

Baillie Gifford™

Private growth: Looking over the overlooked

Brian Kelly, Investment Specialist Director

January 2025



Risk Factors

The views expressed should not be considered as advice or a recommendation to buy, sell or hold a particular investment. They reflect opinion and should not be taken as statements of fact nor should any reliance be placed on them when making investment decisions.

This communication was produced and approved in January 2025 and has not been updated subsequently. It represents views held at the time of writing and may not reflect current thinking.

Potential for Profit and Loss

All investment strategies have the potential for profit and loss, your or your clients' capital may be at risk. Past performance is not a guide to future returns.

This communication contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research, but is classified as advertising under Art 68 of the Financial Services Act ('FinSA') and Baillie Gifford and its staff may have dealt in the investments concerned.

All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this communication are for illustrative purposes only.

Legal notices

FTSE Russell

Source: London Stock Exchange Group plc and its group undertakings (collectively, the 'LSE Group'). © LSE Group 2025. FTSE Russell is a trading name of certain of the LSE Group companies. 'FTSE®' 'Russell®', is/are a trade mark(s) of the relevant LSE Group companies and is/are used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

S&P

The S&P 500, S&P Global SmallCap and Dow Jones Islamic Market World (index) are products of S&P Dow Jones Indices LLC or its affiliates ('SPDJI'), and has been licensed for use by Baillie Gifford & Co. S&P®, S&P 500®, US 500, The 500, iBoxx®, iTraxx® and CDX® are trademarks of S&P Global, Inc. or its affiliates ('S&P'); Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC ('Dow Jones'); and these trademarks have been licensed for use by SPDJI and sublicensed for certain purposes by Baillie Gifford & Co. Baillie Gifford & Co Product(s) are not sponsored, endorsed, sold or promoted by SPDJI, Dow Jones, S&P, their respective affiliates and none of such parties make any representation regarding the advisability of investing in such product(s) nor do they have any liability for any errors, omissions, or interruptions of the S&P 500, S&P Global Small Cap and Dow Jones Islamic Market World Index.

Contents	Private growth: Looking over the overlooked	04
	Revenue growth drives return	05
	Power law asymmetry exists in large companies too	07
	Private growth provides VC asymmetry with less than VC risk	10
	Non-control investments lead to positive selection bias	11
	Investors can still provide value-add without control	12
	Portfolios are increasingly incomplete without private growth	12
	Worthwhile returns	13
	Conclusion	14

Private growth: Looking over the overlooked

When Americans think of a Brit, they typically imagine someone more cultured with a better accent. So, when I first arrived in Edinburgh to hear colleagues describe their lunch in terms of 'quid,' I figured it was a reference to the taste or an ingredient I had never heard of.

I quickly learned that quid is just shorthand for the price of lunch. Quid is to sterling what 'bucks' is to dollars. Quid (always used in the singular) poetically traces its name to the saying, 'If you want the quo, you'll need to give them some quid'. It is a subtle reminder that everything we buy, the transaction is quid pro quo. The value received needs to be worth the cash.

Understanding quid pro quo is an investor's top priority. When it comes to illiquid investments, the quid pro quo is for the asset to provide 'something extra'. One rule of thumb is to receive an extra percentage point rate of return for every year of illiquidity. Another is to achieve value creation that would be impossible in public markets.

Buyout, for example, takes control of every investment and provides margin expansion and financial engineering. Early-stage venture sidesteps market risk by being active in company formation to achieve asymmetric 50–100 times outcomes. Other illiquid investments provide truly diversifying returns, such as catastrophe bonds, infrastructure or biotech's isolation of scientific risk.

Heuristics such as 'illiquid investments require something extra' help us scale decision-making by taking it as a ground truth, a 'base rate,' freeing up attention for higher-value decisions. Investors can quickly rule out entire asset classes and focus instead on the nuances of which company or fund manager is most likely to succeed.

This leads to two potential issues. First, what if the base rate assumption is too narrow and we overlook an entire asset class with exceptional return opportunities? This is a classic type II error. Second, as the entire market follows the same logic, risk and reward change and opportunities can disappear. George Soros describes this second phenomenon as the 'Theory of Market Reflexivity'. This could happen if too much capital chases high returns in small asset classes such as early-stage venture capital, pushing valuations too high for the risk.

Private growth equity is a \$5tn asset class, often overlooked due to these heuristics. It a) resembles public equities but with less liquidity, b) generates no contractual higher return because returns are uncertain, c) has limited ability to manufacture returns as minority shareholders, and d) has some degree of market risk, especially given the need for an open initial public offering (IPO) or mergers and acquisitions (M&A) window for exits.

But ruling out the asset class means missing out on the opportunity to invest in future market leaders and rising monopolies. Those companies can grow their revenue by 5–10 times or higher over the next 5–10 years, with venture-like exponential growth, but with less than half the risk.

The broad misunderstanding of this category has resulted in less competition and attractive valuations.

Below are six reasons why investors should care about private growth companies.

01. Revenue growth drives return

The human brain underestimates the power of exponential growth. It's not intuitive that a piece of paper folded upon itself 42 times would reach beyond the moon. Even investors who do understand it often don't imagine it applies to private growth-stage companies. But it works.

Payments company Wise has grown revenues 133x since their Series C in 2016. Consumer credit company Affirm has grown revenues by 24x since their Series F in 2019. Social Media company ByteDance has grown revenues by 23x since their Series E in 2019.

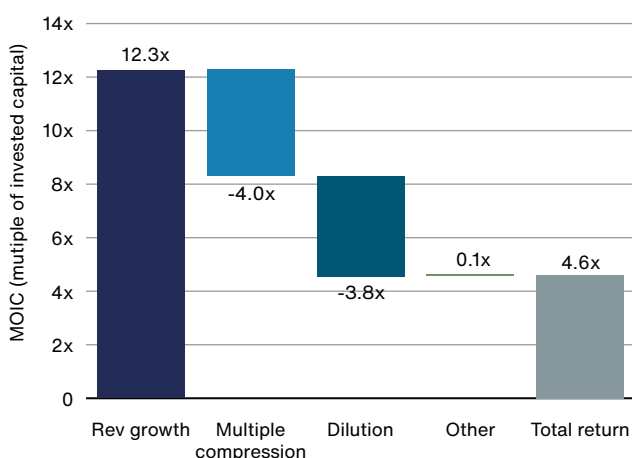
Exponential growth introduces two unique opportunities. First, a company growing 30–60 per cent per year can expand its revenue base

by 5–10 times or more during a fund's holding period. This growth is driven not by GDP like many businesses but by a great product, a growing market, and management execution.

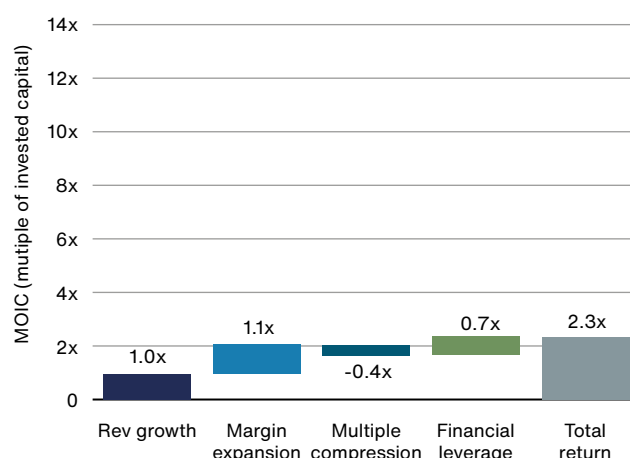
Second, this revenue expansion can absorb dilution, multiple compression and operating expenses to generate attractive shareholder returns.

To visualise this, see the 'value creation bridge' below based on the average Baillie Gifford holding as a guide. Even if a company is initially expensive and has operating expenses greater than revenues, revenue growth provides a large base to absorb multiple compression and dilution and still deliver attractive shareholder returns.

Growth return based on BG portfolio



Buyout return based on average middle-market deal metrics



Source: Baillie Gifford & Co, Pitchbook.

Growth

Based on the average Baillie Gifford private company holding with 30–60 per cent annual growth and a 40 per cent gross margin, with the representative challenge of high operating expenses of three times revenue, and multiple compression from 10 times revenue to 7 times. The key driver here is revenue growth and management execution.

Buyout

Based on the average deal metrics today from Pitchbook, if buyout achieves a 10 per cent revenue growth rate, 10 points of margin expansion (from 20 per cent to 30 per cent), levered at 47 per cent debt/EV, and multiple compression from 12.7x to 11x EV/EBITDA, it will achieve a 2.3 times return.

Given the frequent comparison of private growth to buyout, comparing the value creation between the two is useful. The most significant conclusion to highlight is that buyout and growth are complementary. One generates returns from revenue growth. The other generates returns from operating improvements and leverage. Portfolios will hold completely different underlying companies and return drivers. See Bain's private equity report for more on buyout value creation¹.

Public investors may argue that this revenue growth opportunity isn't unique to private companies. This is true, as companies like NVIDIA have also grown revenue 12x in 5 years. But younger private companies have a better foundation in place to pursue ambitious revenue growth, free from old 'tech debt' of legacy

systems and software, and enabled by aligned shareholders permitting bold investments in future growth. Public shareholders, by contrast have a much wider range of objectives and time horizons, which can encourage management to maximize cash flows to please as many as possible.

One housekeeping point on the value creation bridge above is that it represents the average holding. It does not reflect portfolio outcomes. A portfolio outcome requires taking hit rate into consideration. If only 33% of holdings generate a 460% outcome (ie 5.6x), and another 33% return invested capital, and 33% lose everything, then a fund will return 2.2x. Risk comparisons between venture and growth is discussed further, below.



Ruling out growth equity means missing out on the opportunity to invest in future market leaders and rising monopolies... with venture like exponential growth, but with less than half the risk

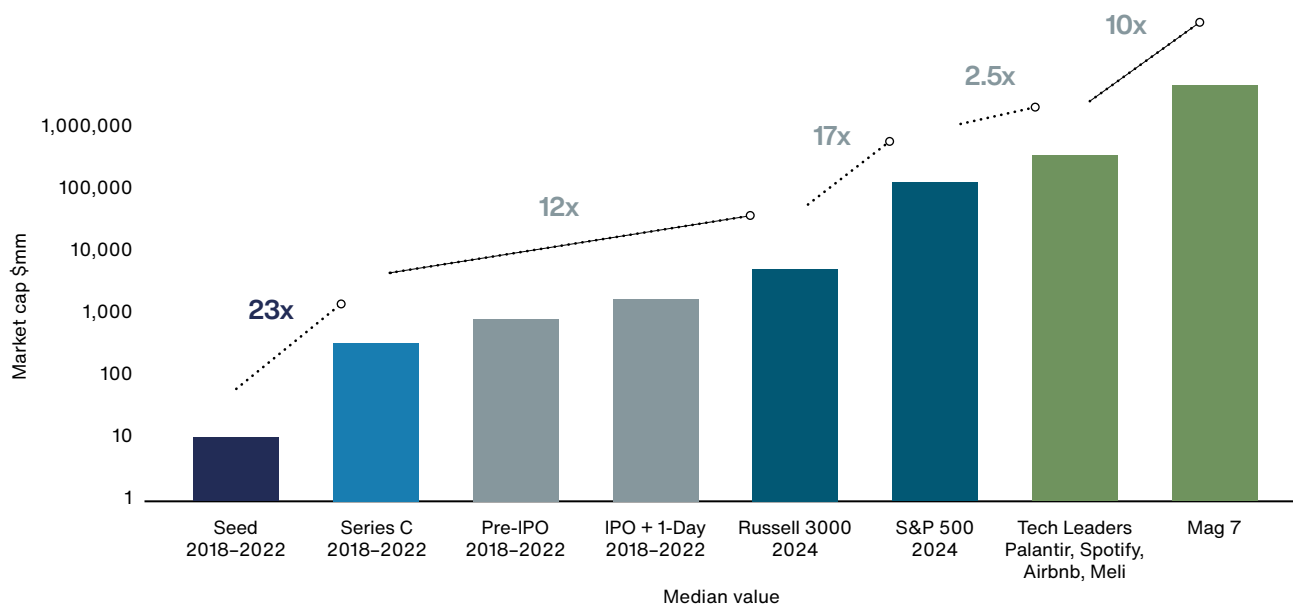
¹ Private Equity Outlook 2024: Industry Trends | Bain & Company

02. Power law asymmetry exists in large companies too

Power law upside isn't limited to small, early-stage venture capital-backed companies. \$10bn and even \$100bn companies can generate enormous asymmetry.

Value creation

Median market cap by investment stage or cohort



Source: Baillie Gifford & Co, Pitchbook, Statista, Jay Ritter, Russell, S&P.
As at 30 September 2024. The information is based on the median valuation of a company at each investment stage.

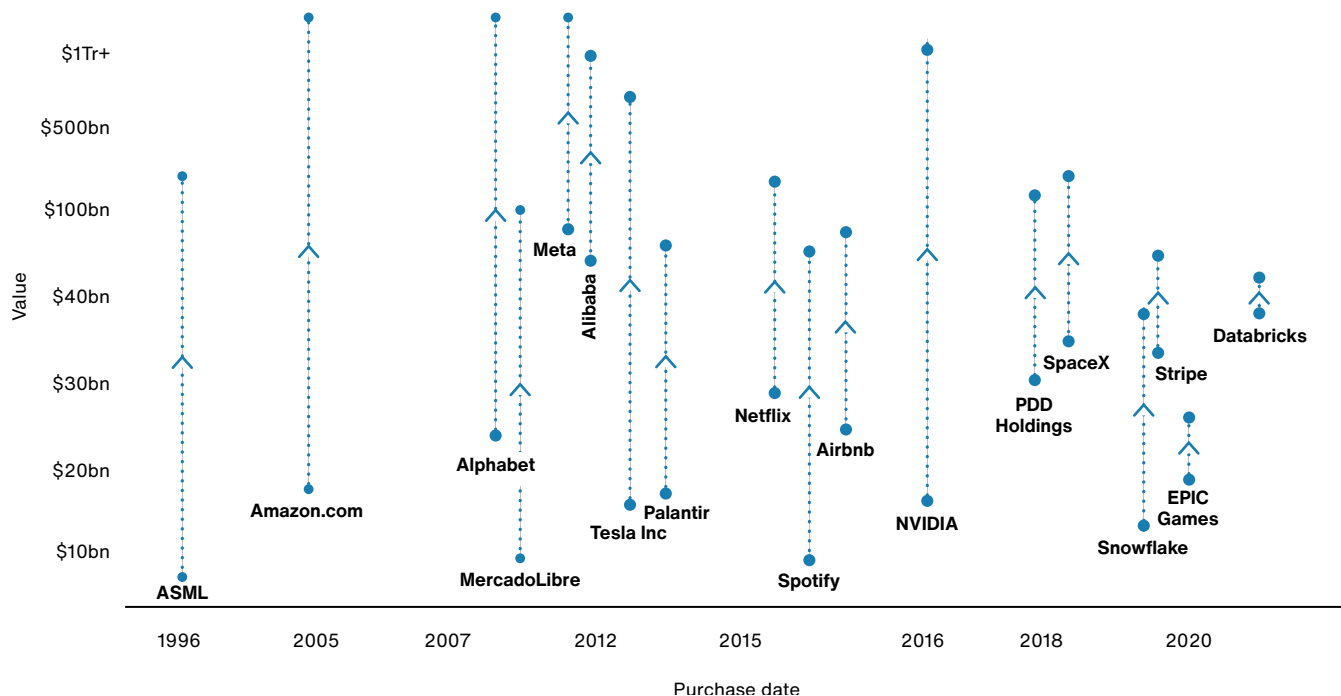
As an example, over the past 25 years, Baillie Gifford's investment teams have generated 50–100 times outcomes by investing in public and private companies of the same size, stage of life, and risk profile as many of today's larger private growth companies. Some examples are shown in the chart below.

To understand why the power law exists in larger companies, look at the size of public market leaders today. Twenty years ago, the largest company in the world (GE) had a market cap of \$380bn. At the end of 2024, the largest company in the world had a market cap 10 times the size (Apple), and ten companies were valued at over \$1tn. Before 2018, zero companies had ever been valued at over \$1tn (with one short-lived exception²).

Just like the public market leaders, private companies such as ByteDance, SpaceX, Stripe and Databricks can reach customers worldwide and have increasing returns on scale. The upside for these companies is no longer constrained to a \$10–100bn market cap. It could in theory approach \$1tn.

As a final note on power law, great investments often require comfort being uncomfortable. If an investment was comfortable, others would agree and there would be no opportunity. It is uncomfortable underwriting private companies to large market caps: this is the opportunity.

Power law in action – valuation growth since purchase



Source: Baillie Gifford & Co, Bloomberg. US dollar. As at 31 December 2024. Based on a selection of public and private Baillie Gifford holdings. Not all companies are currently held by Baillie Gifford.

² <https://www.theguardian.com/business/2007/nov/06/china>

Why are some prominent growth companies electing to stay private?

Many of the <\$10bn market cap public growth companies profiled above would likely still be private today, given companies' tendency to stay private for longer. This trend is expected to continue.

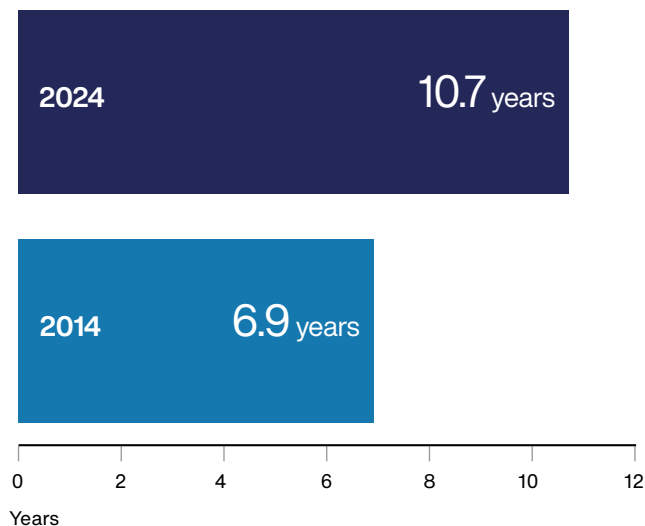
Why private for longer? Because private companies can carefully select their investors, allowing management to make bolder, longer-term investments than public companies. Examples include a) acquisitions that cement leadership, like Databricks acquiring Mosaic for \$1.3bn, or b) foregoing revenue to build something bigger, like SpaceX loading rockets

with Starlink satellites instead of third-party paying payloads, or c) funding loss making growth to achieve scale, like Airbnb or Spotify.

In addition to cap table and governance benefits, the public market structure no longer supports profitless, small cap IPOs. Historically, mutual funds drove demand for small cap IPOs. Over the last decade, nearly \$3tn of mutual fund assets have flown out into large cap index funds, leaving less demand for small IPOs. This benefits companies that continue growing privately until they are either profitable or at a scale to be near index inclusion, like Palantir who was added to the S&P in 2024.

Median age of VC-backed companies

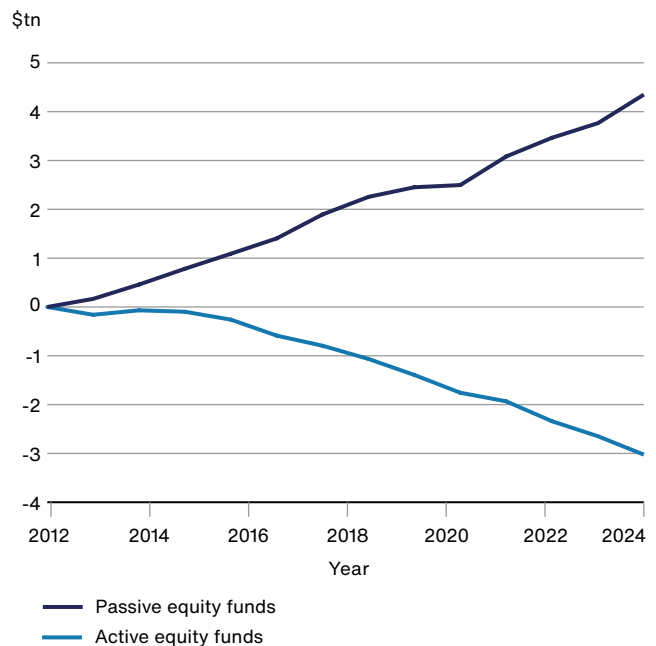
Private companies are stretching fund term limits of their early venture partners



Source: PitchBook. As at 31 December 2024.

Cumulative fund flows

\$3 trillion cumulative outflows from active funds, results in less demand for IPOs



Source: Bloomberg. US dollar. As at 31 December 2024.
The information is based on US domestic mutual fund and ETF flows.

03. Private growth provides VC asymmetry with less than VC risk

While power law upside opportunity exists, growth-stage companies are de-risked compared to earlier-stage companies.

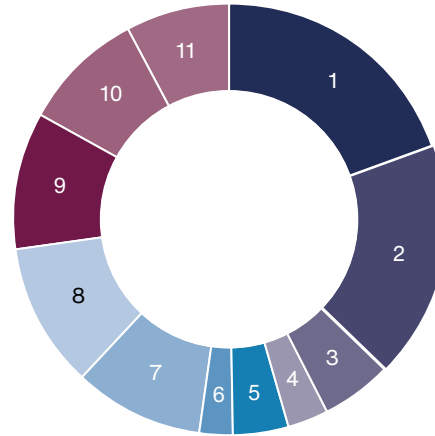
Two-thirds of CB Insight's top reasons for startup failure are early-stage concerns, ie they cannot access financing, manage cash burn, find market fit or get along as a team.

By the time companies reach the growth stage, these risks are less of a concern. This is because growth equity companies generate revenues (ie they have solved market fit) and are often near profitability (making cash burn and financing less of a risk).

To add more context with numbers, a Baillie Gifford study explored the failure rate of private growth investments based on series D investment data in Pitchbook. The study showed that one out of four growth investments returns less than 1x. By comparison, earlier stage venture returns less than 1x on two out of three investments, according to industry studies³.

CB Insights top reasons for startup failure

Blue = early-stage risk, red = later stage risk



		%
1	Ran out of cash	38
2	No market need	35
3	Product mistimed	10
4	Pivot gone bad	6
5	Poor product	8
6	Burned out	5
7	Flawed business model	19
8	Wrong team	21
9	Got outcompeted	20
10	Regulatory challenges	18
11	Pricing/cost issues	15

Source: CB Insights. Based on an analysis of 111 startup postmortems from 2018 to 2021.

Figures sum to more than 100% due to possibility of more than one reason can account for start up failure.

³ <https://medium.com/correlation-ventures/venture-capital-no-were-not-normal-32a26edea7c7>

04. Non-control investments lead to positive selection bias

Many of the best investment opportunities don't allow investor control. Imagine seeking control of Alphabet (Google), Meta (Facebook), or Berkshire Hathaway in exchange for investing in the business.

Should an investor not invest in these businesses because there is no option for control? In fact, their dual-class shares give shareholders even less control than the average public company. Imagine the difficulty of keeping up with market returns if an investor didn't own the best, largest companies today.

The same logic applies to private markets. Limiting investments to companies that allow investor control misses the opportunity to invest in exceptional growth companies. Brian Chesky (founder and CEO of Airbnb) and Daniel Ek (founder and CEO of Spotify) don't need investors to tell them how to run their business. Passing simply because they don't need investor advice would have cost Baillie Gifford clients 10-20x of missed upside.

Market leading private growth companies are at a stage of life where customers love their product, they're generating growing revenues, and they're mapping out ambitious 10-year plans to grow, scale, and create profits for shareholders. Most are removing investor board members who have overstayed their welcome in favour of strategic experts.

By expanding the private investment opportunity set to include non-control investments, investors positively select for high-quality companies.

For example, Bending Spoons is a private software aggregator like Constellation Software. Since 2013, they have bootstrapped \$40,000 of initial capital into \$3bn of value at a 160 per cent compound annual growth rate (CAGR). It has achieved this through great acquisitions and a skilled playbook for increasing revenue and reducing overhead. The team has neither required nor desired outside capital or value-add investors. However, Bending Spoons recently invited a small group of aligned, non-control equity partners as a first step to building a roster of stable, long-term shareholders.

Shares today are valued less than a market multiple on cash flow, with growth rates north of 30 per cent. Bending Spoons could grow another 20 times from here to reach the market cap of Constellation Software.

Another feature of non-control investments is that certain management teams will accept a lower valuation to retain control. Baillie Gifford recently witnessed this while negotiating the valuation with a drone company who had a billion-dollar term sheet outstanding from a major buyout fund. The company decided to partner with Baillie Gifford at a valuation 40% lower than the competing term sheet, while retaining control.

Bending Spoons and this second example both highlight another feature of non-control, in that both are still led by their visionary founders. Baillie Gifford found that of their largest private growth investments, 90% were founder-led companies. These founders have grown alongside their company and demonstrated skill in execution and management. This contrasts with hired CEOs who may come in with a playbook at odds with company culture or DNA, and less resilient to change.

Investors can still provide value-add without control

Adding value to a company doesn't require control, it doesn't even require a board seat. It just requires having something valuable to add. As one well-known founder recently quoted, "There's a shocking sparsity of good advice [from VCs] ... actually zero to negative advice".

What exceptional growth companies need most is long-term capital partners, preparation for life as a public company, and a board positioned to solve the next decade's challenges.

One way investors can help growth companies is with governance best practices. It is said that a company's board is like a second balance sheet and can increase a company's value. This is because a board steers management's conversations, helps focus on strategic priorities and oversees major capital allocation decisions.

A good board chairperson can be a mentor during good times and an asset during crisis. A bad chairperson can be a distraction at best, by draining resources on PowerPoint and procedure, or harmful at worst. Investors can help with introductions and best practices.

Another way investors can help is through mentorship and preparation. Many founders have zero experience being public company chief executive officer (CEO), chief financial officer (CFO) or chief operating officer (COO). Investors can help by facilitating introductions to public fund managers in preparation for quarterly financial Q&A, or through introductions to other c-suite executives who can share best practices.

The risk of poor preparation is high. Simply rushing an IPO and selecting the wrong audit chairperson can kill the IPO. An audit chairperson assumes enormous risk. If they aren't diligent or resign at the last minute, even future IPOs can be tainted. Investors can be a sounding board during this process.

05. Portfolios are increasingly incomplete without private growth

Today's leading private growth companies are natural monopolies with a sizable growth opportunity. Many are growing 30–60 per cent per year and would be sized among the top 50 largest companies in the world.

SpaceX is among the world's 40 largest companies and has two monopoly businesses. One is a monopoly on commercial rocket launches, cemented by a 99 per cent 15-year success rate (measured by successful payload deployment)⁵. The other is a monopoly on global internet access. Together, the two businesses are priced at the high end of leading public software companies. However, a simple price to revenue multiple fails to capture Starlink's potential to convert five billion global 4G and 5G customers over the next few years, with potential for a billion dollars of revenue per million customers, and to expand partnerships with industries including cruise, agriculture, aviation, manufacturing, and defence.

ByteDance is among the 40 largest companies in the world, is a duopoly in social media, with the same revenue and user metrics as Facebook, growing faster, but valued 80% lower.

Stripe is among the 150 largest companies in the world, growing 30 per cent, now profitable, and valued at a 30 per cent discount to their payment peer, Adyen as of December 2024 (based on price to sales).

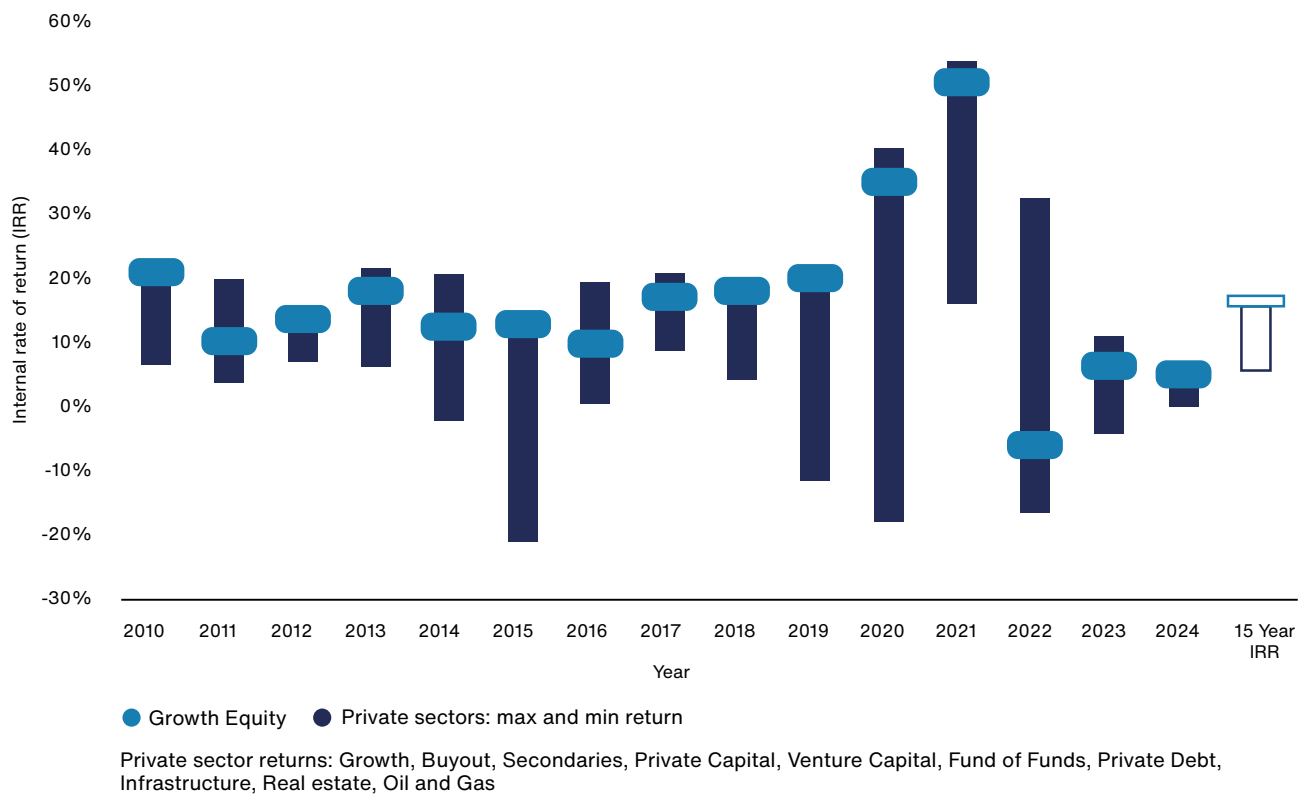
Databricks is one of the most important AI companies, with an AI advantage over their closest competitor Snowflake, and growing 2x faster. Epic Games is a leader in gaming, priced at a 50% discount to Roblox.

⁵ https://en.wikipedia.org/wiki/List_of_Falcon_9_and_Falcon_Heavy_launches

06. Worthwhile returns

Historically, private growth returns have been worthwhile, outperforming every other asset private asset class (and public equities, too).

Private Investment Calendar Year Returns



Source: Pitchbook. Data as of 31 March 2024. Note: All private capital returns are net of fees and carry.

Conclusion

Private growth is often overlooked by investors who opt for buyout or venture instead. Some rule it out as too late, others as too big, and the rest cite the lack of control or comparisons to public equity.

Contrary to these perceptions, private growth companies can achieve power-law returns with less risk than early-stage venture, and value creation that complements buyout. Returns are driven by revenue growth and by management execution to achieve scale, margins and profits.

Private growth companies today include market leaders and monopolies. Investments require a time horizon, governance, and value-add playbook best suited for shareholders who aren't seeking control or board seats. Long-term data suggests private growth returns have been worthwhile for investors that choose to participate.

Long-term data
suggests private
growth returns have
been worthwhile for
investors that choose
to participate



Important information

Baillie Gifford & Co and Baillie Gifford & Co Limited are authorised and regulated by the Financial Conduct Authority (FCA). Baillie Gifford & Co Limited is an Authorised Corporate Director of OEICs.

Baillie Gifford Overseas Limited provides investment management and advisory services to non-UK Professional/Institutional clients only. Baillie Gifford Overseas Limited is wholly owned by Baillie Gifford & Co. Baillie Gifford & Co and Baillie Gifford Overseas Limited are authorised and regulated by the FCA in the UK.

Persons resident or domiciled outside the UK should consult with their professional advisers as to whether they require any governmental or other consents in order to enable them to invest, and with their tax advisers for advice relevant to their own particular circumstances.

Financial Intermediaries

This communication is suitable for use of financial intermediaries. Financial intermediaries are solely responsible for any further distribution and Baillie Gifford takes no responsibility for the reliance on this document by any other person who did not receive this document directly from Baillie Gifford.

Europe

Baillie Gifford Investment Management (Europe) Ltd (BGE) is authorised by the Central Bank of Ireland as an AIFM under the AIFM Regulations and as a UCITS management company under the UCITS Regulation. BGE also has regulatory permissions to perform Individual Portfolio Management activities. BGE provides investment management and advisory services to European (excluding UK) segregated clients. BGE has been appointed as UCITS management company to the following UCITS umbrella company; Baillie Gifford Worldwide Funds plc. BGE is a wholly owned subsidiary of Baillie Gifford Overseas Limited, which is wholly owned by Baillie Gifford & Co. Baillie Gifford Overseas Limited and Baillie Gifford & Co are authorised and regulated in the UK by the Financial Conduct Authority.

South Korea

Baillie Gifford Overseas Limited is licensed with the Financial Services Commission in South Korea as a cross border Discretionary Investment Manager and Non-discretionary Investment Adviser.

Japan

Mitsubishi UFJ Baillie Gifford Asset Management Limited ('MUBGAM') is a joint venture company between Mitsubishi UFJ Trust & Banking Corporation and Baillie Gifford Overseas Limited. MUBGAM is authorised and regulated by the Financial Conduct Authority.

Australia

Baillie Gifford Overseas Limited (ARBN 118 567 178) is registered as a foreign company under the Corporations Act 2001 (Cth) and holds Foreign Australian Financial Services Licence No 528911. This material is provided to you on the basis that you are a 'wholesale client' within the meaning of section 761G of the Corporations Act 2001 (Cth) ('Corporations Act'). Please advise Baillie Gifford Overseas Limited immediately if you are not a wholesale client. In no circumstances may this material be made available to a 'retail client' within the meaning of section 761G of the Corporations Act.

This material contains general information only. It does not take into account any person's objectives, financial situation or needs.

South Africa

Baillie Gifford Overseas Limited is registered as a Foreign Financial Services Provider with the Financial Sector Conduct Authority in South Africa.

North America

Baillie Gifford International LLC is wholly owned by Baillie Gifford Overseas Limited; it was formed in Delaware in 2005 and is registered with the SEC. It is the legal entity through which Baillie Gifford Overseas Limited provides client service and marketing functions in North America. Baillie Gifford Overseas Limited is registered with the SEC in the United States of America.

The Manager is not resident in Canada, its head office and principal place of business is in Edinburgh, Scotland. Baillie Gifford Overseas Limited is regulated in Canada as a portfolio manager and exempt market dealer with the Ontario Securities Commission ('OSC'). Its portfolio manager licence is currently passported into Alberta, Quebec, Saskatchewan, Manitoba and Newfoundland & Labrador whereas the exempt market dealer licence is passported across all Canadian provinces and territories. Baillie Gifford International LLC is regulated by the OSC as an exempt market and its licence is passported across all Canadian provinces and territories. Baillie Gifford Investment Management (Europe) Limited ('BGE') relies on the International Investment Fund Manager Exemption in the provinces of Ontario and Quebec.

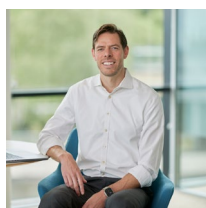
Israel

Baillie Gifford Overseas Limited is not licensed under Israel's Regulation of Investment Advising, Investment Marketing and Portfolio Management Law, 5755-1995 (the Advice Law) and does not carry insurance pursuant to the Advice Law. This material is only intended for those categories of Israeli residents who are qualified clients listed on the First Addendum to the Advice Law.

Singapore

Baillie Gifford Asia (Singapore) Private Limited is wholly owned by Baillie Gifford Overseas Limited and is regulated by the Monetary Authority of Singapore as a holder of a capital markets services licence to conduct fund management activities for institutional investors and accredited investors in Singapore. Baillie Gifford Overseas Limited, as a foreign related corporation of Baillie Gifford Asia (Singapore) Private Limited, has entered into a cross-border business arrangement with Baillie Gifford Asia (Singapore) Private Limited, and shall be relying upon the exemption under regulation 4 of the Securities and Futures (Exemption for Cross-Border Arrangements) (Foreign Related Corporations) Regulations 2021 which enables both Baillie Gifford Overseas Limited and Baillie Gifford Asia (Singapore) Private Limited to market the full range of segregated mandate services to institutional investors and accredited investors in Singapore.

Author biography



Brian Kelly

Brian Kelly, Investment Specialist

Brian is an investment specialist in the Clients Department and is a member of the Private Companies Team. He joined Baillie Gifford in 2024. Prior to joining the firm, he was head of Alternative Investments at Allen & Co Investment Advisors, where he oversaw investment research on opportunistic investments, alternatives, and third parties. Prior to Allen & Co, he was an analyst within global capital markets at Morgan Stanley in New York, focused on private capital markets and student loan securitizations. He graduated with a BSc in Mechanical Engineering from Brown University in 2008 and is a CFA Charterholder.

bailliegifford.com

Calton Square, 1 Greenside Row, Edinburgh EH1 3AN
Telephone +44 (0)131 275 2000

Copyright © Baillie Gifford & Co 2025.