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RURAL INEQUALITY

Bridging the social divide

Social problems that appear intractable to governments can have clear solutions if viewed through private equity's ESG lens, says Blue Wolf Capital founder and managing partner Adam Blumenthal

US mid-market firm Blue Wolf Capital has established its reputation on a willingness to take on industrial and social challenges that private equity firms tend to avoid. Whether it is acquiring heavily-unionised companies, investing in highly-regulated sectors such as the healthcare industry or identifying opportunities in some of the poorest regions in the US, Blue Wolf has built an impressive more than $1.2 billion in capital by focusing on some of the more disadvantaged areas of the economy.

Here Blue Wolf founder and managing partner Adam Blumenthal explains why he believes that private equity can deliver great returns to investors – and help solve some of the biggest challenges facing the country – by focusing on some of society's most intractable problems.

"We are addressing social problems of community stability and giving an economic future to areas that are not attracting capital

Q Blue Wolf has been calling attention to challenges that governments are not addressing. Why is that?

Companies thrive by solving problems – that's what drives value creation. In today's environment, there is a chance to shift the line that divides those facts about the world that can't be changed and the value creation opportunities that benefit both business and society. By doing so, you can make outstanding investments.

Q From a value creation perspective, what are the divisions in society that private equity can address?

The urban-rural divide is a good example of a social division that policymakers wring their hands over, but provides a value creation opportunity for investors. When we leave our offices in New York to go to the pulp and paper company we run in Madawaska, Maine, or to the saw mill we own in Dixie County, Florida's poorest county, we are the only private equity investors in the room. Most of our best investments have resulted from us getting out of the city and going to places where there is an arbitrage opportunity because there is no other private equity there.

When we do that we solve two problems. First we generate great returns for our investors because we are not following the crowd. Second, we are building a bridge across that divide. We are addressing social problems of community stability and giving

A CARING APPROACH

Q From an ESG perspective and an investment perspective, what was the opportunity in Elara Caring?

The opportunity in providers of home-based care is driven by demographic and structural trends that an ESG lens makes clear. Homecare allows people to be looked after in a way which both improves care and keeps them out of institutions. It reduces costs, improves quality and addresses one of the greatest problems America faces. There are challenges. Payment systems and the incentives for hospitals and providers don't provide a well-coordinated and functioning system. But because we understand the government programmes, and the differences between not-for-profit and for-profit institutions, we have been able to design products that improve outcomes for patients and healthcare systems, and are still regulatory compliant.

Q How do you manage risks, such as the threat of a shifting policy landscape, complex regulation and public scrutiny of the handling of vulnerable people?

We are 100 percent confident that we don't know what the healthcare system will look like in five years. That's clarifying because if you don't know, you have to create a business strategy that works regardless of the macro structural outcome. Our business strategy for Elara is based on keeping people healthier than they would be, avoiding unnecessary costs, and doing it in a way that customers appreciate and that has consumer support. If we do those things, we are confident that whatever the macro

look likes, we will have created a company that truly creates value for the system.

Q Great Lakes Caring – part of the Elara network – was named one of the best places to work in ageing services in 2018 by Fortune Magazine. How important is focusing on the wellbeing of the staff as well as the patients in healthcare companies?

It's really the S in ESG. We focus on how employees are treated and retained, what kind of career ladder they have, what kind of partnerships there are with communities to provide opportunities for people where they live. Getting that right has allowed us to grow much faster.

Coming from an industrial background, another thing we found eye-opening was safety. Employees were very appreciative when we brought a safety focus to the homecare industry.

an economic future to areas that are not attracting capital.

Another gap which I believe is more pronounced in the US than in many EU countries is the disparity in healthcare outcomes. We think more private equity firms should address the arbitrage opportunities in this market, which will result in improving patient outcomes and reducing overall medical spend for individuals and the country.

Q So why aren't more private equity firms looking at these opportunities?

People tend to enter private equity because they want the clarity of driving returns and achieving outcomes. We are told that it is counterproductive to pay attention to anything other than a narrowly-defined path to increasing shareholder value. And many are afraid that if they broaden their horizons, they will take into account things they shouldn't.

Early proponents of ESG didn't see that ESG concerns have to be tightly knit to the core investment thesis and strategy to really drive value. Private equity is now finding ways to knit those principles to the investment thesis to make it more robust and less risky. The more that happens, the more widespread the opportunities will become.

Q For private equity, ESG is often about mitigating risks and protecting value. Should the industry think differently about approaching opportunities and adding value?

If ESG is going to be meaningful, it should be about building, not playing defence. If you prevent a bad press story, or pay attention to workplace safety or environmental compliance, you can protect a company »

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» from risk. But if you look around the world today, the next 20 years' worth of value is not going to come from people being more careful about these issues. Creating value will come from helping society to work better, and building companies that deliver on those opportunities.

The world today is typified by polarisation. You don't get constructive outcomes from polarised sides that fixate on impractical problem definitions. With private equity now at a global scale where we can provide leadership, our role should be about defining a better path forward. And the primary impact of ESG should be identifying clearer opportunities.

One place where this has happened in the US is the move to quality and value in healthcare. This has been led by private equity-backed companies that have found ways to address problems that had proved to be quite intractable for governments. It's the perfect example of how leadership can create value.

Q You've spent a career in investments, but you've also worked in government in roles including the chief financial officer for the New York City comptroller. How has your work in government played into your strategy about solving societal challenges?

Most mid-market companies simply see government as something that gets in the way. What I learned from working extensively with different parts of government at the federal, state and local level is if business takes the time to understand the direction regulators are looking to go, and finds ways to align strategies, it is possible to make government relations an accelerant for business.

We have seen that in our pulp and paper businesses. These are large industrial complexes that are typically critical to the economic stability of the regions in which they

Blumenthal: value comes from helping society to work better

operate. Where there is an opportunity to advance the stability of a region, we get significant economic development support because we have long-term relations and people know what we want to achieve.

Q So should investors think more like policymakers, and policymakers more like investors?

In industries as diverse as forest products and home health, we have found that if we have a seat at the table in Washington when the regulations that affect our companies are hammered out, we wind up in a regulatory environment that we understand better and can respond to more rapidly. And we have found that regulators are much more likely to make good decisions if we have fully presented our case and described the impact of regulation on our businesses.

Q In the age of unpredictable political outcomes – such as Brexit and the Trump presidency – how has your approach to solving challenges changed?

We are certainly aware of political risk and the risk of rapidly changing regulatory environments – volatility in government policy has preceded volatility in equity markets over the last 18-24 months. However, business opportunities are related to the structure of our economies and that does not change with political volatility. Fundamentally, if you have an investment thesis based on a real understanding of industry demand, cost curves, and the ability of human capital and strategy to enable you to outperform your competitors, that's not going to change because of political shifts in Washington, London or Paris.

Q Global corporations are focused on creating ever-larger profits and delivering those back to shareholders. How does your approach to value differ?

If you look at the US and Britain at the end of WWI and WWII, the idea that business leadership involved looking broadly at building a better future was non-controversial. Somewhere along the way in the 1970s, that perspective was marginalised. 'Greed is good' was a fictional statement by a fictional character but it exemplified an ethos – it stuck because it had roots in how people were behaving and what the business community thought its mission should be. If you look across societies today, we are reaping the whirlwind that attitude sowed.

The culture obsession with quarterly earnings guidance has not produced good results for society as a whole. If you have a three-month time horizon, doing tomorrow pretty much what you did yesterday probably is the best solution. But some of these intractable problems around healthcare, urban-rural divisions, income inequality, or training and education, aren't problems you solve in a quarter, they are problems where meaningful progress can only be made over a period of a few years.

Private equity is uniquely suited – not to solving every problem in one grand stroke but at least to building organisations that do a better job. ■