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Extra Crunch

Baillie Gifford's Charles Plowden on 110 years of investing

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Baillie Gifford

"**It is our** contention that the investment industry may be experiencing a peak of its own, in this case the point of the maximum rate at which it extracts value from its clients' assets. Let's call it Peak Gravy." That's a recent quote from Tom Coutts, who is one of a few dozen partners at Baillie Gifford. It's also typical of the provocative sentiments offered by this band of fund managers who are based in Edinburgh, but scour the world looking for opportunities.

In an effort to distinguish its world view, the firm has introduced the somewhat eyebrow-raising tagline, "We're actual investors." For many US technology observers, though, Baillie Gifford is known for its investments in unicorns. But as Extra Crunch's executive editor Danny Crichton and I found out in a recent conversation with Charles Plowden (one of two senior partners and the overseer of the firm's investment departments), there's a lot more to the story and motivations behind this unique 110-year-old partnership that's still going strong.

Gregg Schoenberg: Charles, Danny and I are happy to connect with you. I'll kick things off with an easy question to get things going: Why is Baillie Gifford different?

Charles Plowden: Unlike a lot of firms based in New York or London, we stand outside the bubble looking in. We also don't report to anyone, don't have outside shareholders, and don't have to produce cash flows, dividends or capital returns to anyone, which means we can focus 100% of our efforts in doing what we think is right for our clients.

Danny Crichton: I take it Edinburgh is outside of the bubble?

CP: Yes. Scottish accountants, bankers and lawyers are famous across the world, but it has the scale of the professionals without being part of the market and the buzz. Of course, there's also a lot of technology buzz in San Francisco and the Valley, but we are the opposite of all that. We have quiet rooms full of libraries and books.

GS: Sounds lovely. Could you talk about what your approach means for your clients?

CP: The first question we always ask is whether it's good for the clients. I think that's quite unusual, because for most participants in our industry, they're either public, or they're subsidiaries of large financial conglomerates, or they have outside shareholders, or they've been dominated by one or two founders. With us, we are fourth generation and 110 years old. So we've found a way of rolling forward.

GS: Who are your clients?

CP: Our clients are nearly two thirds outside the UK, with the largest share in North America. They are principally institutional in nature — the professional's fund manager, if you like. Historically, our client base was very much old-fashioned defined benefit pension funds. But as most of those around the world are closing and will eventually wind down and shrink, we've been putting a lot of effort into increasing the distribution. But we're not selling off the page or through the Wirehouse brokers.

GS: Perhaps it explains your tagline, "We're actual investors." I like it, but I want to square it with what you have told me about how Baillie Gifford focuses on what it's doing and doesn't pay too much attention to the world. Because the implicit message here is that you've surveyed the competitive environment and concluded that there are not a lot of "actual investors" out there.

CP: We don't think of it as, 'We're better than them because they're not actually investors.' It comes back to what the purpose of the stock exchange is. It's called the capital market, but it isn't a capital market anymore. It's a de-capital market.

GS: How has that happened?

CP: Over the last 30 years or so, equity markets have become this shrinking pool of capital that people just extract capital from, as a source of annuities, share buybacks, dividends, etc. That's all, particularly in the US, but globally that's what investors seem to be focused on. It's how to get money out of Apple. It's not how to get money into Apple because Apple wants to build a new factory and grow. We don't think that's investment. That's extraction. That's hollowing out. So our general thinking is that our whole industry, not individual competitors, our whole industry, has forgotten its core purpose.

GS: Fair enough. But if I went to the TechCrunch Christmas party and introduced myself as an "actual" contributor, nobody would want to hang out with me around the punch bowl. Speaking of which, I talked to a few sell-side firms about Baillie Gifford, which confirmed your unpopularity as well. Everybody pretty much said the same thing: "We know them, we respect them, they do great analysis, but they don't trade a lot."

CP: Yes, because if you look at the academic data, which is very persuasive, people who trade a lot underperform. We're long-term investors. In fact, the duration of our investing has gotten longer. We used to maybe turn over our portfolios every three or four years. It's now every six, seven, eight years.

GS: How does this conform to your firm's mission when you go to work?

CP: We want to do something that is contributing to society, not just be a part of the merry-go-round of money from bank to custodian to mutual fund, who are all buying and selling bits of paper. We want to put our clients' money, and our own money, into worthwhile companies that are creating wealth, products and jobs.

GS: You hear a lot of people on Wall Street saying, "We believe in the long-term." But it's nonsense, because many investors are judged on short-term performance, and as you know, people follow the incentives. An investor buys a stock and it jumps, and then the investor—

CP: —Why are you buying a stock if you're going to sell it a month later? You're buying it on a hunch that it's going to go up or on some momentum or some graph. You're not buying it because there's a business you believe in and a product that is going to do well and gain sales. You're buying it because you think you're cleverer than the other guy. There's no fundamental basis for buying it. It's a hunch.

GS: Danny and I are aware that you run the Global Alpha Fund and that you have no involvement in running or direct link with Baillie Gifford's Schiehallion Fund, which we have termed a private unicorn-hunting fund. But we have also followed Baillie Gifford's longstanding private company investing activities. Could you comment on the broader company ethos on private company investing and how it started?

CP: When you see a great opportunity that happens not to be listed on the stock market and you have a client that is structurally able to invest, why wouldn't you? So that's where it started, with one particular client.

GS: How did it grow from there?

CP: We found that these companies were then talking about us to other private companies. And so we started being approached by private companies saying, "Would Baillie Gifford be interested in considering an investment in our company?" And private companies get to choose who invests in them, unless they're really desperate.

GS: Yes, that's a good point.

CP: It's by invitation only, which means reputation is much more important in private markets than it is in public markets. Because when you buy a stock in a public company, you're anonymous. So it went from one investment that happened to be very successful in Alibaba, and it broadened out.

GS: What happens when a private holding goes public?

CP: We can be a bridge investor, and this I think is of particular relevance to people who read TechCrunch, because if you go to private equity specialists, they have shorter time horizons, and at some point, they're going to want to make exits. If you come to us, we don't need an exit. We can hold you whether you're private or public. We can hold you for five years or for 20 years. But as I said earlier, the public market's function has changed from raising capital to actually giving the entrepreneurs a bit of an exit where they can sell down part of their holding.

DC: That part is one of the challenging contradictions here, which is that although you're a long-term investor and you don't necessarily need the exit, many of your clients may want an exit. Certainly, the early employees of the company want an exit. So there's always this pressure to get back into the public markets where you're not as time-unlimited as you might expect.

CP: Yes.

DC: This is the same story with Lyft, which of course debuted recently. The more you move to the private markets, isn't that creating even more negative outcomes for public equity markets? Because now you're moving to the private markets, and if you're the good guy—

CP: —That implies that little old us are causing this. I saw some statistics that show that private companies are staying private for longer, and that more of the best growth and value creation is happening as private companies. So we have a choice as growth investors. We can just say that's a missed opportunity, that we can't get involved now and buy them on the IPO. But if the best value creation has already happened, why would we do that if we had a structure or a client that was able to access it?

GS: Let's talk about how you straddle the private markets and the public markets. You're active investors, and you have all these relationships with founders of companies. In some cases, you're also invested in the public companies that these founders are going after directly, right?

CP: Yes.

DC: From a corporate governance standpoint, how do you think about being on both sides of the coin?

CP: We proactively consider conflict scenarios that could arise from unlisted investments through a dedicated group within our Compliance Committee.

GS: I'll translate that to mean that you're very sensitive to the Chinese wall issues.

CP: Oh god, yes, and how. That was the big worry at the beginning. But just think of the broad numbers. We've got approximately $2 billion invested in private companies and about $220 billion invested in public ones.

GS: No, but the intel, you could argue, is —

DC: — Or the scale of the private companies is much smaller.

CP: But it's not. You could imagine, if you've got an investment in Airbnb and an investment in some hotel group like Hilton Hotels — which we don't have an investment in — that having an insight into Airbnb's growth potential is very valuable. It's not in any way a conflict. You're seeing the blindingly obvious before many others might have even heard of Airbnb. And you know, blimey, this is going to pressurize the real estate industry or the hotel industry. It's not specific information. And if you're going to own companies for ten years, you're not trading on it. Even if you wanted to and it was legal, we would never trade, whether inside or not, on short-term quarterly information.

GS: But it speaks to the fact that you're buying an education.

CP: Absolutely. That's why at the beginning, even though this was a project that would only benefit a tiny proportion of our client base, those that were able to invest in private alongside public, we felt that it was good for the firm as a whole because it was another differentiated insight. And something we haven't talked about, but which is part of actual investing, is if all your information comes from investment banks, you're going to read the same stuff and have all the same data as everyone else. How are you ever going to have a differentiated view?

GS: It's a good point.

CP: So we've put huge amounts of effort into having different insights. We talk to private companies, competitors, academics, regulators. We even employ former journalists as investigative reporters to go and do projects for us. We actually had one who went around to all the dentists in Germany, asking which manufacturer of spare teeth—

GS: —I hope you paid that guy a lot of money.

DC: Or he got free teeth out of it.

CP: That guy was amazing, because he taught us how to find information.

GS: Can you give an example?

CP: He would wait outside the CEO of some company's house and say, "Can I have a word?" We would never do that, because we wear jackets and ties and go to investment conferences.

DC: I just want to revisit something: You don't take board seats on private companies you invest in?

CP: No. For all sorts of reasons. Also, going on boards takes an enormous amount of time, and you've got unlimited liability—

GS: —What does that mean, the unlimited liability aspect to Baillie Gifford's story? Because you've effectively turned it into a point of differentiation, and I'm trying to understand what the implicit message is. For example, if one of your analysts at the Global Alpha Fund said to you, 'Here's a firearms maker that is a screaming buy.' Do you think about your unlimited liability and say no because as a shareholder, you may get sued?

CP: Not at all. There might be other reasons, ethical and stewardship reasons for why we might not do that. But essentially the unlimited liability only affects us, the partners, and we think it makes us much more risk-aware. Without putting any numbers on it, we have professional liability insurance as a firm. In fact, we've heard our cover is higher than any of our peers in the UK. But for us, if we're bust, we're bust. We're homeless.

GS: What I'm trying to understand, then, is how this unusual setup impacts you and/or is a selling point.

CP: Essentially, our thinking is we have a very low-risk tolerance when it comes to the business. And that allows us to have a high-risk tolerance for the risks you get rewarded for, which is on the clients' side, on the investment side. So, bizarrely, the fact that we're a very cautious firm allows us to take these long-term risks in portfolios.

GS: I want to revisit the sustainability aspect of your story, because it looks like a prominent part of your mantra. Are you able to take that stance because you are very much fixated on the long term?

CP: Again, part of actual investing is being around to help companies. Because if you're only going to be a shareholder for six months, you're probably going to miss an AGM anyway. You're never going to exercise your vote, whereas for us, the exercise of a vote is real power. It's influence that we want to use to help companies do the right thing, which generally means trying to get them to focus on the long term and invest in their business, not to extract.

GS: How does this philosophy influence your selection of names in your portfolio?

CP: What we've found is that companies have gone from investing nearly twice as much as they pay out to paying out twice as much as they invest. So they are extraction machines, whereas our portfolio is the other way around. Our portfolio still invests in R&D and CAPEX about twice as much as it pays out. Actually, one of the things that we love is when a stock price falls because investment is unexpectedly high. It's what we saw with Amazon year after year.

GS: I'm glad you mentioned Amazon. Are you worried about potential antitrust issues associated with some of your big holdings?

CP: I don't want to get into specifics, but to me, Amazon is a force for good. Why would people want to see it as the wicked enemy? It's produced massively lower costs, faster delivery and a wider range of products to people all around the world. That's somehow a bad thing? It's contributed to lower inflation, lower interest rates, faster deliveries, higher expectations, wider choice. Those are all incredibly good things. I don't see why you'd want to reverse history, to go back to the expensive store on the High Street that doesn't have in stock what you want and charges 30% higher prices.

GS: What about some of the other Big Tech names?

CP: Facebook and Alphabet are in a different category, and I think they have a higher level of responsibility. They have a huge share of the online advertiser market and they have more market power. So I can see why people, customers, advertisers, users are more anxious about them, and I think that's probably justified. They need to be good citizens, not bad citizens, and our general view is that these founders have some growing up to do.

GS: Let's talk about Naspers. It's a fascinating company, the biggest name in your fund, and yet it isn't as well recognized in the US as maybe it should be.

CP: Almost certainly. Yes.

GS: Did your investment in Naspers come before it took a stake in Tencent or after?

CP: Not before the Tencent stake. They took that stake 18 years ago… lots of really good stuff at a very significant valuation discount.

GS: What's so great about them?

CP: The great thing about Naspers is it's basically bringing internet services in whatever form to parts of the world where the big US companies are not. Across Africa, large parts of Asia and Latin America they've got these operations. They're not going head to head with your companies. And the reason it's our largest shareholding is it gives us exposure to lots of really good stuff.

GS: Speaking of good stuff, I'd like to finish by discussing your culture. You have a culture where you bring people up through the farm system. In fact, many people have been with you their entire career. It's admirable, but do you risk becoming insular?

CP: That is always a risk, and it's a risk we're very open about. In many ways, given that our job is to invest globally in all of these disruptive new technology businesses, it's unlikely we're going to get too insular. Also, when you're investing, particularly in public markets, there's a very well established feedback loop. But sure, there's no revolving door of talent coming in and going out. We're not Google, where you get the world's expert in something and you keep them for three years and then they go and work somewhere else.

GS: Danny and I were discussing your inclusion of friendliness as a core principle of your culture. I take it you actually mean it.

CP: Look, I'm not a technology investor. I'm not even a private company investor. I come from quite a conservative firm in quite a conservative part of the world. And yes, we do talk about friendliness and being honorable: treating each other honorably, treating our clients honorably, treating the companies we invest in honorably. It's very old fashioned and very unusual. But it seems to work. It's not just a marketing gimmick. It comes through in our staff's stability and loyalty, but most importantly, in investment returns.

GS: Well on that note, Charles, thank you for your time, and we wish you continued success.

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