INTERVIEW

BARING PRIVATE EQUITY ASIA, GORDON SHAW

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GORDON SHAW IM GESPRÄCH

TATKRÄFTIG, BESCHEIDEN UND VISIONÄR – MIT MUT ZUM UNTERNEHMERGEIST

Im September hat Dr. Patrick Maurenbrecher ein Gespräch mit Gordon Shaw, Managing Director bei Baring Private Equity, in China geführt. Gegründet 1997 in Hongkong, ist das Unternehmen zum führenden Private Equity Haus für Asien aufgestiegen. Ein Gespräch über Unternehmergeist, den asiatischen Private-Equity-Markt und die Stärken seines Teams.

MAURENBRECHER: **Gordon, thank you so much for taking the time. Let's start this conversation with a personal note: how did you get into the Private Equity space and how did your time with the Baring team evolve?**

SHAW: I joined AIG Investment Corp Asia in 1993 shortly after business school. Private equity attracted me as an opportunity to partner with successful entrepreneurs and managers to help them grow their businesses. It was at AIG that I worked with Jean Salata, before we left to form Baring Private Equity Asia. It has been exciting being part of the fantastic transformation of China over the past two decades, having lived in Shanghai during most of that period.

MAURENBRECHER: **How does the private equity market in Asia differ from the American or European markets and what are the changes you observed over the last 20 years?**

SHAW: The private equity market in Asia was only established in the late 90's, so it is coming from a 20-year deficit relative to the US and Europe. In the 20 years since it was established, we have seen a fairly rapid evo-

lution from predominantly minority growth investments to a more mature industry and the emergence of the mid- and large-cap buyout market. Today, we're at a point where Asian PE managers are operating at the same level as their Western counterparts in terms of capabilities and sophistication. We believe it is critical as a firm to be aware of developments in the external environment and we are constantly striving to stay ahead of those changes.

In the early years the market consisted primarily of small funds that were doing minority stakes, primarily in growth capital and some venture capital type opportunities. This strategy worked reasonably well for a while because the region had high economic growth with lots of entrepreneurial activity, and inefficiencies between private and public markets that led to a buoyant IPO market. But that started to change in 2008, in particular post-GFC (global financial crisis). The high growth rates started to slow, and the IPO markets also became more challenging. For us as a firm, it was then that we started to shift our strategy towards more of a control buyout strategy.

It has really been in the last five or six years that the broader market has evolved to provide all of the tools that are necessary to succeed in a buyout market. Today, it really has a lot of the same characteristics that you see in developed markets: Entrepreneurs' willingness to give up control, the ability to replace management, or to control the board, control over the exit, higher numbers of trade sales, and the ability to add leverage. Most importantly, almost all of our value creation happens post-investment as we try to help the business at an operational level, rather than just passively trying to select the right company and then hoping we can exit well.

So we've seen that shift from minority to buyout, from IPO exits to more trade sale exits, and from relying on macro tail winds and sector growth to more value creation and what you're doing with the asset. From that perspective I'd say Asia has now caught up to the US and Europe, despite the 20-year head start for those markets.

MAURENBRECHER: Can you summarise Baring PE Asia's investment approach?

SHAW: The objective of our investment program is to provide investors with a broad-based exposure to the higher rates of economic growth in Asia, but with a lower level of risk than investing via the public markets. In doing so, we aim to generate returns far in excess of those available in the Asian public markets. Over the past 20+ years, we have created an institution that is capable of achieving this objective consistently and at scale, so that it can deliver a predictable and meaningful impact for our clients' portfolios.

In simple terms, we're a pan-Asian mid- and large cap buyout fund. We have a stable and experienced senior team who source and execute deals across the entire Asia Pacific region, and – unlike many Asian firms – we pride ourselves on being truly pan-regional. There are very few sponsors in Asia who have the same team size and geographic footprint as us, and I believe that gives us an advantage.

Post-investment we place a lot of emphasis on creating value through implementing operational and strategic initiatives within our portfolio companies. In order to deliver consistent returns to our investors, we have developed a playbook called the Baring Management System (BMS). This distills our 20+ years of experience into an institutionalized process to consistently drive transformational value creation and control investment risks. This process is applied to all portfolio companies and encompasses initiatives applied at all stages of the investment process, from pre-investment to exit.

MAURENBRECHER: Baring PE Asia operates with 8 offices in Asia covering very diverse countries such as India, China and Japan. Could you explain your philosophy on the country allocation and how you foster cooperation between the different teams?

SHAW: We have pursued a pan-regional approach since inception in 1997,

even when we were a small team investing just a few hundred million. We've lived and worked in Asia our whole careers and we know that Asian markets are typically more dynamic than more mature markets, which can result in significant changes to the quality or quantity of attractive investment opportunities in specific countries during the investment period. So right from the outset we wanted to have the flexibility to allocate capital to the best opportunities across the region. We don't predetermine allocations to specific countries, instead we prefer to operate through a "bottom-up" selection of the best opportunities across geographies and industries.

I think this is an advantage because it helps avoid deploying capital in a particular market during periods when the price expectations of vendors are beyond justifiable levels, or when factors beyond the Firm's control limit its ability to invest in a specific country. As part of this process of continuously comparing relative values across the region, we can identify dislocations that represent mispriced risks or mispriced assets across Asia. Our approach to multi-market investing adapts to suit the characteristics of each country in which we invest.

The other significant factor is the prevalence of intraregional trade among the Asian countries. The majority of our portfolio companies operate across multiple countries, so we usually find that the deal team on a particular transaction consists of professionals from our various offices in each country. This has become more important over time as we've become more sector focused. Today, each of our Managing Directors has both a regional focus and a sector focus which facilitates a lot of collaboration between the teams.

Of course, none of this would be possible without the right culture and incentive structure. Our team understands that their worth to the company isn't just getting their own deals done - it's about everyone achieving success together, with the combined results being far greater than they could have achieved on their own. We believe that we have the lowest turnover ra-

tes in the industry. Our Investment Committee members have been together for 18 years on average, and our broader Managing Director group for 12 years, and we want to maintain that culture and strong relationships.

MAURENBRECHER: **Please explain your incentive system for the team members. Do the teams in different countries participate equally in country-specific deals?**

SHAW: Carried interest is shared broadly amongst BPEA's investment professionals to foster a sense of ownership. We have a shared compensation structure which is determined at the start of the fund's investment period. It's not allocated based on who deploys capital into a specific deal. This is important as it ensures that people are incentivized to help out on every deal, not just their own.

Another part of the compensation is the GP commitment, and we expect that the team and firm will invest around US$200 million of their own capital into Fund VII. When your own capital is on the line there's also a pretty big motivation to ensure everyone is pulling in the same direction.

MAURENBRECHER: **We understood from our conversations with the various MDs of Baring that the set up of your Investment Committee is a particular competitive advantage: could you explain the role of Jean Salata and the impact of the proximity of investment decisions to the companies you buy?**

SHAW: All of our investment decisions are made locally by the deal teams and the Investment Committee, who all sit in Asia. We're not relying on decision makers who sit outside the region and don't understand the culture, or the market, or the competitive dynamics, or the nuances of dealing with local entrepreneurs.

Jean Salata is the Chairman of the IC. By the time an investment reaches the final voting stage of the IC, it has already been thoroughly scrutinized by the broader team and will have been through several initial rounds of

voting, with only the highest conviction investments making it through to this final stage. A majority affirmative vote is required in the case of both investments and divestments, including the affirmative vote of the Chairman. However in practice most decisions made by the IC are unanimous.

MAURENBRECHER: How do you deal with different opinions in the Investment Committee? How do the investment decisions evolve?

SHAW: The IC members have been working together for an average of 18 years; our different background and experience complement each other. All of us have fund-wide carry with most of our net worth invested in Baring's funds. As such, our interests are quite aligned in seeking the best risk-reward investment decisions; not just on a deal-by-deal basis, but also in the portfolio construction to have a well-diversified portfolio across industry and geography. Only the highest conviction investments make it to the final stage of the IC and our decisions are usually unanimous.

MAURENBRECHER: Could you elaborate on the way you "manage" the cultural aspects in your deals. I would assume the deal sourcing in India works in different ways compared to a Chinese or Indonesian deal?

SHAW: The cultural aspects need to be considered, not just in deal sourcing, but even post-investment value creation with management teams and corporate partners. Even exits to local strategic buyers will require some local understanding. The Baring team consists of 19 nationalities and we strive to be "local" in terms of understanding the cultural aspect of operating in each of our markets, which is critical given the heterogeneous makeup of the region that we cover. To give an example, for a good part of the history of BPEA, we limited ourselves to opportunities working with entrepreneurs in the private sector. In 2012, we felt that we could enhance our experience working with Chinese State-Owned Enterprises (SOEs) so we onboarded a new MD in Beijing, Guy Cui. He has a wealth of experience from growing up

in China & working with SOE clients which gives him valuable insights that allow us to better assess the benefits & risks of partnering with SOEs. That led to successful examples of working with leading SOEs like COFCO and Bright Foods.

MAURENBRECHER: One of the success factors in the value creation seems to be the "Baring Management System". Could you explain the implementation and how this system pushes growth?

SHAW: The Baring Management System, or BMS, is the crux of our active ownership model to driving the value and growth in our businesses. It's our proprietary playbook that we've developed over the past 20+ years.

The BMS is based on three fundamental principles, namely Control, Value Creation, and People. These principals are further broken into six pillars: Governance, Managing Risk, Building Alignment (OGSM Blueprint), Driving Results, Building High Performing Teams, and Fostering Ownership.

Our teams start by defining and quantifying value creation opportunities for each potential investment as part of the due diligence process. We see this as a critical step in uncovering value and building conviction around an investment opportunity, and it will be discussed extensively by the IC prior to investing. We will develop a 100-day plan which sets out priority strategic objectives with clear accountability, timelines and quantifiable values. We also look at the company's management teams, the governance structure and how to devise the right incentive structure to ensure alignment with the corporate governance. After the first 100 days, the deal team will continue to engage with the company in accordance with the BMS framework to ensure that the plan is implemented and the agreed objectives are being met. As an additional oversight measure, the Portfolio Management Committee will review the delivery of the plan alongside the deal team several times per year.

One of the most important factors in this entire process is access to management talent, and that makes a huge difference in the outcome of the investment. It is critical that you have the right people running those companies. This is something we're seeing increasingly available now in Asia, especially when we're investing in larger businesses where you can attract and afford larger professional management teams. BPEA is also fortunate to have a large external network of highly respected experts. We work extensively with top CEOs from well-established firms who can come in as advisors both pre-investment and post-investment. Amongst those are Alan Mulally, former CEO of Ford Motor Company and Boeing Commercial Airplanes, and Sandy Ogg, former Chief Human Resources Officer for Unilever.

MAURENBRECHER: **Looking at the final phase of the holding period, how do you go about exiting your companies. We understand, this is of particular concern in China?**

SHAW: In short, we start preparing portfolio companies for exit before we've actually made the investment.

The team has considerable experience in achieving liquidity for its investors, including via trade sales, IPOs, secondary offerings, block trades, secondary sales to other private equity firms, redeeming securities and refinancing of investments. This is illustrated through the fact that the majority of our funds are top quartile in DPI, and between 2017 and 2018 alone we generated $4.3bn of proceeds back to our investors.

We are acutely aware of the benefits of proactively taking advantage of market windows of liquidity as and when they present themselves. In order to achieve liquidity for our investors, the firm has developed a disciplined exit process that is deeply engrained in the firm's culture, which begins prior to an investment being made. Before proceeding with each investment recommendation, the firm identifies potential exit routes, which are then regularly assessed throughout the investment's life. We do this through the Exits and

Liquidity Committee (ELC) which is exclusively focused on holding teams accountable and driving exits or partial liquidity across the entire portfolio. This can be via a full exit, or through other liquidity measures such as dividend recaps or partial exits. We also have full time professionals that are dedicated to exits and financings / refinancings within the portfolio.

MAURENBRECHER: **Sometimes it's also very interesting to look at deals that have not worked out the way one had hoped at the beginning. Could you tell us about your worst deal and what you learned from that experience?**

SHAW: The worst deal I led was in a minority investment into an agricultural business in Northeastern China back in 2008. During that period, we felt that deals in the more developed areas in China seemed over-priced, and we consciously travelled far and deep across the country to look for opportunities. While we were able to structure the investment with lots of protection and ratchets, we never anticipated the depth and extent of the fraud that we experienced: the local officials, the expert we contacted via GLG, the customers and even the Big4 audit partner were all part of the fraudulent set up. It was a painful learning experience. Though we managed to convict the family at the center of the fraud, and there were repercussions for the advisors, we were unable to recover much of the investment.

Fortunately, the market has evolved significantly since then. We have built 20 years of institutional knowledge from experiences like this, we've resourced our firm with professionals (both internal as well as outside advisors/ industry veterans) who can avoid such situations, and have refined our investment strategy and deal process with the appropriate safeguards. Occurrences like the one I just described are incredibly rare today, and even rarer in the segments in which we operate.

MAURENBRECHER: **As a final question we would like to look a bit ahead. What would you expect of the next 10 years for the private equity markets in Asia? Are there some country specific developments you can spot already?**

SHAW: I believe the Asian private equity market will continue to outpace the more mature Western markets given its under-penetration (compared to GDP), and the higher GDP growth in the region. At the same time, the Asian PE industry will continue to mature in the sense that firms will specialize more by sectors, or by geography.

As many Asian countries have an abundance of capital, there is a tendency of national policies towards encouraging the domestic PE industry with funds that are limited to domestic investing. However, such single-country funds are more susceptible to economic cycles compared to a regional fund with flexibility to invest across multiple countries.

MAURENBRECHER: Gordon, thank you so much for your time. It's been great talking with you and we very much appreciate all the insights you shared with us.