We examine the empirical evidence for a connection between good governance and company financial performance and find mixed results.

In our white paper, "Assessing Corporate Governance – A Review of the Literature," we explore whether there is an empirical link between traditional principles of good governance used by investors and rating agencies (see Table 1), and company performance[1]. After reviewing the academic literature, we found limited evidence of a relationship between these 'good' governance principles and strong company performance.

Table 1

'Good' Governance Principle	Definition	Academic Evidence
CEO/Chairman separation	CEO and Board Chairman should not be the same person	?
Dispersed Ownership	Adopt one-share-one-vote structures; minimize influential shareholders (e.g., family/ founder firms)	+/-
Board Independence	Majority independent board; audit committee fully independent	+
Smaller Boards	Smaller boards are more effective	+
De-Classified Boards	Board directors should be up for election each year	+/-
Board Diversity	Boards should have diverse (race, gender, etc.) members. Female target is at least 30% (moving towards 40%)	?
Pay-For-Performance	Executive pay should be closely tied to company performance through various short- and long-term metrics	?

After reviewing the academic literature, we found limited evidence of a relationship between good governance principles and strong company performance. In conducting primary research, we also did not find compelling evidence of a relationship between good governance principles and cumulative total shareholder return.

These findings do not, however, undermine the importance of good governance analysis in the investment process. Rather, they call into question the way 'good' governance has come to be defined. In our view, backed by the academic literature, good governance goes beyond a board's structural features. Rather, assessing good governance necessitates analyzing the way the company is run and the context in which it operates on a case-by-case basis. Assessing companies effectively requires a fundamental understanding of the business and a commitment to ongoing engagement, both directly and through proxy voting.

In our experience, the most important considerations are:

i. Actions/judgments of the management team making the strategic and operational decisions
   a. Efficient capital allocators
   b. Focus on long-term product/service excellence vs. peers
   c. Transparency in discussions of critical issues impacting the company
   d. Action orientation in attacking any weakness or implementing turnaround

ii. Alignment of shareholder/company interests over the long term
   a. Alignment of values and beliefs between majority/controlling shareholders, management and minority shareholders
   b. Incentive plans that focus on long-term rather than short-term financial metrics
   c. Cultural emphasis on developing and retaining the best executives and employees

iii. Stewardship and effectiveness of the board members
   a. Board members with relevant experience (mixture of company/ industry/product/service)
   b. Mixture of board tenure and fresh perspectives
   c. Mixture of deep company expertise/ interests and independence from management
   d. Ability to hold management accountable when necessary

iv. Operating context
   a. Strong jurisdictional legal rights
   b. Strong company adherence to any relevant law or legislation
   c. Relationships with and accountability to external stakeholders

1. *As measured by company financial performance metrics or total shareholder return*

Assessing good governance is not straightforward, but it is fundamental to what we do. As value investors, we analyze companies experiencing pain. Part of the judgment call—whether the pain is temporary or permanent—involves assessing whether good governance is embedded in the investment opportunity. The absence of good governance can lead to a permanent impairment of capital. In this sense, good governance can be an effective risk management tool for any investment. In this form, good corporate governance is foundational and could even be the difference between a good and a bad investment.

We hope our whitepaper helps shift the focus of the investment community to those elements of good governance that really matter. As ESG-integrated investors, we approach our analysis of all ESG issues, including governance, through the lens of financial materiality, and our goal is financial returns through strong ESG integration. This means we consider the elements of good governance that really matter to a company's success rather than 'good' governance metrics that lack an empirical connection to company performance.

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