOUR**

> Business ethics

> Tax transparency

## WHY IS CORPORATE GOVERNANCE IMPORTANT?

All of the issues listed above are important in terms of incentivisation for company management. Firms are traditionally profit maximising, seeking to squeeze the greatest amount of profits out of the goods and services that they provide, but this pressure can also incentivise firms to cheat.

There are numerous examples where poor governance has enabled firms to overstate profits, to avoid regulations or to undertake practises that are unethical. In the short term, this is a boost to profits, but over the long term, or once discovered these transgressions can be devastating to a firm's stock price. In the wake of the Volkswagen emissions scandal being uncovered by US regulators for example, which was clearly a failure of both incentive and oversight, the company lost over a third of its value in a number of days!

## IS THERE EVIDENCE THAT CORPORATE GOVERNANCE IMPROVES RETURNS?

Can we prove however that running a company with processes for oversight and independence improves returns however? Academics have sought to prove this across papers studying the impact of good and bad governance on stock market returns.

**60%** **In a survey of over 600 academic studies we see that over 60% of them link good Governance to improved company return, or reduced risk, and very few (less than 10%), find the opposite effect.**

This is the highest sensitivity of the Environmental, Social and Governance pillars to performance of companies that we typically look at when considering sustainable investment opportunities.

There are also several real-world examples of how Governance issues can impact returns. Governance issues are not just about CEO pay and board composition, but also issues like worker rights.

Source: Pacific Asset Management

## REAL-WORLD EXAMPLE OF HOW GOVERNANCE ISSUES CAN IMPACT RETURNS

### IPO of Deliveroo

A recent example of this has been the IPO in the UK of food delivery service Deliveroo on the 30th March 2021.

Within several days of the IPO launch, Deliveroo stock fell over 27% from the initial IPO price. There are several investment rationales to explain Deliveroo's underperformance, including market volatility or the prospect of the UK coming out of lockdown and therefore limiting the importance of food delivery post-lockdown. However, some of the U.K.'s largest asset managers said at the time that they would not participate in the offering because the company's treatment of couriers doesn't align with responsible investing practices.

This IPO came at the same time as strikes by couriers, who said they want to be paid the living wage, have safety protections in place and rights as workers including access to holiday and sick pay. This is unsurprising, given a Bureau of Investigative Journalism study analysed invoices from more than 300 riders and concluded that one in three made less than £8.72 an hour – below the minimum wage for those aged over 25.

Further, Deliveroo launched with a dual-class share structure for the first three years of the listing, which gives co-founder and chief executive Will Shu more control over the company. Dual-class share structures are a common feature of listed technology companies in the United States but are frowned on by some British investors as they can give executives outsized influence on shareholder votes relative to their stake sizes. This has prevented Deliveroo from being granted a FTSE 100 listing, despite it being of the size to normally be included in the benchmark index of UK stocks.

So clearly here we see how there is a link between treating workers fairly, being careful around incentivisation and long-term rewards in terms of stock price.

## HOW DO WE ASSESS GOOD GOVERNANCE?

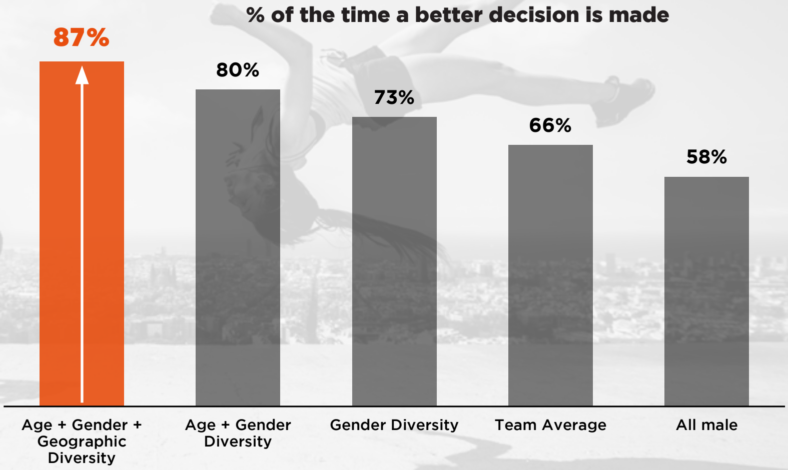
At PAM we utilise two methods to screen holdings to ensure we hold companies that display good governance. These are the Global Sustainable Investment Alliance and the UN Sustainable Development goals. They provide the framework to analyse the strength of processes and real-world impact of our holdings and help us identify themes within governance.

One of the key themes within governance is equality. For example we are still far from reaching gender balance in the workplace at any level, with women representing 25% of the boards, 17% of executives, 24% of senior management, and 37% of the workforce overall.

Diversity of the workforce is a key issue, often overlooked by investors, and we believe that companies that focus on issues such as Gender Diversity show characteristics of good governance and can outperform over the long term.

### DIVERSITY LEADS TO BETTER DISCISIONS

A study covering real-world business decisions from 2015–2017 showed that a diverse workforce improved outcomes in terms of senior executive decision making. Providing clearer goals, more information, multiple alternatives and lowering the risk of group think.




*Source: Cloverpop*

## CONCLUSION

It is our belief that governance across all aspects of business is important for both investment returns and sustainability. Our belief is that this should be fully incorporated into a Sustainable portfolio, and that over the long term companies that display good governance will outperform those that don't.

## WHAT DOES SUSTAINABLE INVESTING MEAN TO PAM?

Sustainable investing is a catch-all term for investing in a way that accounts for being socially responsible and investing ethically while also seeking returns.

**At PAM** we use the term sustainable investing to capture the various methods of incorporating concerns around Environmental, Social and Governance (ESG) issues into our investment decision making processes.

### A commitment to responsible investing

As a signatory to the UN PRI Principles for Responsible Investment, Pacific Asset Management has publicly stated our support for the better understanding of the investment implications of ESG factors.

As a business we are committed to constantly strive to be a more responsible firm both in how we operate and how we manage our clients' investments.

## PLEASE GET IN TOUCH

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