Platforms and Vehicles for Institutional Co-Investing

Jagdeep Singh Bachher[1]
Alberta Investment Management Corp.

Ashby H. B. Monk[2,3]
Stanford University

Abstract

A growing number of institutional investors, persistent in their desire to dis-intermediate and align interests with their portfolio managers, are turning away from external asset managers and are instead looking to one another for assistance. These direct investors are hoping to overcome the loss of agglomeration economies that asset managers enjoy within traditional financial centers by leveraging a new set of network economies through collaboration with peers. The over-arching question, however, is how these funds can actually co-invest to take advantage of these network effects in demonstrable ways. This can be quite challenging, as the differing return objectives and investment philosophies, not to mention the basic challenge of geography, all complicate matters. By highlighting a specific case study of co-investment and drawing on the qualitative data collected from over 20 on-site case studies of public pension funds and sovereign wealth funds around the world, this paper offers some insight as to how institutional investors can structure platforms and vehicles that will align interests and facilitate co-investment.

Introduction

In the aftermath of the global financial crisis, there has been a resurgence of dissatisfaction among institutional investors with some of the existing institutions of finance and investment. This is due, in large part, to a perception many funds have over misaligned incentives, high fees, poor returns, and short-termism embedded in certain third party management agreements. As a result, institutional investors are, today, willing to think about new ways in which they deploy their capital, focusing in particular on mechanisms that sidestep the existing intermediaries and agents. For example, many funds are moving assets in house with a view to making direct investments (Clark and Monk, 2013a), as these 'in-sourcers' believe they can operate at a lower cost and still generate better (fee adjusted) returns than external managers. And, according to new research, this appears to be true (MacIntosh and Scheibelhut 2012; Fang et al. 2012).

[1] The author is also a Visiting Scholar at Stanford University.
[2] The author is also a Senior Research Associate at Oxford University.
[3] The authors are pleased to acknowledge the support of Stanford University and members of the research consortium coordinated by the Global Projects Center in the Faculty of Civil and Environmental Engineering. The authors are grateful to Aleksandar Andonov, Gordon Clark, Adam Dixon, Danyelle Guyatt, Andrew Lerner and Ward McNally for comments and insights on prior drafts. None of the above are responsible for any errors or ommissions.

Electronic copy available at: http://ssrn.com/abstract=2174696

But while bringing assets in-house is an appealing mechanism to minimizing the endemic agency costs in finance, there remain a variety of practical questions that institutional investors must answer if they are to execute successfully. For example, how does a public fund located far from the world's financial centers hire the talented staff it requires to implement sophisticated in-house operations for making direct investments (See Bertram and Zvan 2009; Ambachtsheer 2011; Bachher and Monk 2012)? How does it set up a world-class investment operation when finance has been something of an industrial afterthought in its city or even country? How does it access the foreign markets and illiquid asset classes where local knowledge is paramount (Clark and Monk 2013b)? These challenging questions have left many 'would-be-direct investors' with few alternatives to the status quo.

One of the mechanisms to help direct-investors answer this question is to tap into networks of peers (see Clark and Monk 2013c). Indeed, a growing number of institutional investors, persistent in their desire move away from third party asset managers are instead looking to one another for assistance. These direct investors are, in effect, hoping to overcome the loss of agglomeration economies embedded within traditional financial centers (see Wójcik 2011) by leveraging a new set of network economies through collaboration and co-investment.[4] The 'network effects' from working with like-minded peers will, it is hoped, minimize the funds' reliance on the for-profit financial services and asset management sector for deals and intelligence in certain regions and asset classes (Currah and Wrigley 2004; Guyatt 2008). The over-arching question, then, is how these funds can actively collaborate and co-invest to actually take advantage of these network effects.

We believe this requires identifying like-minded partners and finding decision-making processes and vehicle structures that can align the interests of all parties. This can be quite challenging, as the differing return objectives and investment philosophies, not to mention the basic challenge of geography, all complicate matters. As such, we see a need to investigate how institutional investors can structure platforms and vehicles that will align interests and facilitate co-investment. This paper seeks to provide insights in this regard, drawing on a specific case study of collaboration and the qualitative data collected from over 20 on-site case studies of public pension funds and sovereign wealth funds around the world.

Benefits and Constraints of Collaboration and Co-Investment

Ronald Burt wrote a seminal paper in 2004 entitled, "structural holes and good ideas" that had a profound impact on the way many scholars think of the value of networks and collaboration. Burt defined social capital as the advantage an individual enjoys due to their location within a broader social structure, and he went on to define the social capital of brokerage as the ability of an individual to translate information from one group to another in a manner that affords value to one or both of those groups. In so doing, Burt highlighted the value that 'brokers' create by occupying the space between organizations and groups. Specifically, Burt identified four ways in brokerage adds value.

- The simplest act of brokerage is to make two parties aware of the interests, needs and difficulties of the other groups. By explaining the issues between two groups in a way that all can understand, a broker will add value by helping to avoid costly misunderstandings.
- A higher level of brokerage is the transfer of 'best practice'. A broker between groups is often better placed to identify practices in one group that could add value in another group.

[4] For a detailed description of how collaboration can lead to "win-win" opportunities see Guyatte, 2008.

Electronic copy available at: http://ssrn.com/abstract=2174696

- A third level of brokerage is to be able to draw analogies between groups that would otherwise appear irrelevant to the two groups. The skill here is to be able to identify seemingly incongruous behaviors as having some synergistic potential.
- Burt's highest level of brokerage arrives in the form of 'synthesis': This is where a broker synthesizes his or her knowledge of the behaviors of two groups and, in turn, creates new behaviors that bring the best behaviors of two groups into a single set of behaviors.

Brokers thus have the capacity to add a lot of value, which was shown to be true empirically in Burt's research. However, Burt also found that most large organizations have a variety of incentives that push staff away from peer networks; that these large groups actually encourage staff not to collaborate or "broker" between other groups, which results in missing out on considerable value. This finding seems to be particular true in the world of institutional investment, where many pension and sovereign funds have outsourced brokerage functions to bankers, consultants, asset managers, accountants, actuaries and more.

However, these intermediaries have an amazing potential to benefit the institutional investment organizations for the simple reason that they occupy a space between and among the various agents and actors in financial markets. And so a certain amount of value (perhaps even a lot of value) is captured by these external brokers for reasons to do with the structure of the financial services marketplace. And this is perhaps why many institutional investors are interested in greater collaboration and co-investment. If pension or sovereign funds allow external consultants, placement agents or bankers to occupy these 'structural holes', then the former will not only miss out on value-adding opportunities but they will also be handing over a massive asymmetry of information to the financial intermediaries.

It seems clear, then, that long-term institutional investors, such as public pension and sovereign funds, could benefit from working together. They can share local knowledge and asymmetric information as well as pool skill-sets, deal pipelines, and networks in an environment that (in theory at least) offers an environment with better alignment of interests than is available in outsourced options. In general, we see six benefits of peer-to-peer collaboration and co-investment:

- Higher Returns: Communities of like-minded co-investors can, in theory, leverage one another's local advantages on a global basis, which can help bolster returns (Gertler 2003). For example, research shows that tapping into local knowledge can translate into as much as 2% in additional returns per annum (see Coval and Moskowitz, 2001).

- Cost Savings: Pooling resources through co-investment can be a useful way of sharing costs, such as due diligence, legal, and human capital .

- Deal Flow: Co-investment platforms offer access to deals that some funds would otherwise find difficult to source and validate.

- Diversification: Co-investments offer investors the benefits of direct investing with the diversification of holding a broader portfolio of assets.

- Governance Rights: Co-investing allows investors to bypass traditional intermediaries and maintain some additional control over investments.

- Headline Risk: By co-investing (especially with local and trusted peers), institutional investors can minimize headline risk and mitigate political risk.

The potential benefits of 'direct, co-investing' are thus significant. So why aren't there more examples this among institutional investors? There have been ad-hoc club deals. And institutions often formalize collaboration with private managers through co-investment rights. But very few examples of formal peer-to-peer co-investment platforms or vehicles exist. Over the past decade, numerous attempts have been made to launch co-investment platforms and almost all (if not all) of these have failed to achieve their original objectives. Why?

Generally, there are a variety of factors that make this sort of peer-to-peer collaboration difficult, and these factors fall into five categories:

- Structure: Can institutional investors actually set up a formal mechanism for sharing deals that is agreeable to all parties (E.G., loose or formal; discretion or non-discretionary)?

- People: Can institutional investors get non-executive staff to coordinate? Can the investors hire the talent they require to be good partners (E.G., experienced or novice; seconded staff or external hires)?

- Governance: How do investors get buy-in from each fund's leadership for the requirements to run the collaborative endeavor? (E.G., public bureaucracy; resources constrained; allergy to innovation.)

- True Alignment: While long-term investors should, in theory, have similar objective functions, the reality is that even among institutional investors it can be a challenge to find true alignment of interests. So, can an investor find like-minded parties with the same investment beliefs and philosophy? Can large institutional investors get along with other large institutional investors? What happens when there's a leadership change at one of the participating funds? Do the funds have shared values, beliefs, objectives, motivations, trust, and perceptions of legitimacy? (E.G., culture; norms; process, philosophy.)

- Regulation: Are funds going to have to face off against the in-house lawyers to get a co-investment platform off the ground (E.G., fiduciary duty, compliance)? Are there tax issues that will prevent funds from working together on transactions?

These are serious challenges. And, as a result, we encountered as part of our research and case studies senior executives at public pensions and sovereign funds around the world that were quite cynical about co-investment platforms that seek to bring peers together around an investment proposition or philosophy.

Notwithstanding, given the benefits cited above, we believe the institutional investment community should persevere and find a way to work together. As such, in order to consider how best the community of institutional investors and beneficial institutions can move forward, the next section offers an in-depth case study of a real-world community that is, today, actively co-investing through a bespoke vehicle tailored to meet their needs: 'The Cleantech Syndicate'. Drawing on the this case and our the others we've conducted anonymously, we will then sketch out some paths forward for co-investment vehicles more generally.

Case Study: The Cleantech Syndicate

Background: The Cleantech Syndicate ("The Syndicate") is a group comprised of 12 family offices, representing roughly $40 billion in capital. Conceived of in June 2010 by Black Coral Capital, a family

office, and McNally Capital, a Merchant Bank to family offices, the Syndicate's stated mission is to assemble a select group of family offices to "pool expertise, resources and capital to invest directly in clean technology and alternative energy companies". It is a virtual private equity firm with all aspects of the value chain and investment stages covered, with family offices offering staff to act as 'partners' in the virtual PE firm. There are 30 total team members dedicated to the Syndicate, including 17 "institutional quality" clean tech investment professionals. The group has approximately $1.5 billion to deploy into this asset class, which makes the Syndicate among the world's largest players in this niche market. The over-arching objective of the Syndicate is simple: transactions. And, over the last twelve months, there have been approximately ten deals closed, with two of those deals having multiple families represented.

Motivation: The families that came together to form the Syndicate are all institutional investors with professional investors working within their organizations. These investors came to realize that the external fund model did not work in the cleantech space, as the performance did not justify the fees and the time horizon of the investments was too short. This left the families looking around for alternatives. At a certain point, they started investing on a direct basis, and the Syndicate offered a path towards direct investing that was realistic given their resource constraints. By coming together, the Syndicate solved several problems for its members:

- Deal flow: The Syndicate is a very large investor in this niche market. Most cleantech investment opportunities in North America (and the world) come through the inboxes of either the Syndicate Administrator (McNally Capital) or one of the families. For example, Syndicate members saw, in rough numbers, 1500 deals last year.

- Scale in Capital Raising: Clean tech investments require a significant commitment of capital over the long term to be successful. Raising this capital can be a challenge, but working together in a Syndicate makes this much easier.

- Expertise: Syndicate members have, in most cases, already built successful businesses in the marketplace, which means the investment professions running the family offices have ready access to some of the best insights in the industry. Moreover, the staff of the investment organizations that participate in the Syndicate are all focused on this area specifically, which means they have domain expertise.

- Post-close: Syndicate members are intent on creating value beyond the transaction. Members have indicated that the Syndicate has become invaluable for identifying potential customers or suppliers for portfolio companies. In short, the long-term goal of the Syndicate is to create value beyond the deal; in the words of one member, "That's the magic dust."

- Due Diligence: One important function the Syndicate plays is providing advice that prevents members from doing a "bad" deal. This is hard to quantify but was cited as valuable by many Syndicate members.

- Costs: Access to third-party industry reports and attendance at cleantech conferences become time and cost efficient when the benefits are spread across a larger group. More importantly, the Syndicate members pool human resources, which provides considerable cost saving.

- Relationships: The Syndicate offers family offices a unique platform for developing relationships among the members and external partners. The Syndicate can serve as an

outward facing organization that offers external partners an easy point of access through which to seek (or bring) opportunities.

In short, the Syndicate is all about institutions coming together to collaborate (e.g., sharing content, knowledge and deal flow) and co-invest (e.g., sharing capital and risk).

Structure: The Syndicate is not set up like a traditional private equity fund. The group operates based on loose principles and policies, with discipline coming from mutual respect and trust (and, it seems, the threat of embarrassment and expulsion). Most of the Family Offices don't even have NDAs in place. Instead, there is a sense that this group wants to work together for decades, so they won't do anything silly in the short term that could prevent that. Additionally, Syndicate members are carefully screened to ensure fit. And the approval process is often lengthy, as there are a variety of prerequisites for entry. For example, some of the basic requirements include a certain level of AUM targeting the sector and a full time employee dedicated to doing direct investments in the space. All potential members are asked to complete a detailed "New Member Survey", which drills down all the way into the family's cleantech portfolio. Also, new members have to be sponsored by existing members, and the total membership is capped to prevent the group getting too big. Beyond those criteria, there also has to be a willingness to share knowledge and information as well as have some unique access to deal flow.

Responsibilities: Syndicate members have several responsibilities. They are expected to recommend prospective investment opportunities as well as lead the investment process for certain opportunities. They may be asked to bring in non-Syndicate co-investors when necessary. A member will also act as a resource for other members, perhaps even assisting with due diligence (even when not participating in the transaction). In order for this to function, the member has to be present (on calls and at meetings). The ethos of the organization is to develop trust through active engagement and responsiveness (i.e., being a good citizen). Syndicate members are expected to return each other's phone calls and respond to emails in a prompt and courteous manner *at minimum*. And for those members that do not play by these rules, they are politely asked to exit the Syndicate. Interestingly, the fifth member to join the Syndicate was "asked" to leave, which has had a motivating effect on the remaining members.

Investments: The family offices that are members of the Syndicate are all professional institutional investors. They have the internal capability to prosecute deals on their own. All are direct investors in cleantech, which is why they were motivated to join the Syndicate in the first place. Accordingly, the families can all lead deals of a certain type. So when a deal comes in of value, one family will tend to lead the deal with one or two other families helping with various aspects of the diligence. The Syndicate seems to fill the gaps in the members' internal capabilities when it comes to doing a direct investment.

Implementation: The successful functioning of the Syndicate appears to be due to the following key factors:

- Intermediation: The Administrator drives the day-to-day sourcing and screening of opportunities and sharing of deals and information. This role is filled by Chicago-based McNally Capital.[5] This Administrator is perceived to be crucial to the effective functioning of the Syndicate, because everyone is too busy to prioritize this group over their own business. The team at McNally thus spends a lot of time thinking about what the members are presently interested in and working on. They source and screen transactions of interest to Syndicate members, shuffle deals back and forth and flag areas where one member might help another

---

[5] McNally Capital, 190 South LaSalle Street, Suite 3250, Chicago, IL 60603. (www.mcnallycapital.com)

member. They also act to coordinate diligence efforts among multiple members, so information can flow seamlessly across all parties analyzing an opportunity – an important factor in establishing goodwill and an efficient deal process from the perspective of the party raising capital. McNally knows all the holdings of all the members' clean tech portfolios, which allows them to identify opportunities to leverage the collective knowledge of the group. *Take away: Assign an administrator for the Syndicate – the goal is to provide the appropriate investment analysis, group structure and process facilitation*[6].

- Enforcement: The Syndicate diligently enforces any rules or guidelines that have been accepted by the group. The Intermediary thus plays the role of "policeman" (even if the "judge" may be the Syndicate itself). *Take away: The intermediary also has to play the role of policeman, which makes it necessary to have an objective third party playing this part.*

- Mandate: The Syndicate worked to refine the scope of the group's mandate very clearly. In their view, the group would be too unwieldy if it was industry agnostic. *Take away: Have a clearly defined mission based on actions rather than concepts.*

- Membership: To ensure success, the Syndicate focused a great deal of time determining the types of members it would accept into the group. This, they feel, has been crucial for keeping the momentum moving forward. *Take away: It is important to take the time to determine what an" ideal member" is for a given group.*

- Commitment: Nobody gets into the Syndicate, and nobody stays in the Syndicate, without real commitment. This commitment can be quantified (e.g., a Full Time Employee in the industry, fees, capital allocations) and qualified (e.g., perceived as supportive by other members). *Take away: When adding members, weigh equally their suitability with the group's mission and their ability / desire to be active participants. Do not underestimate the importance of creating good group chemistry.*

- Momentum: The Syndicate has created so much momentum behind the organization that members will be embarrassed if they aren't living up to their peers' expectations. *Take away: Obtain a critical mass of 'actions' that drives the organization forward; empower champions early and often.*

- People: The Syndicate has the right people in the room when it comes to co-investing; it's all well and good to have high-level buy-in, but getting the buy-in of staff is often a challenge. At the Syndicate, staff drives the process. *Take away: It's not enough to get senior leaders to buy in. Staff (and especially lawyers) have to be intimately involved.*

- Competition: The membership of the Syndicate was built to maximize coverage and knowledge areas and to minimize direct competition among families for deals. They try to have close enough alignment to have synergies, but not so close as to view each other as competitors. *Take Away: Each member of the Syndicate should bring a skill, know-how or network that complements that of the broader group.*

[6] This has the effect of increasing the costs of coordination, but it is still seen to be much cheaper than providing mandates to external managers and still allows the members to benefit from the other positive aspects of the co-investment platform.

- Sharing: The membership of any transaction-oriented organization has to be open to sharing *valuable* content, contacts, and, especially, deals. For example, Syndicate members are expected, whenever possible, to make room on their good deals for other Syndicate members. So if a member has a $5 million deal, the sourcing family might take $3 million and leave $2 million for other Syndicate members (rather than taking the whole $5 million) because they want to support the Syndicate (and tap into the expertise of the other family offices). *Take Away: Members have to be willing to give of themselves in the short-term in order to ensure the long-term success of the Syndicate.*

- Origins: The Syndicate could not have come about without a handful of families acting as champions for the concept early on. This generated enough momentum to kick-start the whole organization. Had an intermediary tried to start the Syndicate from scratch, there would have been too much suspicion and fear of misalignment for any of the families to embrace the concept. *Take Away: It is crucial to have institutional investors driving the launch of the Syndicate in order to ensure legitimacy and alignment of interests.*

As these implementation lessons demonstrate, the Cleantech Syndicate has thought long and hard about co-investment challenges and how to overcome them. And after three years of conceptualization and, now, implementation, they are to be commended for their perseverance in this regard.

A Path Forward

The Syndicate offers some useful lessons for institutional investors considering co-investment vehicles. Obviously, a family office differs in some ways from a sovereign fund or a pension fund, but they are sufficiently similar to draw useful insights (e.g., all are long-term institutional investors; all prefer direct investments; all are professional investment organizations; all are resource constrained, etc.). Moreover, their motivations for launching the Syndicate (e.g., deal flow, scale, expertise, diligence, costs, etc.) match up with many of the reasons for the broader community of institutional investors launching co-investment vehicles. In this section, then, we draw lessons from the Syndicate but also from our broader experiences co-investing and working studying institutional investors working on co-investment initiatives.

We draw on the implementation criteria above as a framework thinking about how institutional investors can co-invest successfully:

- Intermediation: The success of any co-investment initiative will require a pro-active party to manage and provide infrastructure for the group. This could be an independent party or it can be a leader within the peer group.

- Enforcement: The intermediary will play the role of policeman, ensuring that members are abiding by rules and being good citizens.

- Mandate: In order to be successful, the co-investment initiative has to have a clearly defined mandate and theme that allows the "sell side" to understand precisely what the "buy-side" is interested in. This will ensure that only "quality" deals are brought to the group. These groups should seek to define as much as is possible and feasible (e.g., size, industry, geography, etc.).

- Membership: Not every co-investment platform is going to be appropriate for every institutional investor. Investors must be methodical in determining which funds are brought

into which groups, as these vehicles will only work when investors are truly like-minded. Funds must not underestimate the importance of 'good chemistry' in the success of any initiatives.

- Commitment: Members of a co-investment group must demonstrate some level of tangible commitment to the group and its theme (e.g., full time employees, capital).

- Momentum: The group has to establish a critical mass of credible members and forward actions early in its existence.

- People: The success of any collaborative initiative will be a function of the incentives of the people actually working within the group. The staff doing the heavy lifting to make these groups work should have performance compensation tied to the objectives of the collaborative initiative, such as building companies for long-term value creation (rather than value extraction).

- Competition: Members must bring differing skillsets and networks to ensure synergies.

- Sharing: Members of any group have to be willing to give up some short-term upside in order ensure the long-term success of the Syndicate. These trust-based relationships are often difficult to define in memoranda, letters or articles, which makes the intent of the individual within this group very important. In this case, it appears that members of such an organization should be willing to give up some short-term gain for the promise of long-term rewards.

- Origins: The institutional investors driving the launch of any platform or vehicle should have aligned interests in order to ensure legitimacy.

Co-Investment Vehicles and Platforms

Based on the case study above and the findings from over 20 anonymized case studies of co-investment partners (that included over 100 face to face semi-structured interviews over two and a half years),[7] we believe we have some principles that can facilitate co-investment success. The pressing question, then, is how co-investment vehicles and platforms should be implemented. Based on our experience (and the experience of our cases), there are three co-investment options available to institutional investors (Alliance, Syndicate, and Seed) and, in the subsequent sections, we will review these options against the implementation principles above:

1) The Alliance: This group is characterized by a loose affiliation of like-minded investors around an investment theme to share deals and resources. The objective is to institutionalize collaboration and co-investment, offering direct investors the opportunity to tap into a broader network without entering into legal agreements (e.g., Seed) or dealing with the bureaucracy of external administration and intermediation (e.g., Syndicate). Deal flow will be generated by Alliance members through existing channels and then reconciled *by the members' own teams* for presentation to the Alliance. Using the implementation framework described above, here is the way the Alliance could be set up:

[7] We also draw on prior research findings, specifically the work of Danyelle Guyatt (2007).

- Intermediation: Alliance members will internalize this function. Perhaps Alliance members could take leadership roles on a rotating basis.
- Enforcement: The group will have to play the role of policeman and judge.
- Mandate: The Alliance will refine the investment theme along industry, size and asset class so as to ensure only "quality" deals are presented.
- Membership: A questionnaire or survey can be used to assess suitability.
- Commitment: Alliance members will dedicate capital (perhaps formally or through earmarks) and staff (either on secondment or as a full time employee working on Alliance matters exclusively).
- Momentum: This will have to be member-driven.
- People: The staff for the Alliance will have to be seconded directly from members.
- Competition: Members should be selected carefully.
- Sharing: This will have to be member-driven.
- Origins: Because the Alliance will be investor-run, it should be fully aligned. (That said, in practice, there are often competing interests even among long-term investors, which is why the members of an Alliance should be vetted very carefully.)

Questions to consider: How do investors prevent free riding? How to they police membership? How do they ensure momentum? How do they coordinate, triage and share the due-diligence and investment assessments?

2) The Syndicate: This group is characterized by a formal affiliation of like-minded investors around an investment theme to share deals and resources. Syndicate members make a formal agreement through a credible and objective intermediary that will represent its membership externally, source and screen investment opportunities and coordinate the sharing of deals and knowledge. This is the model that was adopted by the Cleantech Syndicate and has been put to use with some success. Using the implementation framework described above, here is the way generic Syndicates could be set up:

- Intermediation: The Syndicate appoints a formal Administrator to act as the members' go between.
- Enforcement: The group will have the Administrator play the role of policeman.
- Mandate: The Syndicate will refine the investment theme along industry, size and asset class so as to ensure only "quality" deals are presented.
- Membership: A questionnaire or survey can be used to assess suitability.
- Commitment: Syndicate members will dedicate capital (perhaps formally or through earmarks) and contribute resources to staff the organization (i.e., pay the Administrator a nominal fee based on a budget for work rather than a fee based on basis points).
- Momentum: This will be driven by the members but encouraged by the Administrator.
- People: Members will second internal staff and pay for an Administrator to round out any gaps in the internal capabilities of members.
- Competition: Members should be selected carefully.
- Sharing: This will be member-driven and facilitated by the Administrator.
- Origins: The Syndicate will be sponsored by the investors, which should ensure alignment over the long-term. (Again, however, this must be carefully monitored to ensure that a single members' misaligned interests does not result in failure.)

Questions to consider: Can public investors find the resources to pay for an Administrator? Who undertakes due diligence?

3) The Seed: This group is characterized by a formal legal structure (e.g., GP, LLC) that brings together like-minded investors around a *de-novo* asset manager staffed by a seasoned investment team. The

objective of seeding a new asset manager is to maximize the alignment of interests (and minimize fees) between the asset owners and the asset managers by extracting concessions from the asset manager upon launch of the vehicle. A seeded vehicle is structured by the LPs for the exclusive benefit of the LPs (e.g., low fees, evergreen, control, no fund raising, etc.). This structure can be applied in a variety of different asset classes and industries; the key is agreeing to a refined mandate in order to attract sufficient interest from a management team.

Let's apply the implementation framework to this model:

- Intermediation: Seed members will delegate authority to an intermediary (unless the LPs want to be part of the GP as well, which is reasonable).
- Enforcement: This becomes less of an issue because the commitment of members is secured.
- Mandate: The Seed will have a refined investment theme, as this will be necessary for hiring the investment team.
- Membership: A questionnaire or survey can be used to assess suitability, which may be relevant if LPs choose to be on the investment committee or Board of the new vehicle.
- Commitment: Seed members will commit capital to the new vehicle.
- Momentum: The fund's new management team will drive this.
- People: The decision to seed a vehicle is almost always a function of the talent available in the marketplace.
- Competition: This depends on where deals are being sourced.
- Sharing: This is not an issue (though it does depend on where deals are being sourced).
- Origins: The Seed will be launched by the investors, which should ensure alignment over the short- to medium-term. (However, past cases do show alignment deteriorating over time.)

Questions to consider: Can the funds seeding the vehicle get the level of control they want over the assets in the fund? What happens over the long-term (see Industry Funds Management in Australia)?

The choice of platform – Alliance, Syndicate or Seed – will be a function of the funds populating the vehicle and their constraints and requirements at the time. Ultimately, the choice will reflect the problems faced by the funds participating and the market or geography or asset being targeted. Indeed, all the participating funds should be asking what their problems are with the current offerings in the market for financial services. Is it duration, alignment, sourcing, control, resources, knowledge, or diligence? Or is it all of the above? The answers to these questions will drive the vehicle selected. For example, if a fund has no interest in control of the underlying assets that are being invested in – or governance rights of any kind – then seeding a new asset manager, such as the Evergreen model, could be perfect. However, if a fund wants to be able to exert direct influence over companies and assets, the Syndicate or Alliance approach may be more appropriate. Funds will also have to consider the resources they have available, as different vehicles will require different resourcing. An Alliance or Syndicate will likely put a burden on the fund's internal costs, while the Seed path will likely fall into the "fee" line of the budget (which, in many cases, isn't as closely vetted by Boards or policymakers as internal costs). The Seed path may thus be a useful mechanism for breaking out from internal resourcing constraints.

Final Thoughts

In the wake of the global financial crisis, institutional investors are rethinking the way they access markets. Are they going to continue relying on external managers? Or, alternatively, are they going to in-source a portion of their investment operations and rely on peers to fill gaps in their competencies? Or are they going to do something altogether different, such as seeding third party managers? All of these options are being viewed in light of the high fees and seemingly misaligned

interests of the current 3rd party fund model. In short, the traditional ways in which large investors deploy assets are being remade, and we expect the co-investment vehicles shared in this paper will play an increasingly important role in this new era of institutional investment.

It's with this in mind that we write this paper; we do not mean to suggest that the Cleantech Syndicate offers insights that are generalizable to all situations or organizations. Rather, we use it as a device to consider the constraints and benefits of co-investing, as our over-arching mission is to better understand practical and feasible ways to deploy assets in more efficient and effective ways. Whether the path is Alliances, Syndicates or Seeds (or some combination), the launch of these vehicles represent important and groundbreaking first steps towards a new model of institutional investment that serves the interests of the institutions and its stakeholders.

References

Ambachtsheer, K. (2011). "How Should Pension Funds Pay Their Own People". Rotman International Journal of Pension Management. Vol 4(1): 18-25.

Bachher, J. S, and A. H. B. Monk (2012). "Attracting Talent to the Frontiers of Finance". Available on SSRN: http://ssrn.com/abstract=2120167

Bertram, R. and B. Zvan (2009). "Pension Funds and Incentive Compensation: A Story Based on the Ontario Teachers' Experience". Rotman International Journal of Pension Management. Vol 2(1): 30-33.

Burt, Ronald S. (2004). "Structural Holes and Good Ideas" The American Journal of Sociology; 110, 2; p349

Clark, G.L. and Monk, A.H.B. (2013a.) Financial institutions, information, and investing-at-a-distance. *Environment and Planning A* (forthcoming).

Clark, G.L. and Monk, A.H.B. (2013b). "The scope of financial institutions: in-sourcing, outsourcing and off-shoring." *Journal of Economic Geography* (forthcoming).

Clark and Monk (2013c). "Principles and Policies for In-House Asset Management". ournal of Financial Perspectives (Forthcoming).

Coval, Joshua D., and Tobias J. Moskowitz, 2001, 'The geography of investment: Informed trading and asset prices', Journal of Political Economy 109, 811-841.

Currah, A. and Wrigley, N. (2004), 'Networks of organisational learning and adaptation in retail TNCs', Global Networks 4:1–23.

Gertler, M.S. (2003). "Tacit knowledge and the economic geography of context, or the undefinable tacitness of being (there)." *Journal of Economic Geography* 3:75–99.

Guyatt, Danyelle (2008) "Identifying and Mobilizing Win-Win Opportunities for Collaboration between Pension Fund Institutions and their Agents" Available online at www.rijpm.com.

MacIntosh, J. and T. Scheibelhut (2012). "How Large Pension Funds Organize Themselves: Findings from a Unique 19-Fund Survey". Rotman International Journal of Pension Management. May 27, 2012 · Innovation in the Pensions Sector Volume 5, Number 1 /2012. Pages: 34 – 40

Wójcik, D. (2011), *The Global Stock Market,* Oxford: Oxford University Press.