

Private companies: backing tenacious trailblazers

December 2024

From spaceflight to a new form of entertainment dubbed 'shared reality', discover the entrepreneurs and companies forging new paths outside public markets

Your capital is at risk.

Leo Kelion (LK): In the early 20th century, Armand Spitz had an epiphany. "Planetariums are the greatest teaching instrument ever invented," he declared. The problem was they relied on eye-wateringly expensive equipment. Only six US cities could afford one.

So Spitz set about building a DIY alternative to inspire his daughter. He displayed the stars' movements by beaming light through hundreds of precisely drilled holes in a mechanised metal ball. And he founded a company to sell the invention to schools for \$500. Over time, the private company grew in scale, advanced its technology and led to the opening of hundreds of planetariums across the world. And, as we'll hear, its legacy lives on today.

I'm Leo Kelion, and in this special episode of Short Briefings on Long Term Thinking we'll hear from Alexander Nicolier, an investment manager in our Private Companies team. We spoke as part of Baillie Gifford's annual Disruption Week series of events, which you can find out more about in our Show Notes.

But before we begin, a quick reminder, your capital is at risk and your income is not guaranteed.

I started by asking Alexander what he thought most people misunderstood about investing in private companies.

AN: Most people still think of private companies as the typical Silicon Valley start-up, founded by two or three college drop-outs and working in a garage, and that maybe a few of these businesses get to reach and exceed the \$1bn valuation and become a so-called mythical unicorn.

The reality is that private companies are real businesses, real growth businesses. And these can be as old as 34 years, as one of our holdings is, and they can have valuations based on fundamentals upwards of \$200bn.

Believe it or not, today there are more than 1,500 of these unicorns globally, choosing to stay private for longer. And so then the challenge is not so much about finding these companies, it's about getting access to the very best of them. And you can only do that if you build relationships and if you have a strong reputation as a firm. That's what's going to open the right doors. That's how we go from meeting 800 companies a year to investing in just 10 or 12.

LK: So, as you say, relationship-building is vital, because these companies get to decide who invests in them, which isn't how it works in public markets. So, can you give me an example of you establishing and developing a relationship with company founders?

AN: Sure. Earlier this year, I travelled to Bogotá and to São Paulo, because I was really curious to hear how the ecosystem of start-ups and private companies are developing in Latin America. That trip was amazing because I learned that Brazil is probably ten years ahead of Europe and the US on anything fintech-related, and the companies there are using this environment to their advantage, to then go global and perhaps dominate.

I met close to 30 companies when I was there, and I reached out to half of them directly myself. The other half, I was kindly introduced by one of the founders of one of our holdings called Loft. He knew exactly who to reach out to that might be a great fit for us as investors, and that [he] thought there would be alignment. And guess what, those were the best meetings that I had. So I came back to my team, and we decided to do due diligence on at least four of them. And this, I think, illustrates the power of the relationships and the trust and alignment that you can have.

LK: So, when you're meeting with these companies, how do they know about Baillie Gifford? Is it by reputation or other means?

AN: Our reputation as public investors also filters through to the private side. I was surprised that the entrepreneurs knew about our story and philosophy. And this is because of our very visible investments in Tesla, in Amazon, but for Latin American entrepreneurs, also our investments in NuBank and MercadoLibre, where we are sizeable investors, those are also these success stories of LatAm, where they have made the jump to the public side, now worth close to \$70bn to \$90bn.

What tends to surprise them, though, is how long we've been investing in private companies, over a decade now. We started with Alibaba in 2012, later on with Airbnb in 2015. This is all on the back of being very deliberate over the past 115 years, we've built a brand that is all about one thing, which is investing in growth companies. And now, we're able to back them when they're private, when they go under their IPO [initial public offering], and later on, when we can actually invest even more and be big partners. This is very attractive to founders, as you can imagine.

And as they start to think about their next journey, that leg of growth of potentially pursuing an IPO in the next five to ten years, they start to think about who are the best partners to go along on that journey. And so they ask their VCs, their venture capitalist investors, they also ask their board members, who they would recommend, and our name comes up again and again. So we get weekly inbound emails from these founders directly.

So to give you a stat, about 81 per cent of the companies that we invest in come directly from our unique network, and we classify our unique network as the companies that we either reach out to directly, or they reach out to us, that founders introduce us to them, and we have a few aligned VCs as well that know what we're all about.

LK: And I should mention, you're Colombian-born, you speak Spanish, you're more than familiar with the local culture. So when you're doing a Latin America trip like this, does that play to your advantage?

AN: Yes, I didn't expect to speak Spanish in Colombia, but as soon as the founders realised that I did, they reverted back to their natural language. As you can imagine, English is their second or third language. And so in Spanish they were able to really tell me what they were all about, their vision, and it felt like having a genuine conversation, rather than something that could have been lost in translation.

And there was actually a funny story, because I met a founder at a restaurant, and he was there earlier than me, and he asked the waiter, be on the lookout for a *gringo*, when he goes through the door. And of course, I passed right through the door, passed [by] the waiter, and I said hello to the founder. And you should have seen the shock on his face when he realised that I was the *gringo*, a fellow Colombian.

LK: That's funny. Can you give me an idea of the global scale of the opportunity? Because there are probably more investable private companies out there than many people appreciate.

AN: Absolutely. This is a very large asset class. It's worth over \$5tn. So, for reference, that's not too far off the \$7.9tn that the global small cap index encompasses. Arguably, though, this is where you're going to find the greatest upside, and where we like to believe we're on the hunt for the next \$1tn companies that are right now in the making.

LK: So, from our clients' perspective, what's the advantage of investing in private companies via us rather than by other means?

AN: We are looking for companies that are near a growth inflection point, and we can see that as they're starting to benefit from scale, operational efficiency, and as they're on a path to profitability, if they haven't already reached that. So that means that we are far, far from the embryonic stage that VCs typically operate, where they're backing an idea, maybe a PowerPoint slide, or where they have a product that is just looking for a product market fit. In that sense, we are investing very

much on the same lines as we do already on the public side. And that's great for us, because we just see it as an extension of what we've always done for the past 115 years.

And that means that, as a team, we get to apply the same analytical frameworks, the same amount of scrutiny that we apply to typical investments. And it also means that we can leverage the potential in the research and insights of 180 investors that are looking at growth companies day in and day out. I like to say that we can have better conversations with this wider lens, because in the same sentence that we're talking about ByteDance, the parent company of TikTok, we can talk about what Tencent and Meta are up to. So we're not missing half of the story, it's a complete circle.

And in the best of cases, we can dare to invest in places like Brazil or India, where the macroeconomics absolutely matters, and then can go to our emerging markets team and ask people that have invested in these countries for the past 20 years. Because if they have a view of how the Brazilian real is going to perform over the next five years, well, I'd like to know that. So this is how we're able to invest in a way that is very different from traditional VCs, or even PE.

LK: PE is private equity.

AN: Private equity, yes.

LK: I want to move onto specific company examples, starting with SpaceX, one of Baillie Gifford's biggest private company holdings. Many in our audience will have seen when it caught one of its rocket boosters with giant metal arms in mid-air. I think this thing was about the size of a 20-storey building, quite incredible.

AN: Gigantic.

LK: And the company's also recently told us that it surpassed 4 million subscribers to its Starlink satellite broadband service. When Baillie Gifford first invested in the firm in 2018, we couldn't have known it would achieve either milestone, let alone on this timescale. So what I'm wondering is, as an investor, how do you deal with the amount of uncertainty that's involved in investing in a company that's truly a pioneer, doing something that nobody else has done before?

AN: Ultimately, we don't know how every investment is going to pan out. And this is especially the case for companies like SpaceX which, as you mentioned, are daring to do something new, going from zero to one. But at Baillie Gifford, we are comfortable leaning into uncertainty, because that is where you find the greatest asymmetric returns. And by that we mean that the worst that an investment can be, the downside is going to zero. And that is very much a possible outcome, but the upside is unlimited.

There's a quote by Jeff Bezos that captures this well. If you have a 10 per cent chance of a 100x payoff, you should take that bet every time. The way that we think about uncertainty in our investments is two-fold. Number one, we think about different scenarios, the good and the bad,

when we analyse a company, and we probability-weight these outcomes to know if, overall, it is worth pursuing. And the second aspect of dealing with uncertainty is that we are backing excellent management teams that have a proven track record of pursuing the plan, but also that show a bit of flexibility in case the environment changes.

Now, in the case of SpaceX back in 2018, when we invested in them, they already had a working and reusable Falcon 9 system, which is something that no non-government agency had ever achieved. And we had a lot of admiration for Musk as well, for the things that he had built in terms of companies. And we knew that the team at SpaceX was quite phenomenal, with Gwynne Shotwell calling all the shots, for lack of a better word, but doing so excellently. And the culture at SpaceX was also quite special. They've been able to gather the best engineers from NASA and other tech companies for the goal of becoming interplanetary.

Now, it's funny because, when we were doing the due diligence on SpaceX, Gwynne Shotwell was also doing a background check on us, to know if we were worth her time, worth an hour of her very busy day. And so she asked board members at Tesla to tell her a bit more about Baillie Gifford. And we're glad that we met her high bar.

LK: That's a great example of relationship-building being important.

AN: Absolutely. And beyond relationship being important is, as you mentioned earlier, is that in private companies investors can do all the research they want, but ultimately it's companies that get to pick the investors that will go along with them for a long journey. And in the case of SpaceX after 2018, now we can talk about them becoming an elevator to Space, essentially, they have a near monopoly. And we can see that they're in control of their own cost curve. They are deploying bigger and bigger rockets that will get them to different stages of potential.

And now, they're about to enable Starlink, the constellation that you mentioned, so that anybody with a smartphone will be able to access it. So you can imagine starting with text messages to the Internet eventually, what this enables could be fantastic. I think we're seeing that SpaceX is a once-in-a-generation type of asset, and we're privileged to have access to SpaceX and to have this for our clients.

LK: But not every investment is going to reach its full potential, or at least some companies can face major setbacks. How do you deal with that, if a company decides that it has to completely change its business plan?

AN: Yes, absolutely, I think companies need to earn their right to exist, and some of them will eventually fail, regardless of how much capital they have raised along the way. To give you an example, when VCs invest very early, their failure rates are close to 95 per cent, so very, very high. Now, when companies are a bit more mature, in later rounds, which are 'C' and 'D' rounds, which is when we typically invest, those failure rates are around 20 per cent.

Now, given the amount of due diligence and scrutiny that we apply to our own investments, we have about a handful of companies that we have either written down to zero or that have, unfortunately, pursued a path of bankruptcy. But that is in 140 investments that we have made over the past decade, since 2012. So, this is very rare for us.

LK: I'd like to move on to some of the Private Company Team's more recent investments, starting with Bending Spoons, maybe a company a lot of people in our audience aren't familiar with. They're based in Italy, aren't they? What do they do?

AN: Yes, usually when I mention Bending Spoons, they think I've watched a bit too much of *The Matrix*, but essentially Bending Spoons is a Milan-based company that has taken advantage of a misconception in tech companies. And this misconception is that software companies are not asset-light. They're just deploying billions into R&D in inefficient marketing and employing really expensive coders that sometimes have salaries in the millions, all to update or maintain a product that has some traction but never goes from good to great, and the potential is never fulfilled because they tend to be loss-making.

So Bending Spoons is turning that model up on its head. It's acquiring these businesses that have potential, that are overly bloated on the operational costs. And so, it acquires them at a fraction of the cost that it took to build them. It also lets go of these very expensive coders and replaces them with equally good coders from Milan, that are a third of the cost. And it uses its internal systems to make the product more efficient, so that it's able to grow and be profitable.

So our thesis is, well, threefold. Number one, there are many targets to go after. Number two, this rhymed with one of our investments on the public side called Constellation Software. They're also an acquisitive company from Canada that acquires software companies, and they've done this really well for decades. By the way, they have a market cap of \$90bn, so there's a lot of potential here. And third, it's those systems internally at Bending Spoons that seem to work across different apps that they acquire, so we know that there's a replicable process here that they've been able to do. Have you heard of Evernote?

LK: Yes.

AN: Okay, great, so this is one of Bending Spoons' portfolio companies. They acquired it for a third of the capital that it took to build Evernote. They replaced 70 per cent of their engineers with Italian ones, and they also increased prices, I don't know if you noticed that. But, their user experience is much better because it's running much more efficiently. And now Evernote is growing at 30 per cent and it's reaching record levels of profitability. There are more like it in the portfolio, like Remini and Splice, that do video editing and AI video generation, but this is a very promising investment that we're happy to have made.

LK: So how did Bending Spoons come to our attention?

AN: Bending Spoons has operated outside of the typical VC space for all of its existence, until now. And that's because it's been self-funded, boot-strapped from within. And this is something that we like to see in companies that are not growing at the expense of just investors ploughing in more money. That said, they were nearing a point where they were starting to think about the next leg of the journey, perhaps an IPO in the next five to ten years. So they reached out to Allen & Co., which is an investment bank that we are very much aligned in their way of thinking, and they introduced them to us. And they were very happy with our long-term thinking, and that's what ultimately won the founder over.

LK: The Private Companies Team first invested in Bending Spoons last year. More recently, you've invested in Cosm, and it has its origins in the firm that was set up by Armand Spitz, who I was talking about at the start. But today, its focus isn't on planetariums, is it?

AN: No, not exactly. So, today, Cosm is now focused on creating a new type of entertainment. They have these planetarium-sized theatres that have 12K-resolution screens that are perfect for seeing live concerts, live sports shows, and also maybe some documentaries. The way to think about them is almost like being immersed in virtual reality, but without the headsets, and with 500 other people that are chanting, that are standing up, singing the National Anthem, and they're even exhibiting some of the behaviours of being in a crowd. For example, doing the Mexican wave in some of the games that they are attending. So they're on to something, and they call it 'shared reality'.

LK: Tell me a little bit more about what this experience offers.

AN: Yes, so, essentially, it's a one-of-a-kind type of experience, where they have controlled everything to make the experience seamless. We like to say this is a vertically-integrated business, because they own the production, they own the cameras, they own the screens, the construction company is Spitz, which is related to [Armand] Spitz from the planetarium. So they own everything, which means that the experience is as good as it gets.

And a few of my colleagues have been lucky to go to the venues in LA and North Carolina, and they said you have to see it to believe it. It's like being in the best seats, regardless of where you happen to be. And as I said, you're seeing these social dynamics develop which you would only really see in a stadium, which is great.

Now, I met the CEO last week, and I asked him, what about Taylor Swift concerts? Because we know that she's travelling across the globe, taking a lot of time away from her career, maybe she could write more music if she only did one big concert and, with all the different Cosm venues all creating that experience as if people were watching it in real life, surely people would pay a lot for that? And the CEO said, actually, we're in discussions around this exact same thing. So stay tuned.

LK: I bet that'd be popular. So, beyond Cosm, what else has the team been investing in recently?

AN: We invested in Tenstorrent. Tenstorrent is a semiconductor company that is designing chips for future workloads in datacentres. And these chips are based on a new standard that is very different

to the one from Intel, AMD and ARM. Part of the appeal of the investment case for Tenstorrent is its CEO, Jim Keller. Now, very few people will have heard of Jim Keller, but he's an absolute legend in this space. He's had a career for 40 years here, and he actually led Apple's first foray into silicon chips that created these low-powered chips that went on to enable the iPad and the iPhone.

He then moved on to AMD and created a family of chips called Ryzen, which took AMD out of bankruptcy to now being a thriving business. And after that, he moved on to Tesla to lead the autonomous hardware team. So a highly decorated, a very smart person, that is actually acting like a magnet for talent. So this is a case where we have a lot of talent, but also the whole pedigree and a lot of evidence to showcase there's something special going on here.

LK: So that's some of the newer investments. I want to discuss what happens when companies stop being private. One of Baillie Gifford's advantages is that we can continue to hold after a flotation, maybe even increasing our stake if we still believe in the investment case. So, can you give me an idea of the current state of the IPO market? Because it had been a bit subdued, and that's had an effect on valuations.

AN: Yes. And before I do that, I think it'd be great to tell you a bit of a secret about Silicon Valley, [which] is that 80 per cent of these investments, of these start-ups, actually exit through acquisitions. So VCs are more interested in pricing the next round and finding the company that will eventually take them out of their portfolio. We care about the other 20 per cent, the ones that are trying to find an independent path, that have the ability to think about potentially pursuing an IPO in the next five to ten years. We won't push them to pursue that if they're not ready, but this is very much the type of company that we're looking for, which is very different.

Now, in terms of the IPO market, you're right, and, as I mentioned earlier, companies are staying private for longer. It's been a trend since the early 2000s. And this year, we've had about 191 IPOs, which is down from around 300 back in 2021. And some people interpret that as the IPO market being closed, but we don't think that's true. We think actually the IPO market is open for the right companies. And we've had two of our portfolio companies go public quite recently. One of them is Tempus AI, which is using machine learning and genomic sequencing to detect, and hopefully treat, cancer early. And the other one is Oddity, which is using technology and also a direct-to-consumer business model to develop better skincare for people.

LK: Not all of these companies have to become public. We invested, for example, in Epic Games, it's been private for 34 years, no sign of it wanting to list any time soon. Can you just explain why that's not a concern?

AN: We know that Epic, sorry for the pun, but they're on an epic journey, and this journey could be 10 to 20 years into the future. And we have to think along those timelines to have even a conversation with the management team. And we know that Tim Sweeney, the founder, he is a very special person that is thinking far out into the future, but he is in no rush to go public, and we are in no position, nor do we put any pressure for them to do something that would feel unnatural and that might even dent the potential that they're going after. So if you're an investor that wants control, if

you want to tell Tim Sweeney what to do or when to go public, good luck. I don't even think they're going to return your calls.

But for those of you that don't know what Epic is, this is the company that is behind the very famous game Fortnite, which has been around for now seven years, but it's still going very strong with about 100 million active users. What's special about Epic, and what's important here, is that they're trying to create a synchronous, persistent and interoperable digital world, which is perhaps a fancy way of saying the metaverse.

And the metaverse, for us, is just a digital world where creations, assets and the journeys that people take on these games will be around, just as we expect things in real life to be there, tomorrow and [in] 10 years and 20 years. And we also want these creations to have value, so there should be some ecosystem and economics behind these assets.

We think to create the metaverse you need three ingredients. Number one, you need the tool, and this is the Unreal Engine which Epic has developed. This is the tool that enables companies like Activision, EA and Square Enix to develop their games. And this tool is getting better and better, to the point that real life and digital worlds are starting to blur. And this is called photorealism. And that might make it more accessible to people who think that video games are still very cartoony. That might not be forever. The second ingredient, as I mentioned, is Fortnite. It's having a massive reach of hundreds of millions of people.

And the third tool is creating an economy, a creator economy, where they are giving people like you and I, if we want to, [the ability] to create our own games, our own assets, and to monetise them through all of these different worlds related to Fortnite. I've even tried to create my own game. It was very basic, it will never see the light of day, but it showed promise that people can create something and monetise it. And now they have tens of thousands of people earning money this way. So you need the three things: you need the tool, you need the audience, and you need the creator economy, which they're in pole position to succeed.

LK: What was the game that you created?

AN: I don't want to say. It has no name. Essentially, it's one where you're jumping from platform to platform and you're hoping not to miss the next platform and get eaten by a shark underneath. But as I said, it will never see the light of day.

LK: Okay, fair enough. Disney, earlier in the year, announced that it's going to invest \$1.5bn into Epic, and I guess that underlines the long-term opportunity for a patient investor like us, doesn't it?

AN: Yes, we were pleasantly surprised by the announcement of Disney, because it's a substantial amount of money to invest in Epic. Now, we know that Disney has historically struggled to monetise its incredible IP, its intellectual property, in video games. And it tried its own studios, closed them down. It's tried different game creators. But to then place all that trust in this IP in Epic's hands, it shows that they are onto something that is quite special.

LK: IP is intellectual property, right?

AN: Correct. So, essentially, what we believe is going to happen is that Epic is going to create a universe for Disney, which could be almost like a theme park of sorts, and there will be a lot of links between the virtual interactions and physical ones. So, for example, say you buy a hat or some costume in the digital version of this theme park, but when you go in real life, somebody hands you over those same exact assets. And there's going to be a lot more interlink, to the point where, in the future, instead of going to Disney.com, you will just go to this digital world and purchase your tickets and anything related to Disney. So that is super-exciting.

Now, what's even better is that Disney are not the only ones entrusting their IP to Epic. There's also Lego that has made that leap. And we think that this could be one of many IP owners that will say, actually, let's create this even bigger universe, let's make it interoperable. So could there be a Barbie World, could there be a Hasbro World? I don't know, but the thought of it is super-exciting.

LK: That's going to be fantastic to see these partnerships develop. Alexander, we're nearly out of time, but can you leave the audience with one final thought?

AN: Yes. It's that private companies are a large asset class, too big to ignore. And these companies are staying private for longer, which means that the value will accrue to those that can have access to the very best of them. As I said, we believe that this is where the next trillion-dollar companies will emerge out of. And we think that our own way of investing and of looking for these companies that are more mature, that are showing signs of scale, operational excellence, and that we are looking at the fundamentals [of], this should tip the odds in our favour. Because it's how we've invested for the past 115 years. I'm personally very excited to be backing companies like SpaceX that, any day now, will enable Starlink, so that anybody with a smartphone will be able to access it. So I think this is what I'd like to say.

LK: That's a great place to leave things. Thank you very much, Alexander.

AN: Thank you for having me. I really enjoyed this.

LK: And I hope you also enjoyed this conversation. You can read more of Alexander Nicolier's thoughts and explore some of our other Disruption Week topics at bailliegifford.com/disruptionweek. In addition you can find out about other private companies we invest in and the team that Alexander is a part of at bailliegifford.com/privatecompanies.

And if you haven't already done so, please do subscribe to Short Term Briefings on Long Term Thinking at Spotify, Apple or any other podcast app to be among the first to know when our next episode is live. But for now, listeners, I look forward to briefing you next time.

Show notes

Many of the world's most exciting, high-growth and disruptive companies are private. Moreover, the entrepreneurs running them are typically keeping them private for longer before trading their shares on public stock exchanges – and in some cases have no plans to do so.

Baillie Gifford's Private Companies Team seeks out exciting businesses and founders in this space to give our clients access to an increasingly important source of long-term growth. Taking a highly selective approach, it has invested more than \$9bn across over 140 firms over the past 12 years. In this podcast, Alexander Nicolier explains how it does so and discusses some of our notable holdings.

Background:

Alexander Nicolier is an investment manager in our Private Companies Team. In this *Disruption Week* briefing, he reveals the scale of the opportunity and the increasing impact that the sector's restless founders and their exceptional companies are delivering.

From SpaceX to Bending Spoons, Epic Games to ByteDance, one of the distinguishing features of these pioneering firms is that they've been able to choose their shareholders. Nicolier reveals why Baillie Gifford's patient approach and reputation have helped make us a favoured partner.

He also reveals how deep research helps him and his colleagues embrace the uncertainty that can be involved with backing companies at an earlier stage of growth than many public market stocks.

And he introduces some of his team's most recent investments, including the immersive experience specialist Cosm and the next-generation computing company Tenstorrent.

Resources:

[Alexander Nicolier profile](#)

[Armand Spitz: seller of stars](#)

[Baillie Gifford Private Companies hub](#)

[Disruption Week](#)

[Private companies: investing in trailblazers](#)

[The hidden cost of software](#)

Companies mentioned include:

[Bending Spoons](#)

[ByteDance](#)

[Cosm](#)

[Disney](#)

[Epic Games](#)

[Loft](#)

[MercadoLibre](#)

[Meta](#)

[NuBank](#)

[Oddity](#)

[SpaceX](#)

[Starlink](#)

[Tempus](#)

[Tencent](#)

[Tenstorrent](#)

[Tesla](#)

Timecodes:

- 00:00 Introduction
- 1:30 What's often misunderstood about private companies
- 2:40 Relationship building in Brazil and Colombia
- 3:40 Why reputation matters
- 5:35 "Look out for a gringo"
- 6:30 Private markets' scale
- 7:00 Our clients' advantage
- 9:25 SpaceX and uncertainty
- 12:40 Dealing with setbacks
- 13:45 Bending Spoons' business model
- 16:50 Cosm's 'shared reality' experience
- 18:50 Tenstorrent and Jim Keller's talent magnetism
- 20:20 The state of the IPO market
- 21:55 Why Epic Games has stayed private
- 25:00 Disney's \$1.5bn stake in Epic Games
- 26:40 "Too big to ignore"

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China

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(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.