Collaborative Model: A New Approach to Invest in Innovation & Energy

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The full article may be accessed here.

Central Issue of the Paper

To address the many inefficiencies with traditional methods of investing, the authors of the paper titled "From Theory to Practice: The Collaborative Model for Investing in Innovation and Energy" argue that an increasing number of beneficiary organizations, such as pension funds, sovereign wealth funds, endowments and foundations, are adopting a new model of long-term investment management. The existing models that have been used by asset owners have included the Norwegian model, which focuses on investing primarily in traditional public markets; the Endowment model, which is based on adding risk into the portfolio by using external managers to invest in alternative assets such as real estate and private equity; and the Canadian model, which is based on investors employing resources in house to invest in real assets such as infrastructure and real estate directly.

While these models provide an option for accessing various alternative assets, there are drawbacks. The endowment model has worked very well for certain investors but the model is premised on investors getting access to the top performing managers, which can be difficult and comes with the very high fees usually associated with this access point. Direct Investing has proven to be a much more cost-effective way of accessing long-term private market assets, but it is very difficult for many investors to fully replicate the required investment management function in house. Furthermore, this paper claims it's in our collective interest to cultivate an appetite for investing in innovation and energy to offset the extreme global challenges associated with rapid urbanization and population growth over the next 30 years.

Approach Employed by Paper

Given such catastrophic events as the Global Financial Crisis, there has been renewed focus among institutional investors on long-term investing in long-term market assets in the most efficient and innovative way possible. As a result, the collaborative model has emerged over the last few years as a fourth model of institutional investment.

The collaborative model of investment essentially combines a number of the existing models, recognizing that:

1. Private market investing is consistent with a long-term investment strategy.

2. The direct method of investing is a more cost-effective means of accessing private market investments, but requires significant in-house resources.

3. Alternative external investment managers are required but the governance needs to be redefined for more alignment.

Against this background, the collaborative model focuses on how innovative platforms can be developed directly with other peer investors and investment partners. The platforms/vehicles can help a group of peers invest more efficiently in long-term assets, get closer to either a direct investment method for real assets, or an endowment method for innovation but on far more aligned terms.

This paper thus tries to further crystallize for readers how long-term investment communities can deploy various investment vehicles (joint ventures, platform companies, co-investment platforms, seeded funds). Specifically, the authors provide an example of how the University of California Office of the CIO has adopted the Collaborative model in rolling out a number of new initiatives over the last two years. What's important to highlight with respect to UC implementing aspects of the collaborative model was the need to search for new sources of value and opportunities that are uncorrelated with traditional sources such as US public stocks (which are unlikely to continue appreciating in the same way they have over the last five years).

Findings of the Paper

One of the key takeaways from UC's implementation is the importance of leveraging the competitive advantages that a long-term investor organization possesses. For a lot of these investors, it is their long-time horizon and size of capital that provides them with significant negotiating power when choosing more efficient access points for long-term investments. Investors need to exercise this power but also understand the responsibility and duty of care that goes with this.

In previous research, the benefits of the collaborative model were theoretically validated and empirically verified by several sophisticated long-term investors around the world. The UC implementation provides useful insights and lessons for other like-minded investors that might not be as sophisticated as the large Canadian direct investors but who share similar values and long-term objectives.

To explore the two collaborative investment vehicles this paper discussed, please click on the link at the top of this summary.