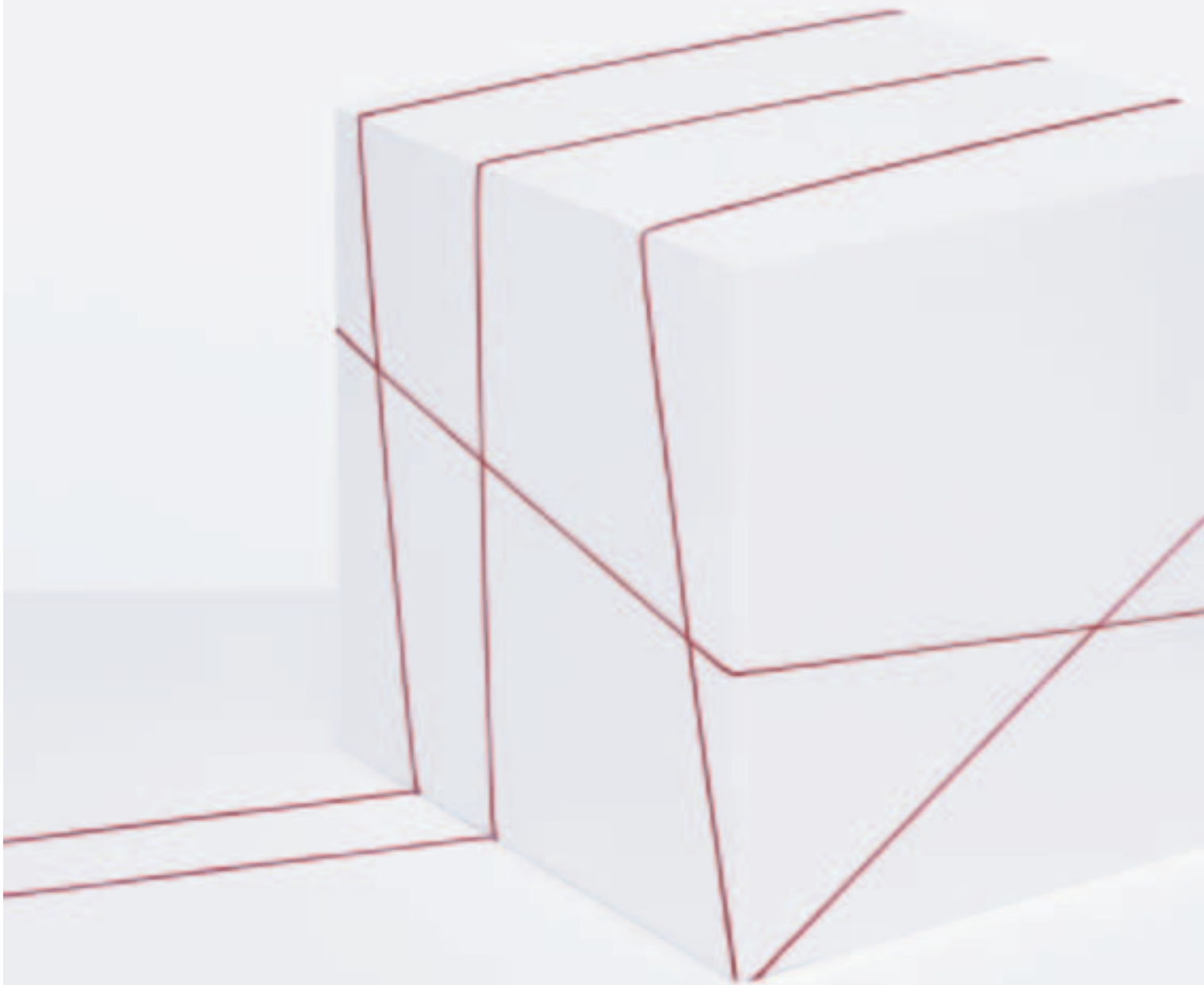


# Design Index: The Impact of Design on Stock Market Performance

Report to December 2004



July 2005



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## Foreword

Good design is good business. We've said it for years, and now we have the proof to back that belief – proof that can't be ignored by anyone who cares about the long-term health of UK plc.

This report shows clearly that businesses which invest in design out-perform their peers. We've tracked the share prices of the biggest hitters in corporate Britain and the evidence is unequivocal: Design-led companies have produced dramatically better share-price performance for their investors, not just for a few weeks or months but consistently over a solid decade. And the report shows that the difference between design-aware businesses and the rest is not just marginal – their share prices have outrun key stock market indices by a full 200 per cent.

I'm sure you will find much of interest in this report. And I hope you'll agree with us that the findings give a strong signal to the nation's businesses that design-led innovation is their chief competitive weapon in ever-tougher global markets.

At the Design Council we're committed to demonstrating the difference design can make to profitability through better products, services and processes. If you want to know more about the exciting results we're getting from our work with businesses and designers, please don't hesitate to get in touch.



David Kester  
Chief Executive  
Design Council

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## Executive summary

The Design Index study measures the relationship between the effective use of design and share price performance. Its key finding is that the share prices of design-aware companies out-perform the FTSE 100 and FTSE All Share indices by more than 200 per cent.

The research identified publicly quoted companies that performed well in a number of design awards and tracked their share prices between December 1993 and December 2004. Design awards with robust criteria act as an external indicator of the way a company uses and values design. This resulted in a 63-strong Design Index of the most design-led companies and an Emerging Index of 103 companies.

Share price analysis carried out for the first edition of this report, published in 2004, covered the period between December 1993 and December 2003. This included a five-year bull market, a three-year bear market and the beginning of the recovery which began in March 2003. The out-performance by the design-led companies persisted throughout.

Since January 2004, the indices have been calculated by FTSE and the analysis has now been updated to December 2004. This update shows that the difference between the design-led companies and other quoted companies is growing. As the market has recovered since March 2003, the Design Index has risen by 43 per cent and the Emerging Index has gone up by 74.3 per cent, while the FTSE 100 and All-Share indices have grown by 26.2 per cent and 32.1 per cent respectively.

The report provides a performance commentary which charts:

- Absolute performance of the design-led companies and the FTSE All-Share and FTSE 100 indices
- Performance of the design-led companies relative to the FTSE companies
- Performance highs and lows for the performance of all indices.

This report also contains a detailed explanation of the study's methodology, as well as company selection criteria, award schemes and index calculation. And for the first time there is a banking and retail sectoral analysis.

# Findings

## 1.1 Introduction

This report updates 'The Impact of Design on Stock Market Performance', a seminal piece of research commissioned by the Design Council in 2003 to analyse the relationship between design and the financial performance of companies.

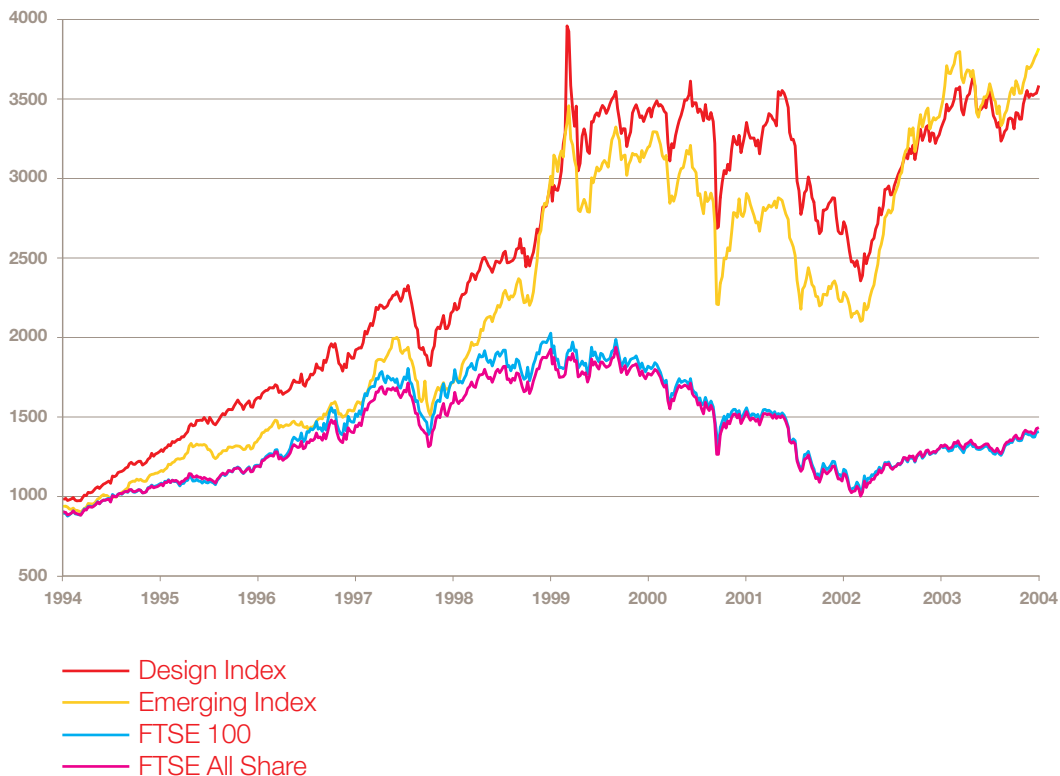
That report reviewed the performance of UK FTSE-quoted companies between 1994 and 2003, encompassing a long bull market period, from March 1995 to March 2000, the bear market period from March 2000 to March 2003, and the more recent recovery period. The key finding of that study was that a group of 63 companies identified as effective users of design outperformed the FTSE 100 index over the full period by 200 per cent, beating their peers in both bull and bear markets.

Since December 2003, the Design Council has been working with FTSE on the development and monitoring of two indices based on that research, consisting of the leading companies (the Design Index) and a wider group (the Emerging Index) identified as being emerging users of design. This new edition of the report reviews the performance of the two indices in the intervening 12 months to December 2004, and their performance over the longer period assessed by the original study.

## 1.2 General overview

The companies have significantly outperformed the FTSE-100 and FTSE-All Share indices over a ten-year period:

Chart 1: Ten-year performance 1995-2004





This table summarises the performance over all the key periods:

**Table 1:** Performance relative to FTSE indices

Indices	No of companies	Full period 28 Dec 1994 to 29 Dec 2004	Bull market 27 Mar 1995 to 31 Mar 2000	Bear market 31 Mar 2000 to 31 Mar 2003	Recovery period 31 Mar 2003 to 29 Dec 2004
<b>Absolute Performance</b>					
FTSE 100	100	+57.0%	+108.4%	-41.7%	+26.2%
FTSE All-Share	700+	+58.5%	+102.2%	-41.3%	+32.1%
Design Index	61	+262.6%	+231.0%	-24.7%	+43.0%
Emerging Index	97	+305.6%	+235.1%	-29.7%	+74.3%
<b>Relative to FTSE 100</b>					
Design Index	61	+205.5%	+122.6%	+17.0%	+16.8%
Emerging Index	97	+248.6%	+126.6%	+12.0%	+48.1%
<b>Relative to FTSE All-Share</b>					
Design Index	61	+204.1%	+128.9%	+16.7%	+10.9%
Emerging Index	97	+247.2%	+132.9%	+11.7%	+42.1%

### 1.3 Key points from 2004

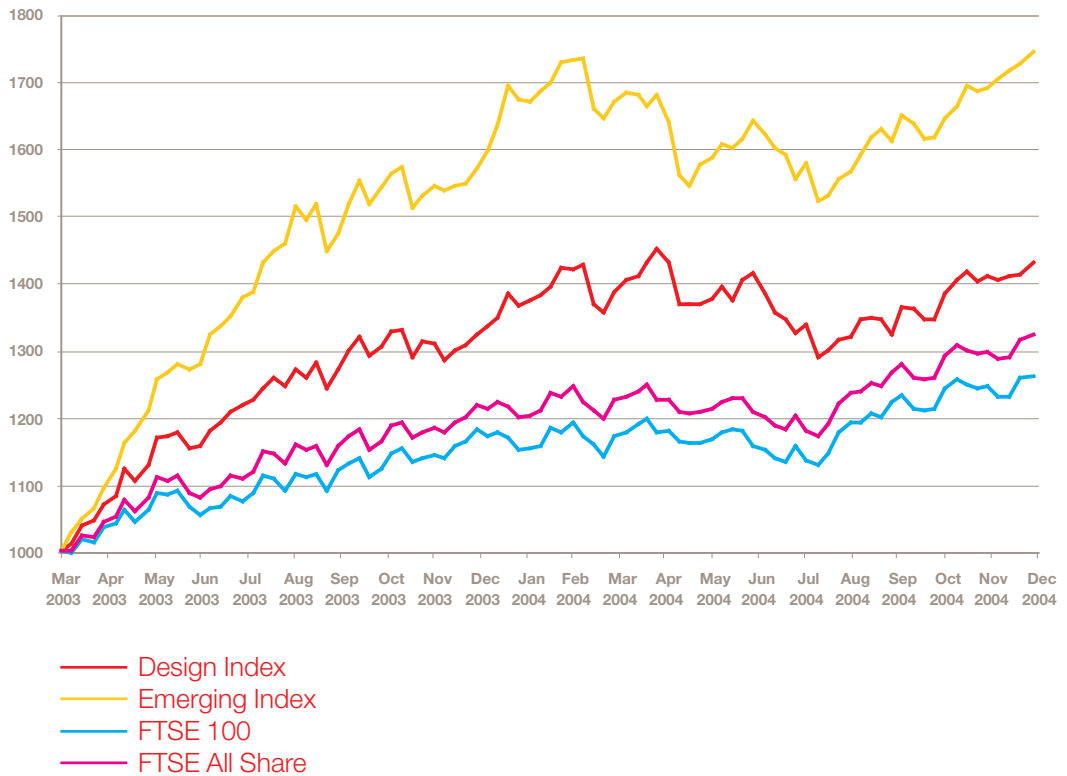
The Design Index and Emerging Index have continued broadly to follow the 'shape' of the UK stock market, but have exhibited a consistently higher performance at all stages in the cycle:

- Both design indices continued to outperform the two FTSE indices, with the Emerging Index running 4.2 per cent ahead of the FTSE 100 for the year, and the Design Index at a lower 1.3 per cent outperformance – reflecting its greater convergence with the constituents of the FTSE 100.
- All four indices ended 2004 at or close to a high for the year, the Emerging Index in fact reaching a new all-time high.
- The Design Index reached a near all-time high on 26 April 2004.

**Table 2:** Highs and lows of performance

Indices	No of companies	Design Portfolio high - 28 Feb 2000*	Emerging Portfolio high - 29 Dec 2004*	Largest one-week fall - 10 Sep 2001	Bear market low - 3 Mar 2003*
<b>Absolute Performance</b>					
FTSE 100	100	+89.8%	+40.8%	+39.1%	+2.1%
FTSE All-Share	700+	+85.3%	+43.3%	+26.5%	+0.2%
Design Index	63	+295.9%	+258.5%	+168.7%	+135.6%
Emerging Index	103	+235.0%	+281.9%	+121.1%	+110.2%
<b>Relative to FTSE 100</b>					
Design Index	63	+206.2%	+217.7%	+129.6%	+133.4%
Emerging Index	103	+145.2%	+241.0%	+81.9%	+108.1%
<b>Relative to FTSE All-Share</b>					
Design Index	63	+210.7%	+215.2%	+142.2%	+135.4%
Emerging Index	103	+149.8%	+238.6%	+94.6%	+110.0%
* All figures relative to start date of Design and Emerging indices (29 Dec 1993)					

**Chart 2:** Recovery performance - 31 December 2003 to 31 December 2004



In the 'recovery' period of the study – March 2003 to the end of 2004 – the design indices have continued to outperform the two main FTSE indices, showing a 43 per cent rise in the case of the Design Index and a 74.3 per cent rise in the case of the Emerging Index.

# Sector performance

## 2.1 The importance of retail and banking

In order to better understand some of the factors driving the continued out-performance of the Design and Emerging indices, we have examined in more detail the performance of two sectors which figure prominently in the design indices and which are often said to drive the British economy – retail and banking.

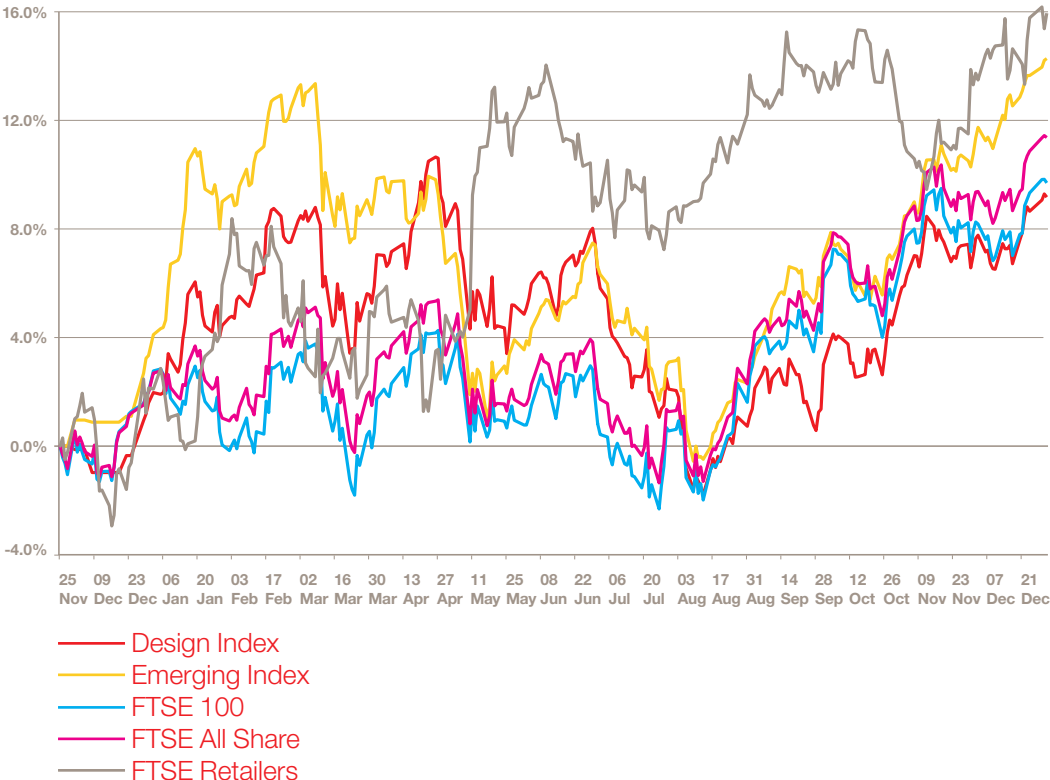
## 2.2 Retail

FTSE divides retailers into 'General' and 'Food'. There are 43 general retailers in the FTSE All Share Index, of which 14 feature in the Design or Emerging indices, including such companies as Marks & Spencer and MFI. The design indices therefore have a significantly higher proportion of retail stocks than in the quoted company population in general. On a portfolio value basis, this difference is even more marked.

Interestingly, although the public perception of retail sector performance over the last couple of years is that it has been poor, the reality is rather different.

The chart below compares the performance of the FTSE UK General Retail index (grey) with that of the FTSE other indices and the design indices.

Chart 3: Retail performance - 25 November 2003 to 29 December 2004



The retail sector has, in fact, significantly outperformed both the FTSE indices for most of period, and was running ahead of the design indices in the latter part of 2004. But as is evident in the headlines focusing on each season's trading, the retail sector is also volatile – partly driven by sentiment and partly by reality. The tail end of 2003's turbulence is seen in the dips at the left of the chart. A closer examination of the quoted retail companies omitted from either of the design indices (see Appendix 3) suggests that the selection criteria

for the portfolio – an emphasis on long-term investment in design – may have contributed to the reduced volatility of the design indices.

Pure investment in the retail sector is highly attractive, but only for those able to accommodate its frequent switches of mood and value. And, clearly, if those investors had put all their money in one or two of the ‘wrong’ retailers that featured in our original report, they would be nursing their financial wounds now. But, in any case, the strong performance of the retail sector over the long term undoubtedly contributes to the overall out-performance of the design indices.

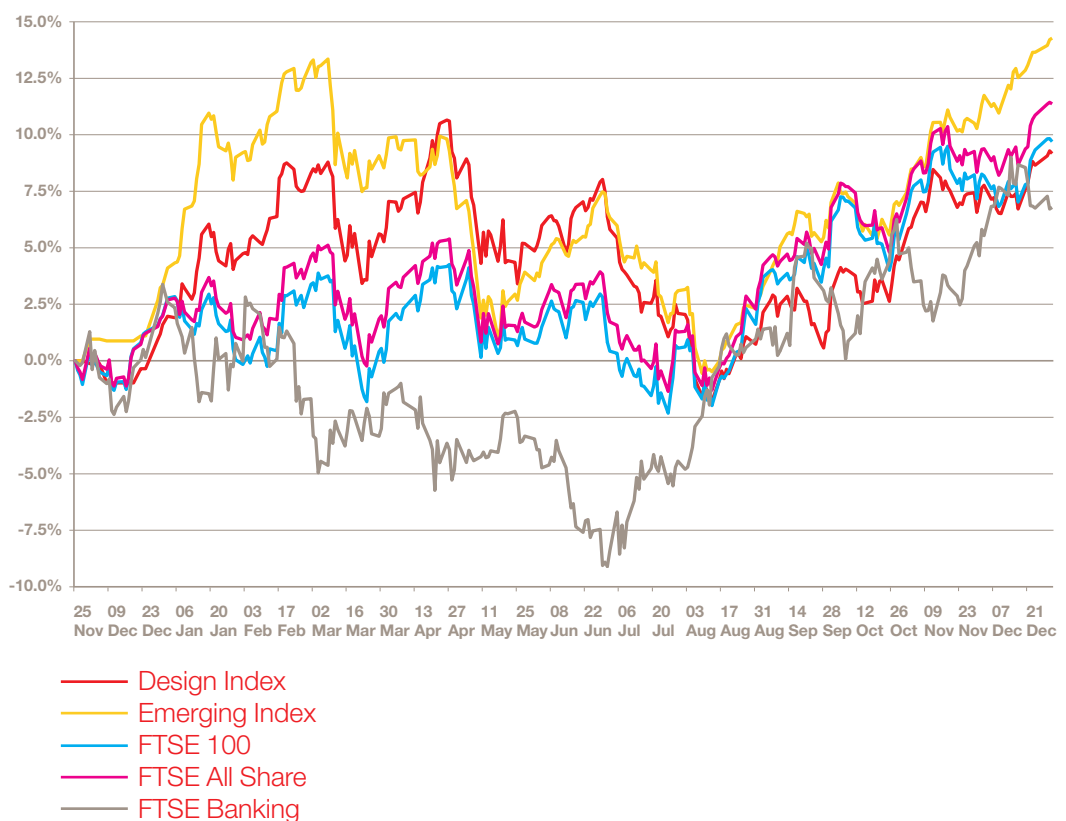
### 2.3 Banking

At first glance, some observers are surprised that banks feature highly in the group of companies that perform well in design awards. However, it is fair to say that this strong presence reflects the huge amount of innovation in the British banking sector over the last ten years.

The stock market performance of the banking sector is rather different to the public perception of continuing growth and stability. In fact, banks have surprisingly volatile share prices, so that they are among both the best and the worst performers over a one-year time frame. But over the long term the banks show their value as investments, out-performing the market as a whole. It is also over the long-term that a consistent focus on design - as reflected in awards - can have a powerful effect, resulting in the sector's strong contribution to the outstanding 10-year performance of the design indices

The chart below compares the FTSE UK Banks Index (grey) with the two main FTSE indices and the two design indices, showing their high volatility over the last year, but also their tendency over the period to perform on a par with the market as a whole.

**Chart 4:** Banking performance - 25 November 2003 to 29 December 2004



## 2.4 What lies behind the outperformance?

When we launched the initial report looking at the impact of design on financial performance in 2004, we and others made several assumptions about what was causing the underlying outperformance. Some of the hypotheses were:

- That the Design Index – and design itself – focused on sectors that ‘inherently’ exhibited high and unrelenting growth, retail and banking being the prime examples. The review above suggests that this is not necessarily the case.
- That design was simply one indicator of good management. If so, it appears to be a very reliable one, delivering long-term out-performance.
- That any analysis of historical performance was likely to be positive, given that the poor performers would be ‘weeded out’. The indices have now been operating live for over a year, and have continued to show their validity as an investment strategy.

With this second edition of the report, we have been able to draw some tentative conclusions as to why the indices are successful:

- One key aspect is the balance of the portfolio – something that could be said of any well-constructed investment strategy. As we see above, retail and banking stocks contribute very different characteristics that, combined, deliver a balanced growth trend.
- The omission of certain stocks is also important. By choosing company shares based on their long-term design focus, those companies whose products may be said to be based on transient consumer or business trends are largely eliminated.
- The net result of these two factors is that the indices have a generally upward trend – they are relatively insensitive to ‘market adjustments’, presumably because these are companies that have demonstrated their worth over the long term.

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## Appendix 1: Index constituents

The following companies no longer appear in the portfolios:

Company	Reason for change
Amersham plc	Acquired by GE (General Electric) USA February 2004
Big Food Group plc	Acquired by Baugur and delisted December 2004
Bookham Technology plc	Delisted UK September 2004
Carlton Communications plc	Merged with Granada to form ITV
City Centre Restaurants plc	Renamed Restaurant Group
Debenhams plc	Delisted December 2003
Galen Holdings plc	Renamed Warner Chilcott June 2004
Granada plc	Merged with Carlton to form ITV
MICE Group plc	Fledgling stock - eliminated from index
Porvair plc	Fledgling stock - eliminated from index
Safeway plc	Acquired and succeeded by Wm Morrison
Telewest Communications plc	Delisted UK July 2004

### Design Index

3i Group	Manchester United
AEA Technology	Marks & Spencer Group
Allied Domecq	Matalan
AstraZeneca	MFI Furniture Group
BAA	Morrison (Wm) Supermarkets
BAE Systems	Oxford Instruments
Barclays	Pearson
Barr (A.G.)	Psion
Body Shop International	Reckitt Benckiser
Boots Group	Rentokil Initial
BP	Reuters Group
British Airways	RM
British Sky Broadcasting Group	Rolls-Royce Group
BT Group	Royal Bank Of Scotland Group
Cadbury Schweppes	Sainsbury (J)
Cambridge Antibody Technology Group	Scottish & Newcastle
Centrica	Scottish & Southern Energy
Diageo	Shell Transport & Trading Co
Easyjet	Smith & Nephew
Egg	Smith (WH) Group
Eidos	SSL International
Emap	Tesco
EMI Group	Tomkins
Gallaher Group	Ultra Electronics Holdings
GKN	Unilever
GlaxoSmithKline	Vodafone Group
GUS	Wetherspoon (J D)
Hilton Group	Whitbread
HSBC Holdings	Woolworths Group
Imperial Chemical Industries	WPP Group
Invensys	



## Emerging Index

Associated British Ports Holdings	ITV
Abacus Group	Johnson Matthey
Aggregate Industries	Kelda Group
Aegis Group	Kingfisher
Alliance & Leicester	Liberty International
Amec	Lloyds TSB Group
Arena Leisure	Lastminute.com
Arriva	Laing (John)
Autonomy Corporation	LogicaCMG
Aviva	London Stock Exchange
Avis Europe	McAlpine (Alfred)
Babcock International Group	Marconi Corporation
Bradford & Bingley	Misys
Barratt Developments	Mothercare
BG Group	National Grid Transco
BTG	Next
Biocompatibles International	mmO2
Berkeley Group Holdings	Paragon Group of Companies
British Land Co.	Pace Micro Technology
Bloomsbury Publishing	Pilkington
BOC Group	Prudential
BPB	Patientline
British Vita	RAC
Bovis Homes Group	Rexam
Capital Radio	Royal & Sun Alliance Insurance Group
Chemring Group	Renishaw
Chrysalis Group	Restaurant Group
Carphone Warehouse Group	Stagecoach Group
Corus Group	Sage Group
Cable & Wireless	Signet Group
Dairy Crest Group	Shanks Group
Domnick Hunter Group	Smiths Group
De La Rue	Somerfield
Diploma	Severn Trent
Elementis	Tate & Lyle
First Choice Holidays	Trafficmaster
FKI	Trinity Mirror
Geest	Trifast
Greene King	TTP Communications
GWR Group	Taylor Woodrow
HBOS	United Utilities
Halma	Viridian Group
Hornby	Wilmington Group
InterContinental Hotels Group	Wilson Bowden
Imagination Technologies Group	Warner Estate Holdings
Imperial Tobacco Group	Wolverhampton & Dudley
International Power	Xansa
Intec Telecom Systems	

## Appendix 2: FTSE 'ground rules'

The following is an extract from the FTSE Specification Details explaining the construction of the indices:

Two indices will be created, the Design Index, and the Emerging Index. As at the close of business on the last working day in December and June, each constituent in the Design Index and Emerging Index will be equally weighted. A weighting factor will be applied to each constituent's market capitalisation to increase/reduce their weight in the index. After this date, the weights of the constituents will move in line with daily price movements until the next six-month rebalancing. The index will follow the FTSE UK Series Ground Rules (available from FTSE), and the universe is limited to the FTSE All-Share Index. There will not be any additions into the indices intra-review.

If an existing constituent is taken over by a non-constituent the new company will become eligible for addition into the index as long as it is a member of the FTSE All-Share Index. The new constituent will use a weighting factor as detailed below. If two existing constituents merge to form one company the merged company will use the weighting factor as detailed below.

Merger between two index constituents		
Amersham plc	Uncapped Mcap (GBPm)	Capped Mcap (GBPm)
Constituent A	100.1	32.3
Constituent B	90.8	29.8
<b>Total</b>	<b>190.9</b>	<b>62.1</b>
<b>New capping factor</b>	<b>0.325301205</b>	
Takeover by non-constituent*		
	Uncapped Market Cap (GBP)	Capped Market Cap (GBPm)
Current Constituent (pre-takeover)	53.2	29.6
New Constituent (post-takeover)	82.1	29.6
<b>New Capping Factor</b>	<b>0.360535932</b>	
* For the company to remain eligible for inclusion in the index, it must be a member of the FTSE All-Share Index		
* This example can also be used for a merger between a Design Index constituent and an Emerging Index constituent.		

Where a constituent of the Design Index merges with a constituent from the Emerging index, and remains a constituent of the FTSE All-Share Index, the combined company will remain a constituent of the Design Index and be deleted from the Emerging Index. The merged company's weight in the index will be determined as detailed above. If a spin-off or share split occurs the new constituent will retain the existing constituent's capping factor. For index deletions, if a constituent is deleted from the FTSE UK Series it will be reflected in the design indices and will not be replaced. Both a price (capital) and total return index values will be calculated in line with the FTSE UK Series methodology. Both a constituent list and valuation (index values) product will be produced on a daily basis. The index is calculated from 29 December 2003.

## Appendix 3: Original selection criteria

### General approach

The original Design Index study sought to develop an objective, comprehensive, means of identifying companies that were active and effective users of design.

There is a wide spectrum of views as to what constitutes design in business. For simplicity, we view the two extremes of that spectrum as follows:

- **Narrow, short-term approach:** Design as a largely product-based activity, focussing on applying aesthetics and form at a late stage in development, often acting in response to the market at large, leaving little room for innovation and not necessarily integrating with wider business strategy.
- **Broad, long-term approach:** An integrated approach using insights from design methods to guide business strategy and shape product, service and process development from an early stage, enabling innovation based on an advanced understanding of user and market requirements. This approach addresses issues of global competitiveness and added value, offering a coordinated approach to long-term business strategy including branding, corporate identity and communications.

The criteria as to what constitutes ‘good design’ can be seen as very subjective. The study therefore principally used the results of a wide range of design awards as the basis for stock selection, because of their comprehensiveness and relative objectivity. In order to ensure completeness, the study also included nominations from a Design Council panel of experts.

### Award and Nomination Schemes

The information used to create the database of selected companies came from five sources and is summarised in Table 3 below.

**Table 3:** Award and nomination schemes

Name of scheme	Scheme sponsor	Time period
Design Effectiveness Awards	Design Business Association	1993 to 2003
D&AD Awards	D&AD	1993 to 2003
Interbrand	Interbrand	1999 to 2003
Millennium Products	Design Council	2000
Panel Nominations	Design Council	2000

These five sources provide a comprehensive database of the UK corporate sector, its use of design and its effectiveness in that activity:

#### Design Business Association: Design Effectiveness Awards (DEA)

The Design Effectiveness Awards call for joint entries by clients and designers. Awards are made for commercially successful design and therefore orientated towards the effect of design on the financial performance of the client company. The scheme is relatively small. Data for prizes and awards during the period 1993 to 2003 were used in this analysis.

### D&AD: D&AD Awards (D&AD)

An annual awards scheme run by D&AD. The scheme spans 27 different categories encompassing all aspects of the visual communications mix (from writing and art direction to architecture, music videos and photography). It attracts more than 21,500 entries globally each year including those from leading agencies and design groups, clients and in-house studios. Awards for the years 1993 to 2003 were analysed for this report.

### Interbrand Study: Brand Values (IB)

An annual survey conducted by Interbrand, a well known international branding consultancy. Using publicly available information, it publishes a list of the most valuable brands on the market. The primary aim is to make clearer the extent to which intangibles, and hence brands, affect the valuation of companies. Data for the period 1999 to 2003 was used for this analysis, with only six companies qualifying (due to the international nature of Interbrand's study).

### Design Council: Millennium Products (MP)

At the turn of the millennium, the Design Council launched a scheme to identify 1,000 products and services which exemplified the effective use of design by UK-based companies. The awards were given to companies for new products, services and processes and tended to lean towards innovation.

### Design Council: Panel Nominations (PN)

In order to ensure completeness, a team of Design Council experts met as a panel to consider which companies from the FTSE 350 should be considered as effective users of design. They selected from five design categories (as shown in Table 4) and the exercise was done 'blind', in that no detailed stock market information was available to the participants when they made their choices. The companies were given points according to the number of categories under which they were listed.

Each of the schemes noted above has many categories and this study therefore standardised them under five basic headings, summarised in Table 4 below. Awards or nominations attributed in different design categories carried the same score, and each of the five basic design headings was assumed to contribute equally to the success of the company.

**Table 4:** The standardised design categories

	Product	Innovation	Brand	Retail	Integrated
DEA	•	•	•	•	•
D&AD	•		•	•	•
IB			•		
MP		•			
PN	•	•	•	•	•

The scores for each award scheme were then added together as a measure of design effectiveness, with all schemes given equal value. A weighting was given for each type of award class: best of class (4 points), gold (4 points) and silver awards (3 points) scoring more than nominations (2 points) or commendations (1 point). These scores were then aggregated over the period 1993 to 2003.

This analysis produced 166 eligible UK-quoted companies that had received at least one award or one nomination since 1993. They could have received these via a subsidiary, for a brand, a product or a service. Under each scheme's category therefore, a company could receive several awards because:

- It had several subsidiaries or products that won awards or nominations
- It received awards over several years in the same and/or different categories
- A single product, service or process received multiple awards in a single year.

The scores of the qualifying UK-quoted companies ranged from one point to 175 points.

In order to provide a more considered analysis of the use of design, the companies were then split into two groups – Design Index and Emerging Index - based on the number of points gained. A minimum score of seven was required for inclusion in the Design Index; this score could be achieved either by a combination of a gold and silver award in a category, or by several mentions and/or nominations in one or more schemes. This demonstrated a more consistent or high level of effective design use. Any company scoring below seven points was included within the Emerging Index, exhibiting a less significant use of design based on the awards and nominations inclusion criteria.

**Table 5:** Number of companies included within the portfolios

Portfolio	Number
Design Index	63
Emerging Index	103

The companies which emerged from this analysis formed the initial universe on which the FTSE design indices constituents were based.

## Appendix 4: Retail and banking sectors

Company	FTSE Sector	Design Council Index
<b>Retailers</b>		
Alexon Group	General Retail	
Ashley (Laura)	General Retail	
Beattie (James)	General Retail	
Blacks Leisure	General Retail	
Body Shop International	General Retail	Design Index
Boots Group	General Retail	Design Index
Brown & Jackson	General Retail	
Brown (N) Group	General Retail	
Burberry Group	General Retail	
Carpetright	General Retail	
Carphone Warehouse	General Retail	Emerging Index
Clinton Cards	General Retail	
Dixons Group	General Retail	
Findel Plc	General Retail	
French Connection	General Retail	
Game Group	General Retail	
GUS	General Retail	Design Index
Halfords Group	General Retail	
HMV Group	General Retail	
Homestyle Group	General Retail	
House of Fraser	General Retail	
Jessops	General Retail	
JJB Sports	General Retail	
John David Group	General Retail	
Kesa Electricals	General Retail	
Kingfisher	General Retail	Emerging Index
Lastminute.com	General Retail	Emerging Index
Marks & Spencer	General Retail	Design Index
Matalan	General Retail	Design Index
Merchant Retail	General Retail	
MFI Furniture Group	General Retail	Design Index
Moss Bros Group	General Retail	
Mothercare	General Retail	Design Index
Next	General Retail	Design Index
Ottakars	General Retail	
Peacock Group	General Retail	
SCS Upholstery	General Retail	
Signet Griup	General Retail	Design Index
Smith WH	General Retail	Design Index
Ted Baker	General Retail	
Topps Tiles	General Retail	
Woolworths Group	General Retail	Design Index
Wyedale	General Retail	
<b>Banking</b>		
Alliance & Leicester	Banks	Emerging Index
Barclays	Banks	Design Index
Bradford & Bingley	Banks	Emerging Index
Egg	Banks	Design Index
HBOS	Banks	Emerging Index
HSBC Holdings	Banks	Design Index
Lloyds TSB Group	Banks	Emerging Index
Northern Rock	Banks	
Royal Bank of Scotland	Banks	Design Index
Standard Chartered Bank	Banks	

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For more information on our research, please email: [research@designcouncil.org.uk](mailto:research@designcouncil.org.uk)

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