

# Investor Responsibility Briefing



## Does good governance pay?

In autumn 2004, we reported on the growing body of evidence suggesting that there is a correlation between good corporate governance and positive stock performance and increased long-term shareholder value. In 2005, several sell-side brokers published research that appears to substantiate this link

Deutsche Bank expanded its corporate governance research in its 2005 'Beyond the Numbers' reports – examining the corporate governance practices of European companies and revisiting those of the UK and South Africa.

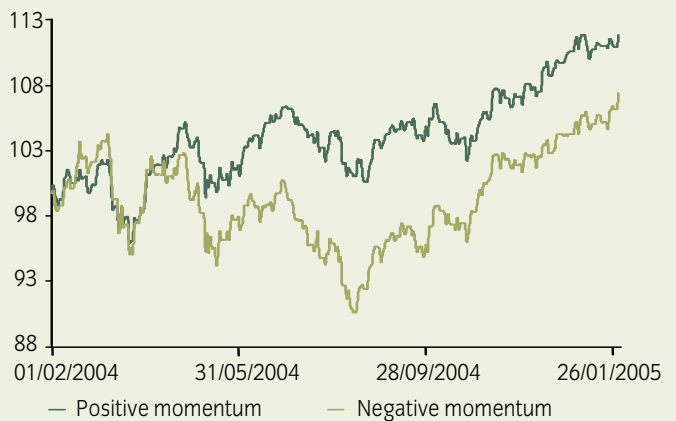
The broker quantified the governance standards of 202 companies in 14 European countries from the end of December 2003 through the end of January 2005. Its analysis found that there is a positive equity price performance differential between the best- and worst-governed companies (see Figure 1 below). In addition, companies identified as having improving governance outperformed those with deteriorating governance (see Figure 2 below).

Figure 1: FTSEurofirst 300 (ex UK) – top/bottom 10% corporate governance assessment companies (indexed, one year)



Source: Deutsche Bank, 25 November 2005. Beyond the Numbers: Materiality of Corporate Governance

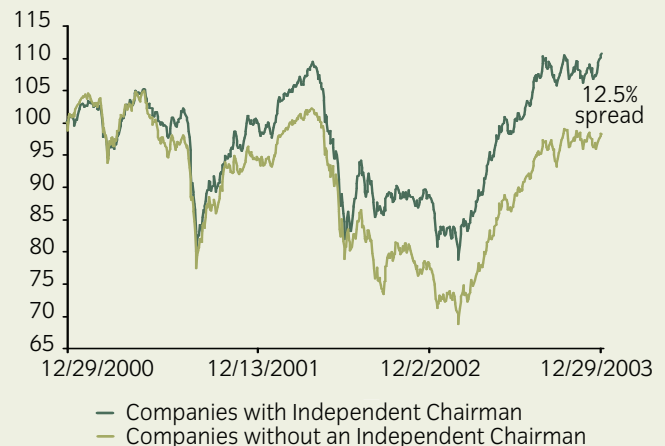
Figure 2: FTSEurofirst 300 (ex UK) – positive/negative momentum companies (indexed, one year)



Source: Deutsche Bank, 25 November 2005. Beyond the Numbers: Materiality of Corporate Governance

In the UK, companies with an independent chairman outperformed companies without an independent chairman over the period December 2000 to December 2003 (see Figure 3 below), and companies with shares with equal voting rights outperformed those with unequal voting rights (see Figure 4 below).

Figure 3: Companies with an independent chairman outperformed companies without an independent chairman



Source: Deutsche Bank, 25 November 2005. Beyond the Numbers: Materiality of Corporate Governance

<sup>1</sup> Insight Investment, July 2005.

Figure 4: Companies with share with equal voting rights outperformed those with unequal voting rights



Source: Deutsche Bank, 25 November 2005. Beyond the Numbers: Materiality of Corporate Governance

In its third study of corporate governance among South African companies, Deutsche Bank reported that top (governance) performing companies outperformed those with poor performance by 12.74%, and low governance risk stocks outperformed higher risk stocks by 32.2%.

Also in 2005, Goldman Sachs JBWere (of Australia), in conjunction with Corporate Governance International (the Australian pioneer of systematic governance analysis of major listed companies) issued a preliminary report examining the relationship between corporate governance and the investment performance and/or investment risk of Australian companies. The research, called 'Corporate Governance Investing,' indicated that there is 'some quantitative evidence of links between company corporate governance ratings and various aspects of company performance [that] merit consideration by investors,' including company share price performance, consensus earnings trends and return on equity trends. In addition, the preliminary study indicated that accounting quality, audit quality, board skills and remuneration are the governance criteria that have an investment link.

The more hard evidence emerges that good governance is linked to shareholder value that emerges, the stronger the case will be for investment managers to consider companies' governance records in investment analysis. A number of investment managers, including Insight, already recognise this. Insight has engaged proactively with companies on their governance practice for years on that basis. (Our quarterly voting and engagement reports provide a commentary of our dialogue with companies on governance and other issues.) In addition, we are currently developing methodologies that will allow us to more rigorously incorporate governance into our investment decision-making processes for both equities and bonds..

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