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THE RISE OF COLLABORATIVE INVESTING

SWF new strategies in private markets

Highlights from the joint SIL-BCG report

Università Bocconi
BAFFI CAREFIN CENTER
SIL Sovereign Investment Lab

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The step into private markets, that large pool of assets stretching from private equity and venture capital to real estate and infrastructure, has been one of the most controversial moves made by SWFs in recent years. This report describes how SWF have tapped this asset class and shows that SWFs have progressively increased the resort to collaborative investment models, following strategies broadly consistent with the recently observed trend of disintermediation of financial markets.

Full report downloadable from Twitter

@bbortolotti **@unibocconi** **#SIW2019**

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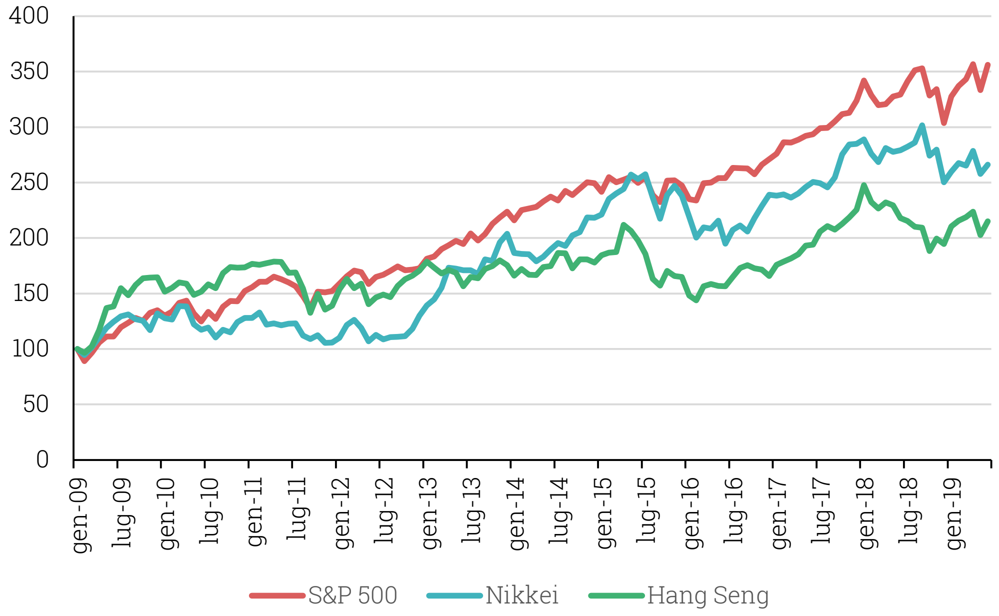
SWF INVESTMENT IN PRIVATE MARKETS

Global stock market trends

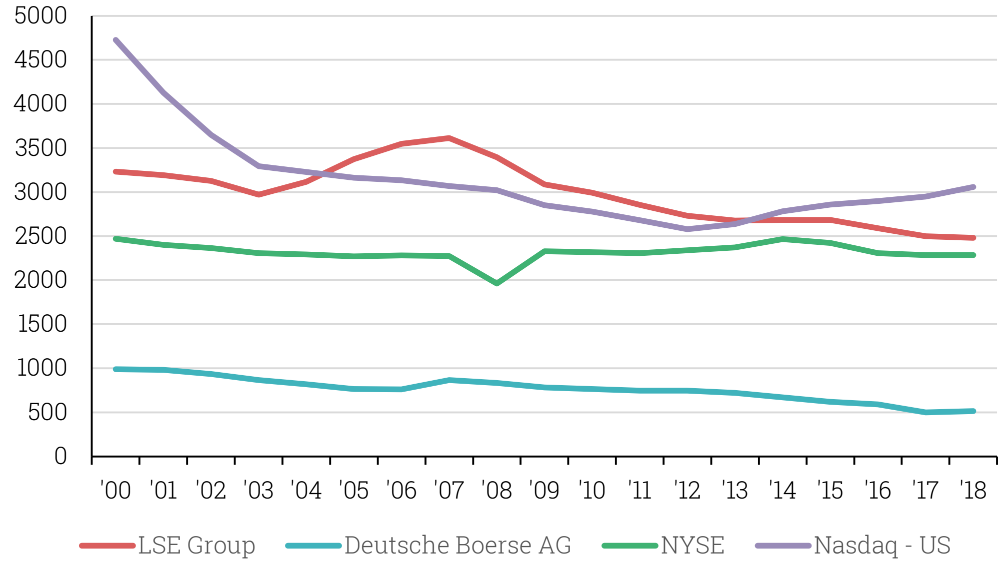
Global equity markets reported a stellar performance over the last decade.

Inflated assed prices in a post QE environment and shrinking liquidity due to massive share repurchases and delistings have shifted allocation from public towards private markets.

Global Stock Indices, 2009 - 2019



Number of listed companies on major stock exchanges 2000-2018



Source: World Federation of Exchanges

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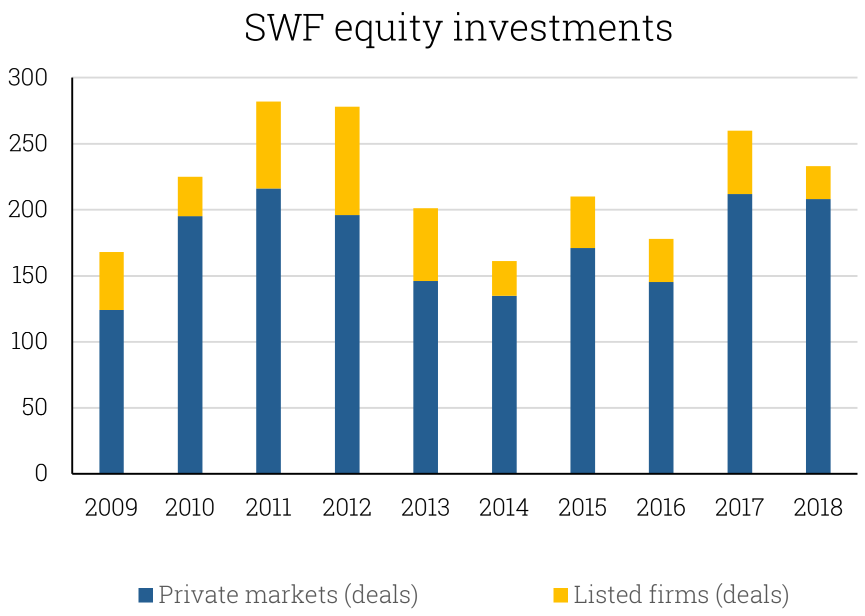
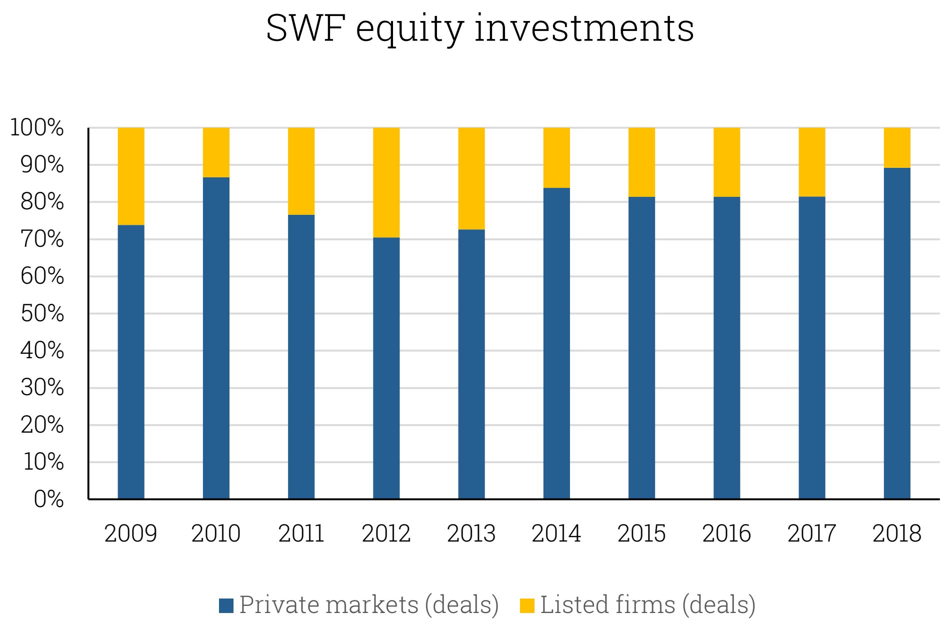
SWFs' shift to private markets

Private markets, a broad category including investments in unlisted targets, private equity, real estate, venture capital, and infrastructure, accounts for $433bn, 75 % of total reported SWF global equity investment.





585$bn

Deal value in 2,196 reported equity transactions

Source: Sovereign Investment Lab

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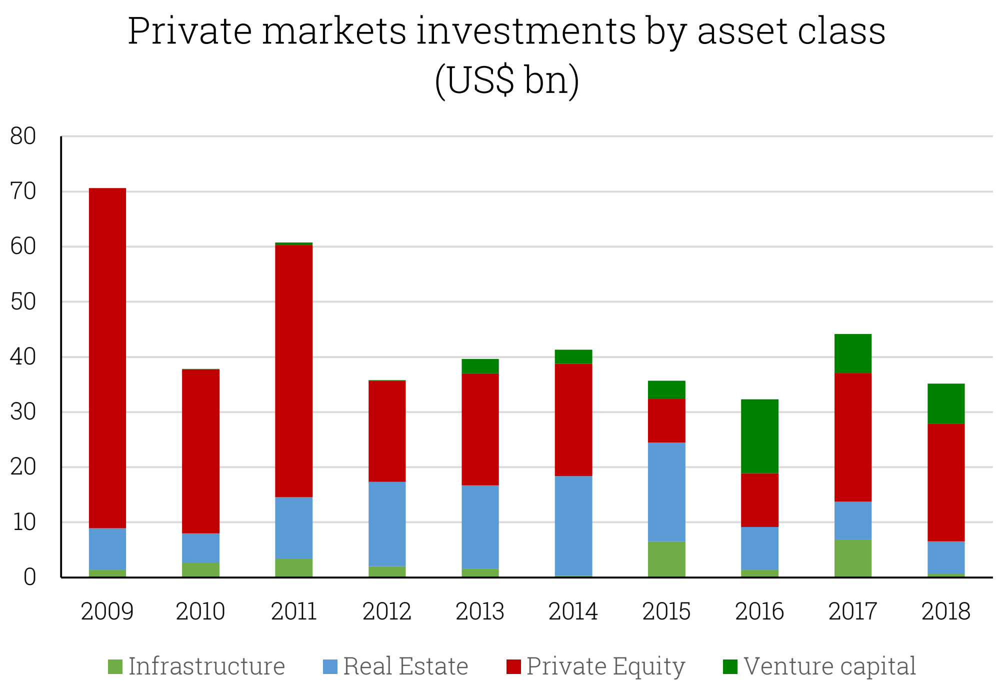
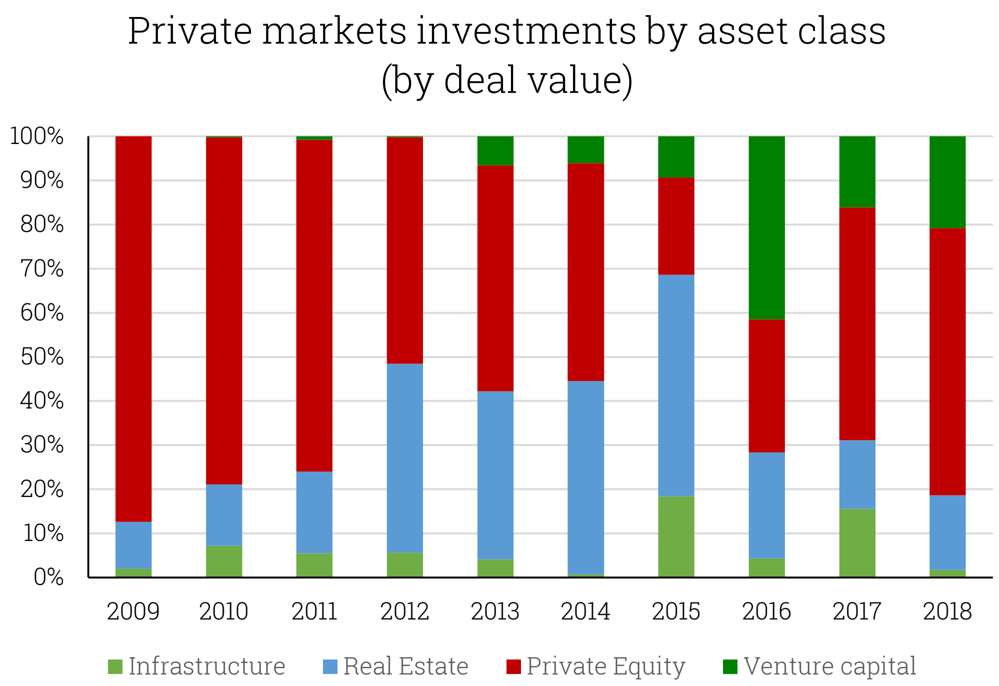
Key fact #1: From safety to venture

Low risk asset-substitution (government bonds), inflation hedging in QE pushed initially SWF into «safe» alternatives such as real estate, infrastructure, and utilities. More recently, SWFs stepped into early-stage, high-growth companies to generate illiquidity premia over the risk-adjusted returns achieved in public markets.





Source: Sovereign Investment Lab

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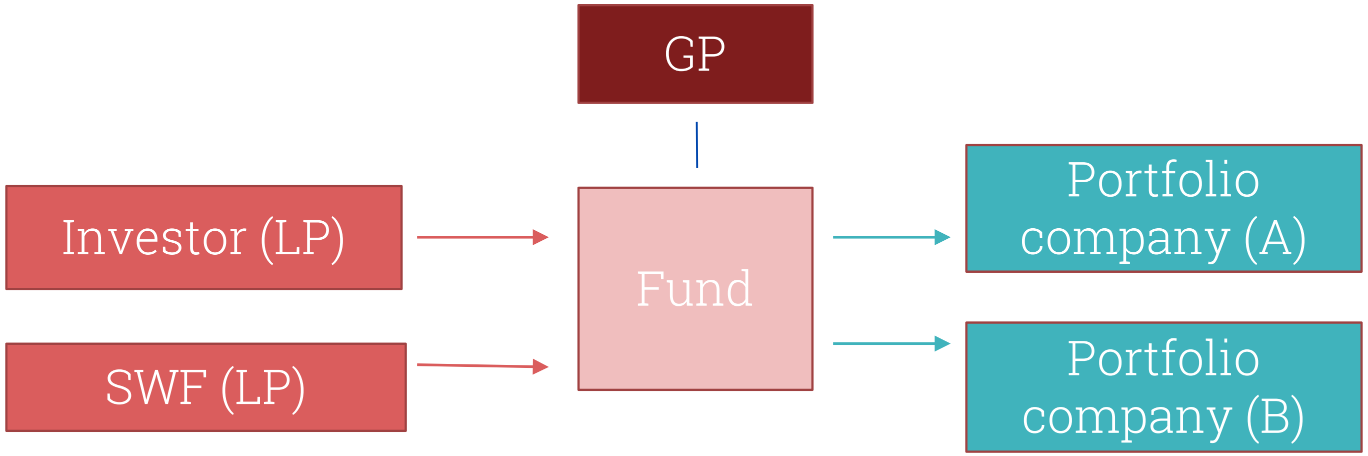
DEAL MAKING IN PRIVATE MARKETS

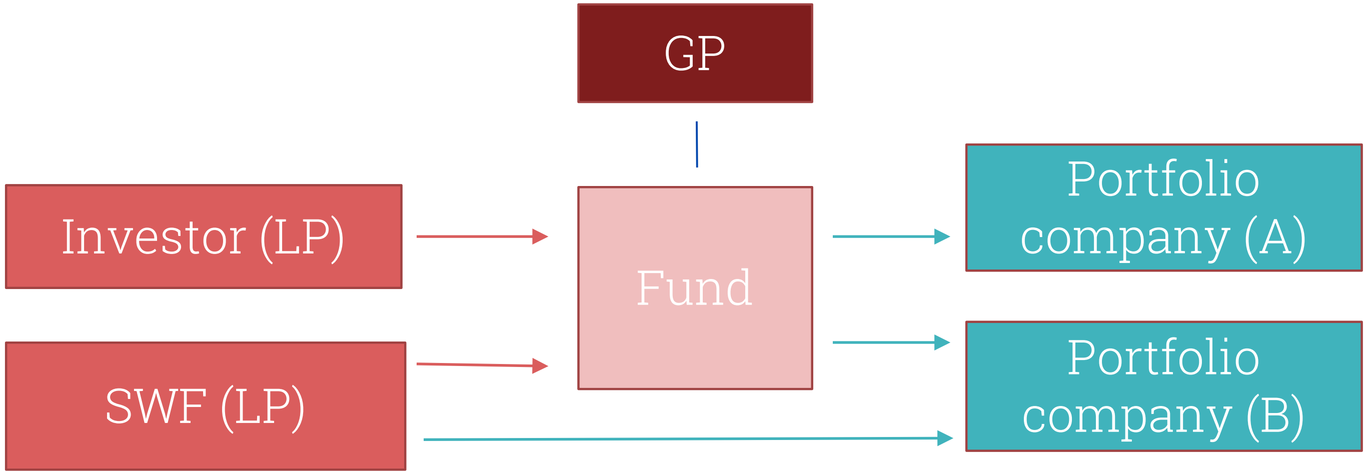
The conventional LP model

SWFs commit capital to funds (especially private equity funds), managed by professional investors as General Partners (GPs). The GPs are in charge of the entire investing process, including deal selection, execution, monitoring, and exiting, while LPs play a pure passive role as capital providers. GPs are compensated through an annual management fee and a share of the funds profits.



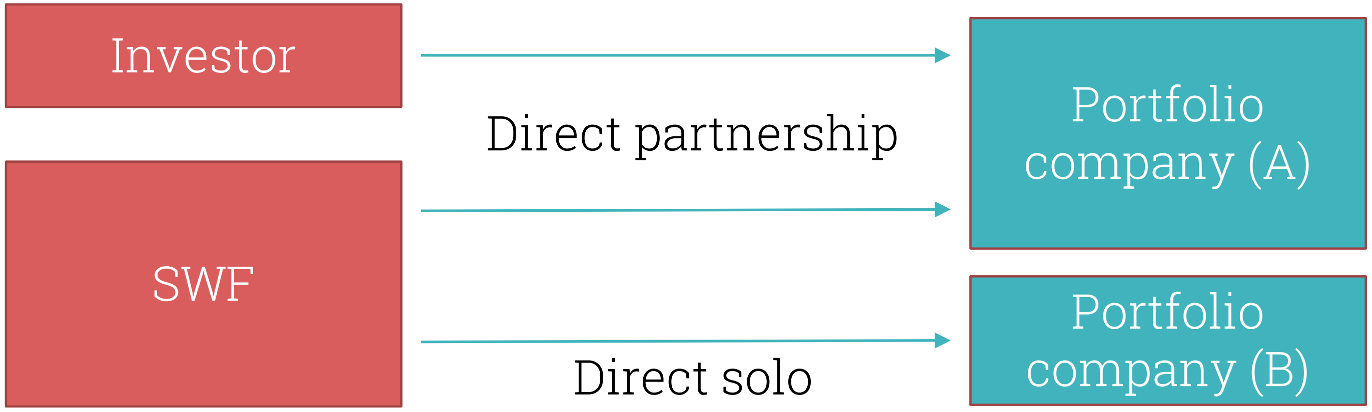
The trade-offs of co-investments

The SWF co-invests alongside the GP in a given target, taking on slightly more risk in return for reduced fees. The benefits from co-investments stem from J-curve mitigation, more flexibility and control in portfolio construction, better ability to time the market and customize the risk exposures. the GP will often leave only a limited amount of time to undertake due diligence, which exposes the co-investor to a classical adverse selection problem.



Direct equity investment

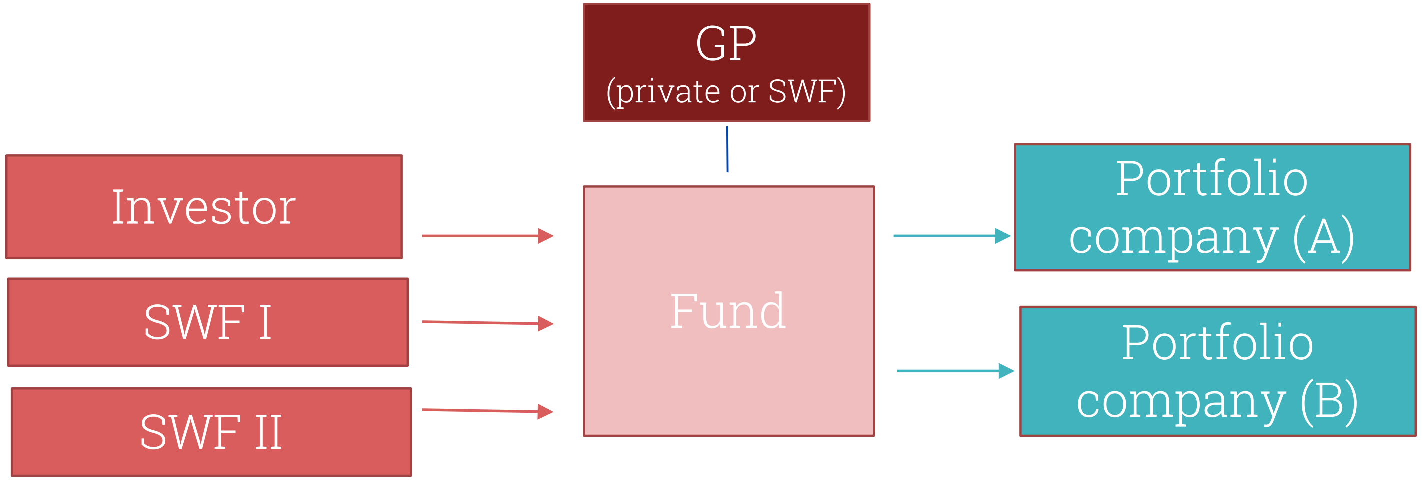
In a direct equity partnership, the SWF invests along with a strategic partner (such as a venture capital fund, an infrastructure or real estate operator) or with other like-minded investors (other SWFs, pension funds or insurance companies), or a combination of both. Direct investment partnerships are thus genuine jointly sponsored deals, as opposed to direct solo



Beyond the LP model: investment platforms

Similar structure to the conventional LP model, SWFs, however, are not any longer the passive players envisaged in the conventional LP model but the main joint lead/sponsor and anchor investors of the platforms (≥ 20% equity capital).

Platforms can be *FDI attractions funds*, *G2G Joint-Investment Funds*, or *Sectoral Investment Funds*.



Delegation vs co-operation: a taxonomy of models

SWFs can position themselves along a range of investment strategies in decreasing order of delegation to third-party managers as they move from LP to collaborative investment models such as co-investments and direct equity partnerships. The transition entails a learning process where SWFs adjust their capabilities and skill sets.

		Cooperation		
		Low	*Moderate*	*High*
Delegation	*Low*	Direct Solo Investments		Direct Equity partnerships
	Moderate		Co-investments	
	High	LP model	Investment platforms	

Successful strategies in private markets

- To become a successful direct investor, there needs to be a gradual evolution (LP investments -> Co-investments -> Direct), with further levels of sophistication around types of direct investing (mature vs. early / growth stage)
- Fund investing is of critical importance for ongoing co-investment volume and knowledge exposure to emerging areas
- Comfort levels naturally around domestic / regional investments, with global (RoW) investments occurring as the model evolves

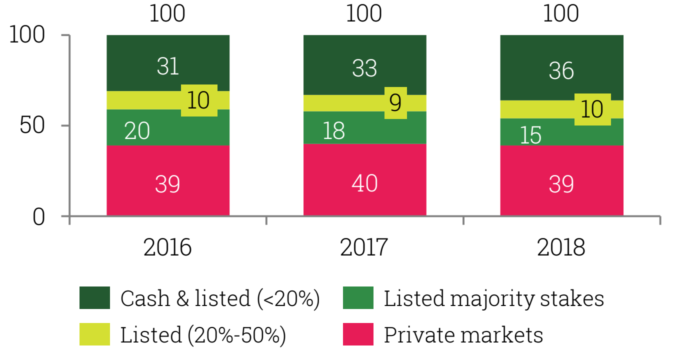
Temasek: Private markets overview

TEMASEK

Private markets breakdown

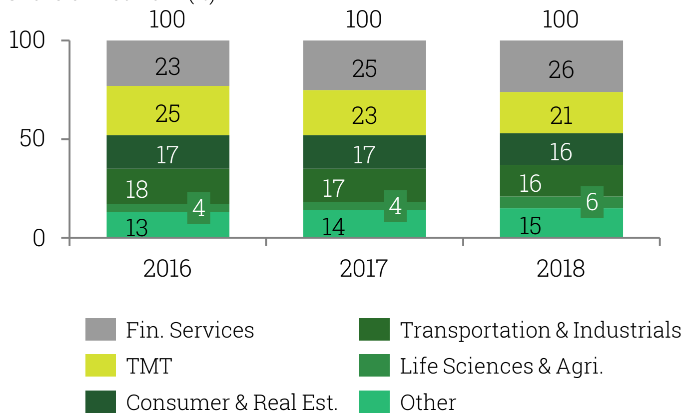
By investment type

Share of Net AuM (%)



By sector

Share of Net AuM (%)



Source: BCG analysis; SWF websites

Operating model and approach to portfolio management

Direct investing experience and appetite

Limited / no appetite | *Intermediate* | *"Quasi PE fund"*

Method of partnership (in relation to the PE fund)

Follower | *Selected input* | *True partner*

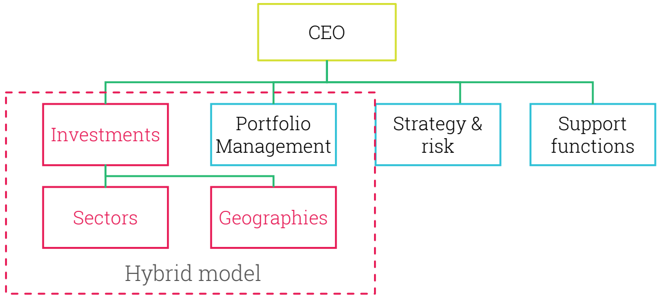
Private Markets operating model evolution

Nascent | *Getting there* | *Fully-evolved*

Portfolio approach

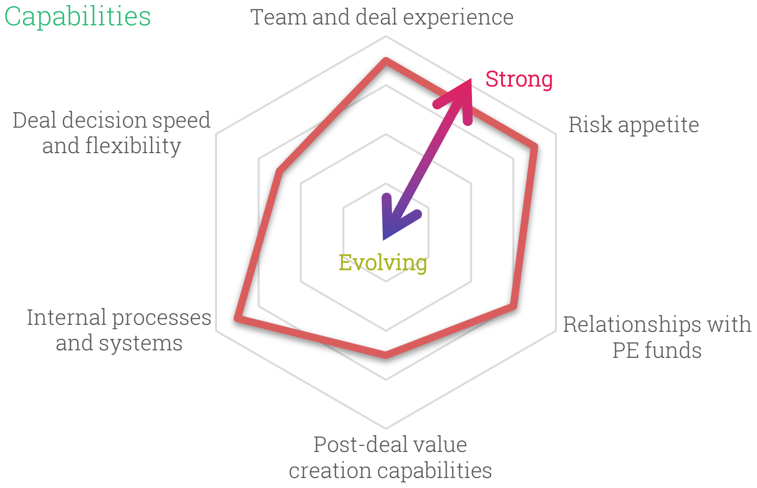
Passive | *Hybrid* | *Active*

Governance



Capabilities and Success Factors

Capabilities



Key success factors

1. **Strong and experienced team:** PE-equivalent team (academic / professional pedigree, philosophy, etc)
2. **Forward thinking:** One of the first SWFs to actively invest in advanced / complex digital and technology
3. **Structured process for direct investing:** Evolved investment process, stress-tested over time

Temasek: Private markets capital deployment

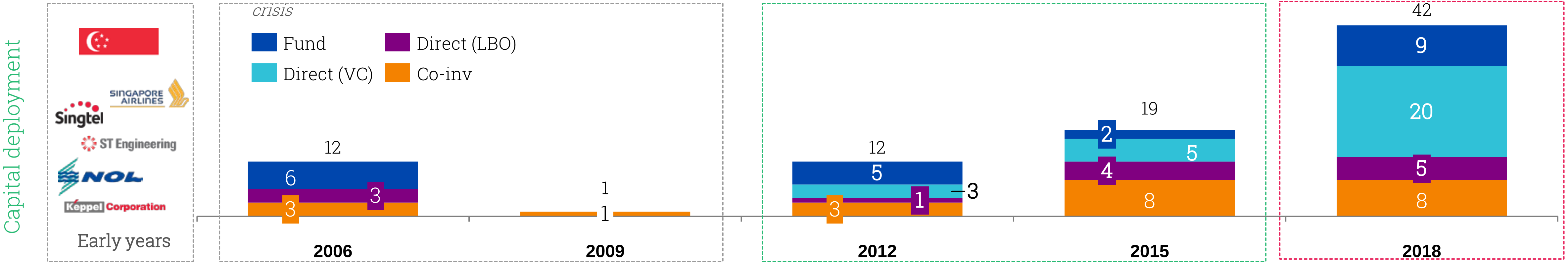
Private markets capital deployment

Held and managed assets previously held directly by the Sg Gov

Temasek was starting out its investment journey, leveraging fund (LP), direct and co-investment strategies. Strong domestic / Asia bias (as expected). 2009 = Global financial crisis

As the fund's model and risk appetite evolved, Temasek started to become more active in the co-investments and direct (PE and VC) space, using the experience to amplify returns AND drive additional exposure to direct investing.

Today, Temasek has a strong direct investments programme, especially towards VC, which is expected given its tech-sector focus.



	2006	2009	2012	2015	2018	
Return (10y TSR)	NA	6%	10%	9%	5%	
Unlisted assets as % of total	17%	20%	27%	33%	39%	Increasing share of private assets
% Singapore	44%	31%	30%	28%	27%	Domestic allocation reducing as model evolves
% Asia (ex-SG)	36%	46%	42%	42%	41%	
% ROW	20%	23%	28%	30%	32%	

TEMASEK

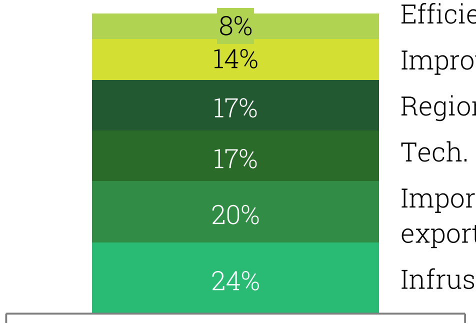
Source: BCG analysis; Pitchbook; Temasek Annual Review and website; SWF Institute

RDIF Profile

RUSSIAN DIRECT INVESTMENT FUND

Overview

Projects according to the national economic priorities



Efficiency growth
Improving quality of life
Regional development
Tech. development
Import substitution & export potential
Infrustruct. development

Fund objectives & focus:

- Provide an inflow of foreign investments;
- Maximize returns on invested capital;
- Contribute to the modernization of the Russian economy;
- Attract the best talent and technology to Russia from across the world.

Geography:

- Russian Federation;
- <20% RDIF's capital may be invested not in Russia (for projects beneficial to the Russian economy).

Investment horizon:

- 5–7 years (10–15 years for 'greenfield' infrastructure projects).

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Private Markets operating model evolution

Nascent — *Getting there* — *Fully-evolved*

Portfolio approach

Passive — *Hybrid* — *Active*

Governance

Supervisory Board	Investment strategy, Approval of substantial/special investments
Investment Committee	Approval of Investments
CEO & Executive Board	Investment origination, structuring, execution

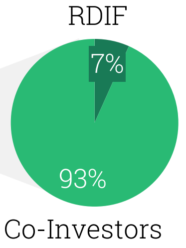
Gateway Fund for FDI in Russia

Key features

$ 10bn reserved capital under management
$ 40bn attracted into joint funds

Co-investment structure
(% of deployed capital)

>$20bn capital invested
90% direct investments
60% Investments in Technology



Investment mechanisms

Direct co-investment with partners:
Project should be in Russia or beneficial for Russian economy.
RDIF investment share must be less than 50%

Direct Investment through mutual funds/platforms

Automatic co-investment mechanism: The mechanism involves automatic participation in all of RDIF's ongoing deals as a co-investor on a pro-rata basis. For instance, there is a $1bn automatic co-investment agreement with Kuwait Investment Authority.

Investment lift: Financial and administrative mechanism for domestic companies having export potential and operating in non resource sectors of the Russian economy.

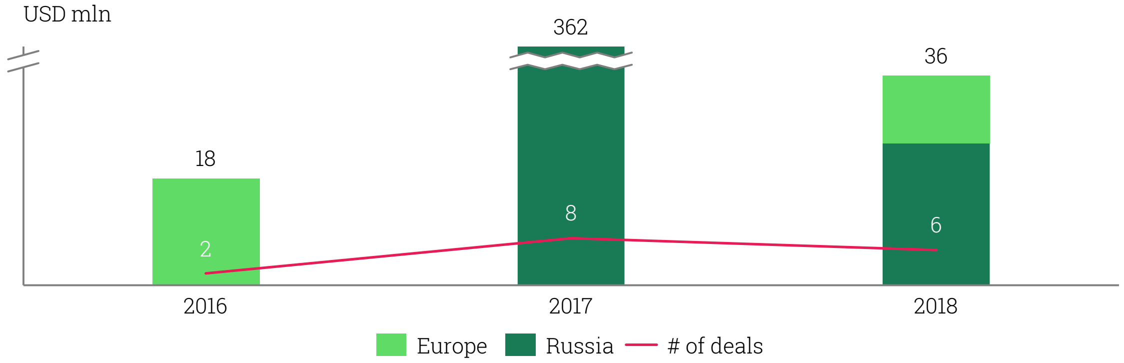
Note: projects in Russia
Source: SWF website, RDIF annual review 2017, Invest in Russia website (ru.investinrussia.com), SWFI, Mergermarket, public sources, BCG analysis

RDIF timeline from establishment

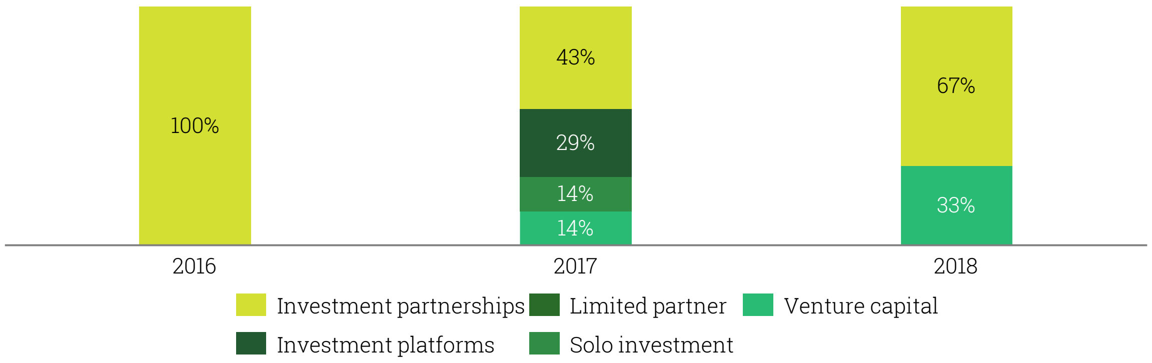
RUSSIAN DIRECT INVESTMENT FUND

Project pipeline since establishment in 2011 (reginal distribution, number of projects)

Deals per region



Deal type distribution (%)



Selected co-investment platforms

Year	Fund/Platform	Country	Estim. Size ($ mln)
2012	Russia-China Investment Fund	China	2 000
2012	Co-investment Mechanism	Kuwait	1 000
2013	Russian-Korean Investment Platform	Korea	
2013	Russian-Italian investment Fund	Italiy	2 000
2013	Russia-France Investment Fund	France	
2013	Co-investment Fund (Mubadala)	UAE	2 000
2014	Co-investment Fund (Qatar Holding)	Qatar	2 000
2016	Russian-Vietnamese investment platform	Vietnam	500

Year	Fund/Partnership	Country	Estim. Size ($ mln)
2016	Russia-China Venture Fund	China	100
2016	Russian-Indian Investment Fund	India	1 000
2017	Russia-Japan Investment Fund (RJIF)	Japan	1 000
2017	Russia-Turkey Investment Fund	Turkey	900
2017	Russia-Armenia Investment Fund	Armenia	
2017	Russia-Saudi Investment Fund (RSIF)	Saudi Arabia	6 000
2017	The Russian-Saudi Energy Platform	Saudi Arabia	
2018	China-Russia The Russian-Saudi Energy Platform	China	1 000

Note: List of partnerships according to the SWF website, not exhaustive.
Source: SWF website, RDIF annual review 2017, Invest in Russia website (ru.investinrussia.com), Bocconi University , BCG analysis

RDIF cooperation examples

Russia - China Investment Fund (RCIF)

Investors: Russian Direct Investment Fund (RDIF), China Investment Corporation (CIC).

Focus: RCIF emphasizes cross-border transactions, as well as investment opportunities within the region.

Launched: 2012

Capital: $2bn

Projects: 25+

PHOSAGRO – Company produces and distributes fertilizer to the agricultural industry. Participation in SPO (2017)

Детский мир – Acquisition of the 23.1 % share of children's goods retailer (2016)

RFP Russia forest products – Acquisition of 42% stake in operator of a wood processing company (2013)

Russia - Japan Investment Fund (RJIF)

Investors: Russian Direct Investment Fund (RDIF), Japan Bank for International Cooperation (JBIC).

Focus: Development of economic cooperation, trade and investments between Russia and Japan, technologies and expertise exchange

Launched: 2017

Capital: $1bn

Projects: 6+

Доктис – Acquisition of a minority stake in developer of multifunctional healthcare online platform (2018)

Investment in Transneft PJSC- company engaged in management of transportation of petroleum and petroleum products (2017)

WAYRAY – Consortium investment in the Zurich based developer of holographic augmented reality (AR) navigation systems designed to improve safety while driving a car (2018)

Co-investment fund with Mubadala Development Company

Investors: Russian Direct Investment Fund (RDIF), Mubadala Development Company

Focus: Long-term investment opportunities across a range of industry sectors, acting as a catalyst for direct investment in Russia

Launched: 2013

Capital: $2bn

Projects: 12+

Deliver. – Investment in the developer of an online platform designed for management of cargo (2018)

World Class – Acquisition of the 22.5 % stake of Russian fitness and health clubs Operator(2018)

PROFESSIONAL LOGISTICS TECHNOLOGIES – Joint investment in the russian diversified logistics portfolio Operator (2016)

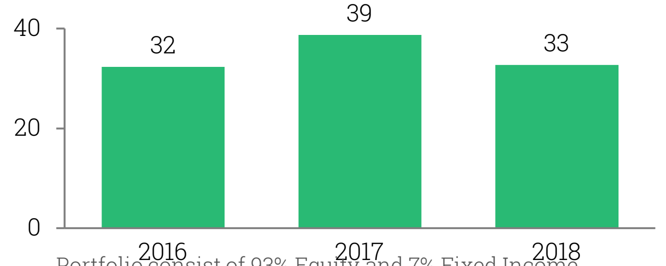
Note: Approximate number of projects based on the publicly available information.
Source: SWF website, RDIF annual review 2017, Invest in Russia website (ru.investinrussia.com), SWFI, Mergermarket, public sources, BCG analysis

Khazanah: Private markets overview

KHAZANAH NASIONAL

Portfolio overview

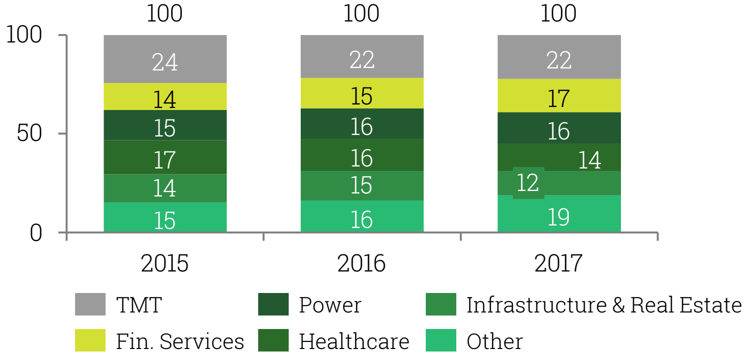
Assets under Management



Portfolio consist of 93% Equity and 7% Fixed Income (2015)

Strong focus on Malaysian companies: 78% in 2017

By sector



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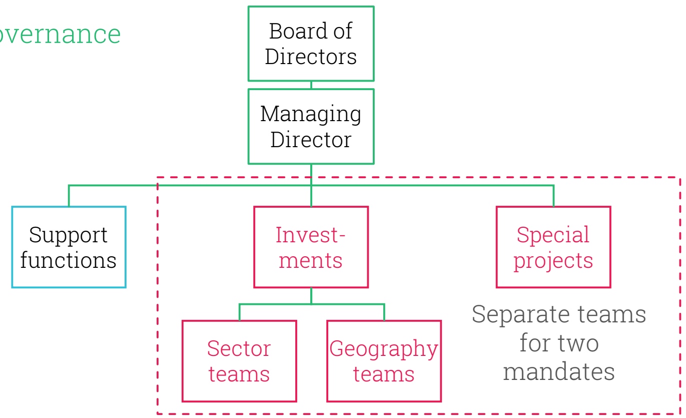
Governance



Changing mandate

Since 2004, Khazanah employs a proactive investment approach with three investment pillars:

- Core investments
  Government linked companies (GLCs) with high strategic value for Malaysia; the main objective is value creation
- Growth investments
  Investment in companies with new growth opportunities (e.g. in the field of Technology & Innovation) and to obtain more global footprint
- Catalytic investments
  Investments to accelerate national development

Under new management in 2019, Khazanah presents new **dual-fund investment structure** to mirror its two distinct objectives:

- Commercial Fund
  Intergenerational fund to obtain risk-adjusted returns and diversify the nation's revenue sources
- Strategic Fund
  Development fund to provide long-term economic benefits with investment in strategic as well as developmental assets
  Explicitly stated preference for co-investment and partnerships in all new developmental assets

Khazanah wants to execute the transition within the next five years

Source: SWF websites; SWFI; BCG analysis

Khazanah's investment approach

KHAZANAH NASIONAL

Deal examples for different investment approaches

Delegation Scale

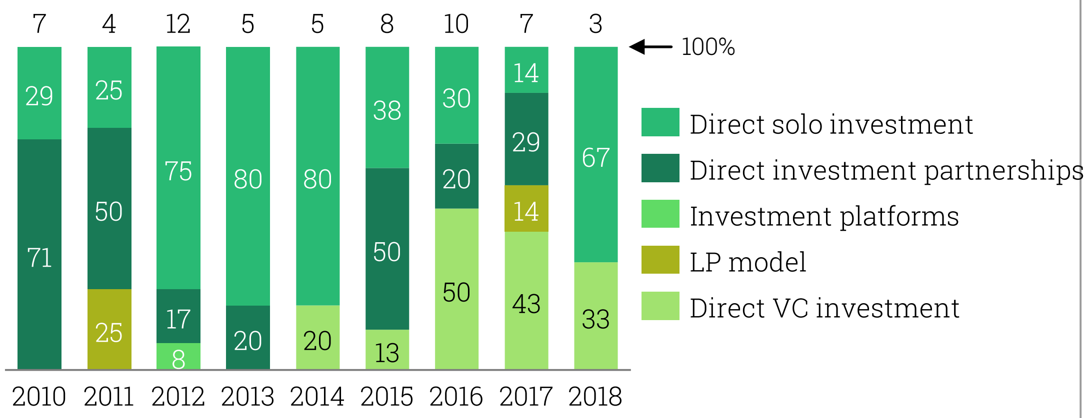
Investment approach	Deal example	
Direct solo Investments	THEMED ATTRACTIONS RESORTS & HOTELS; LeapEd LEARNING ENRICHED	• **Themed Attractions resorts & Hotels**: Khazanah acquired Themed Attractions, a Malaysia-based developer of parks and resorts, in 2015 via a Buyout for an undisclosed sum. • The strategic investment creates jobs in Malaysia and complements growth in other sectors such as construction or real estate. • **LeapEd:** Full acquisition of Malaysia-based Education Service Provider in 2010 for an undisclosed amount. The strategic investment was made to enhance the Malaysian education system, serving the countries development
Direct Investment partnerships	M+S; TEMASEK; CHINA HUARONG; WARBURG PINCUS; Goldman Sachs	• **M+S Pte Ltd**: 60:40 joint venture by Khazanah and Temasek set up in 2011 to develop two mixed-use developments in Singapore (Marina One and DUO). Both projects finished by end of 2017 with a value of about \$8B. Since August 2018, Khazanah in talks to sell its stake to Temasek – no official deal records so far • **China Huarong Asset Management**: Acquisition of 21% for \$2.35B in 2014; a consortium of investors led by Khazanah, Warburg Pincus and Goldman Sachs acquired the company one year before exiting via an IPO
Investment platforms	IDFC; IDFC LIMITED; KHAZANAH NASIONAL	• **Uniquest Infra Ventures:** Infrastructure development platform founded in 2012 together with Infrastructure Development Finance Company Limited (IDFC), focusing on investments in Indian road sector • Khazanah holds 80.1 % of the equity share capital in the special purpose vehicle via portfolio company UEM • Since then, Uniquest invested in two Indian tollway companies (Jetpur Somnath and Sew Navayuga Barwany) and is still looking to make further acquisitions • Uniquest growing in revenue from \$16m in 2014 to \$23m in 2017, however yielding consistently negative net income, with a loss as high as \$74m in 2017
LP Model	ANCORA FAMILY WEALTH ASSET MANAGEMENT RETIREMENT PLANS; atomico	Khazanah invested as LP in • **Ancora Fund II** (Indonesia-focused growth fund) by Ancora Capital Management (VY 2011); Khazanah committed an undisclosed amount • **Atomico IV** (venture capital fund which makes early stage investments focused on Europe's largest technology hubs; VY2017) by Atomico; Khazanah committed an undisclosed amount

Source: SWF websites; SWFI; Preqin; Pitchbook; Orbis; Bocconi University; BCG analysis

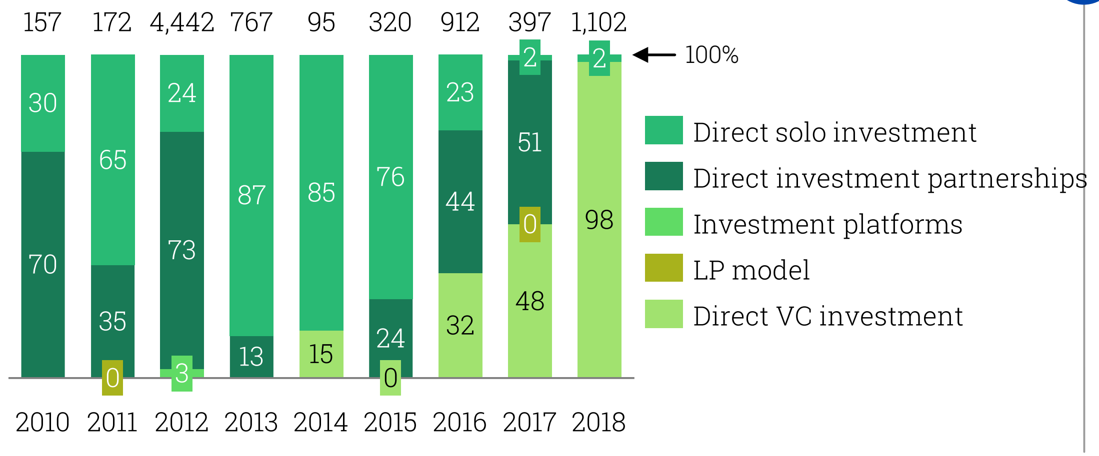
Khazanah's investment stategy over time

Moving from direct investments towards VC investments

Deals by investment type (in %)



Deal volumes by investment type (in %)



- Khazanah predominantly conducts direct investments, solo and in partnerships
- LP investments into funds and investment platforms are the exception
- Strongest relationships to other principal investors is with SWF Temasek: Conducted several JVs (e.g. M+S and Pulauh Indah Ventures) and multiple large direct VC investments: Ant Financial, Alibaba Group, Cainao and Koubei.com
- Since 2014, shift from direct PE investments towards direct VC investments
- These VC investments are larger deals (e.g. making up 48% of invested capital in 2017 and 98% in 2018 – primarily due to a $14b VC investment in Ant Financial) and have higher average number of investors (e.g. 16 new investors in VC investment in Ant Financial in 2018, 6 investors participated in VC investments in Liquidia and Phunware in 2018)
- VC investments predominantly in TMT sector, such as VC investments in Ant Financial (2018), SigFox and VeloCloud in 2017 or Blippar in 2016

Source: SWF websites; SWFI; Preqin; Pitchbook; Bocconi University; BCG analysis

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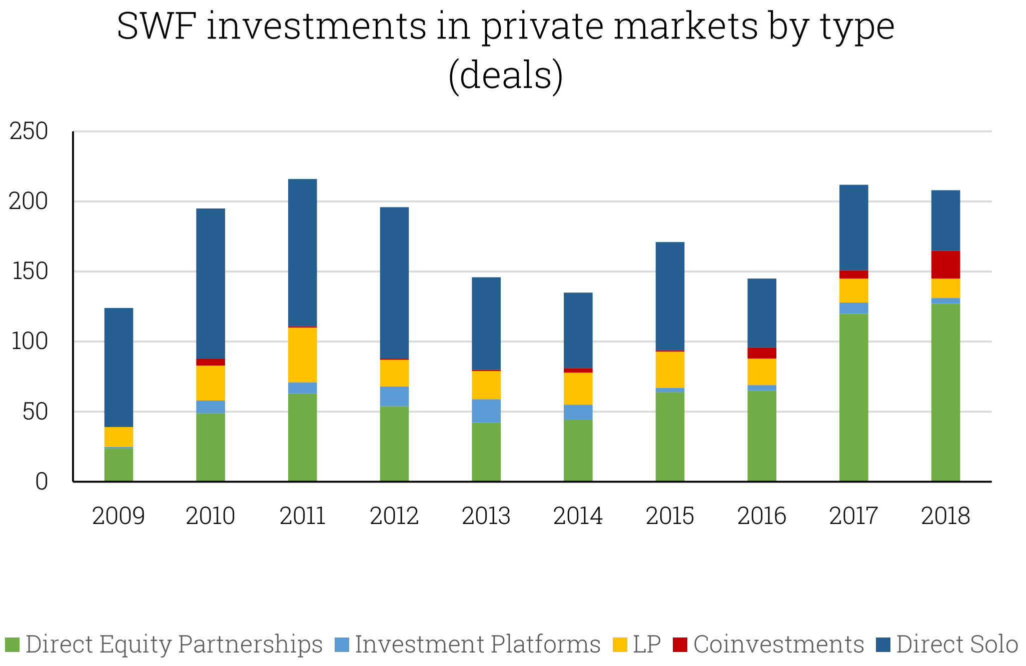
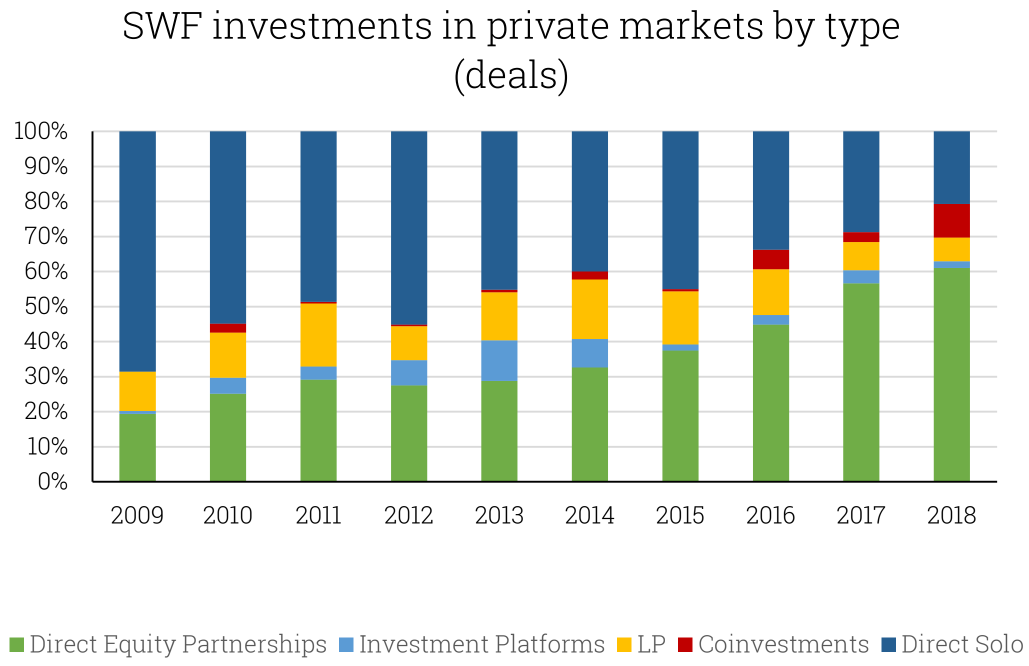
APPLYING THE TAXONOMY

Key fact #2: The rise of collaborative investing

Collaborative investing, particularly in the form of direct equity partnership, is the new, emerging investment pattern on SWF operations in private markets. The overall share of deals with private equity funds remained broadly constant overtime, but co-investments gained an increasing market share.





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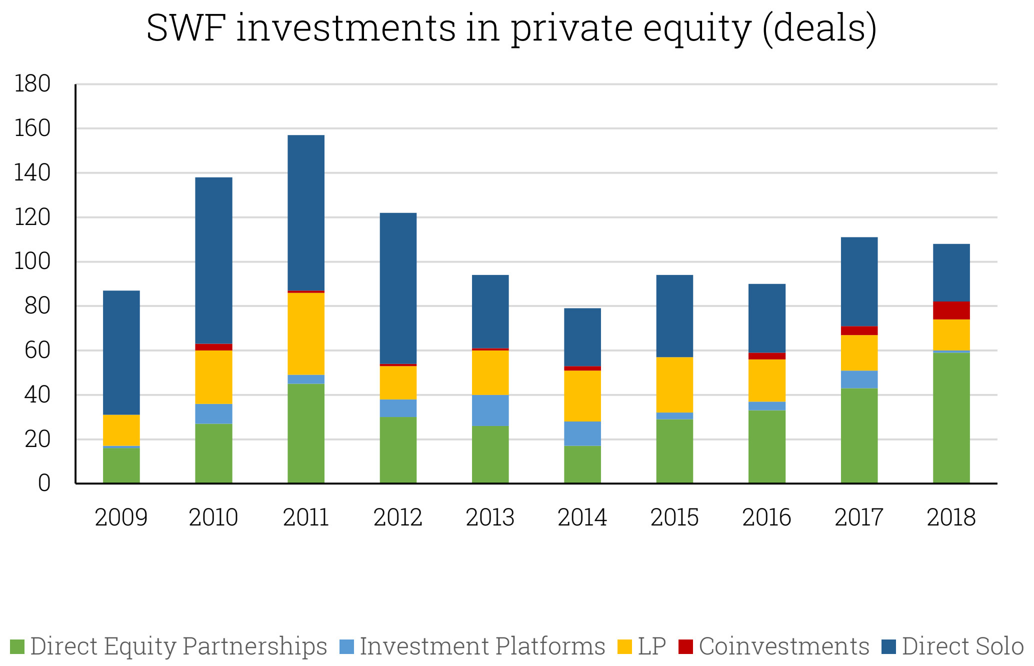
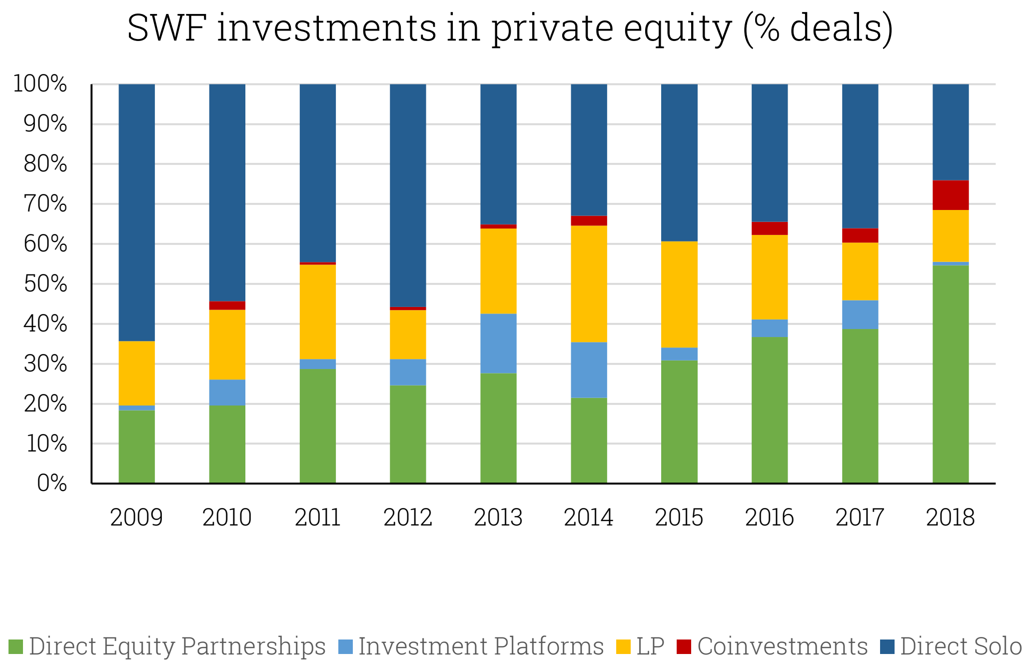
Source: Sovereign Investment Lab

Private equity: from solo to direct partnerships

With $259bn, private equity - including direct investment in unlisted targets and PE funds – is the largest asset class by SWF investment in private markets. Over the last decade, the share of direct equity partnerships doubled to reach 55% in 2018 at the expense of solo investments. Recently, conventional LP models progressively lost market shares in favor of co-investments

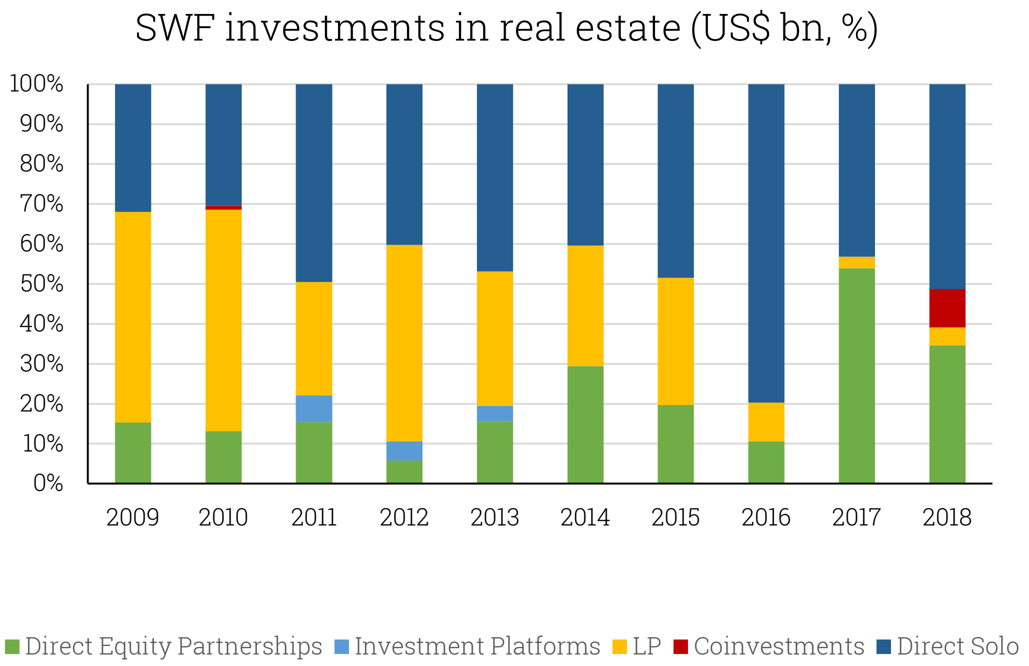


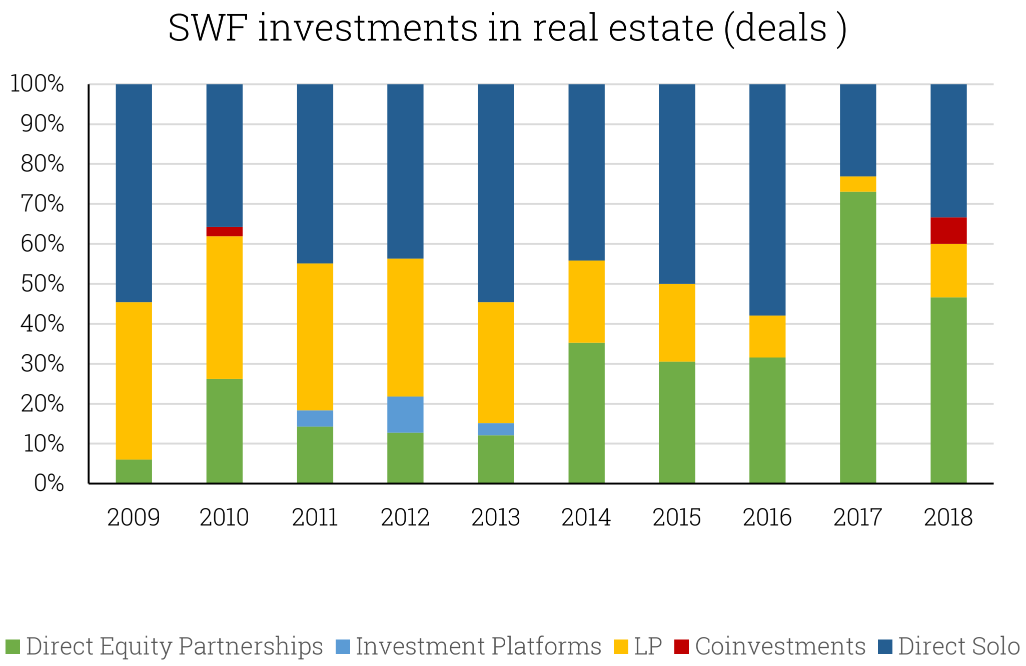


Source: Sovereign Investment Lab

The short happy life of real estate funds

With $111bn, real estate is the second asset class by SWF investment in private market. After the binge after the financial crisis, SWF of all stripes turned their back to the property market, dumping completely the LP model and embracing direct investment





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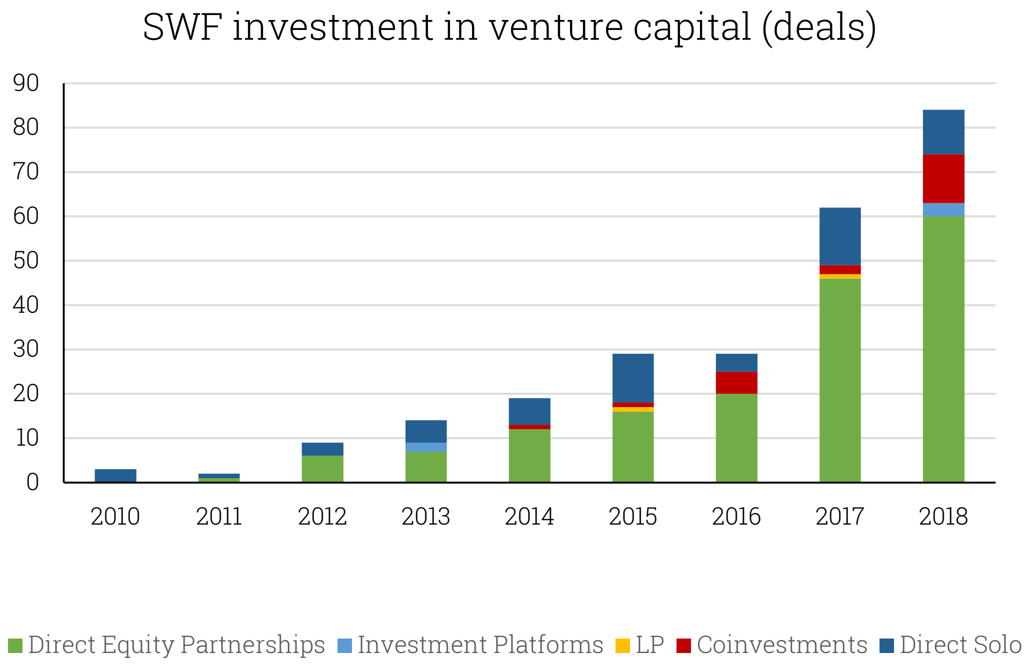
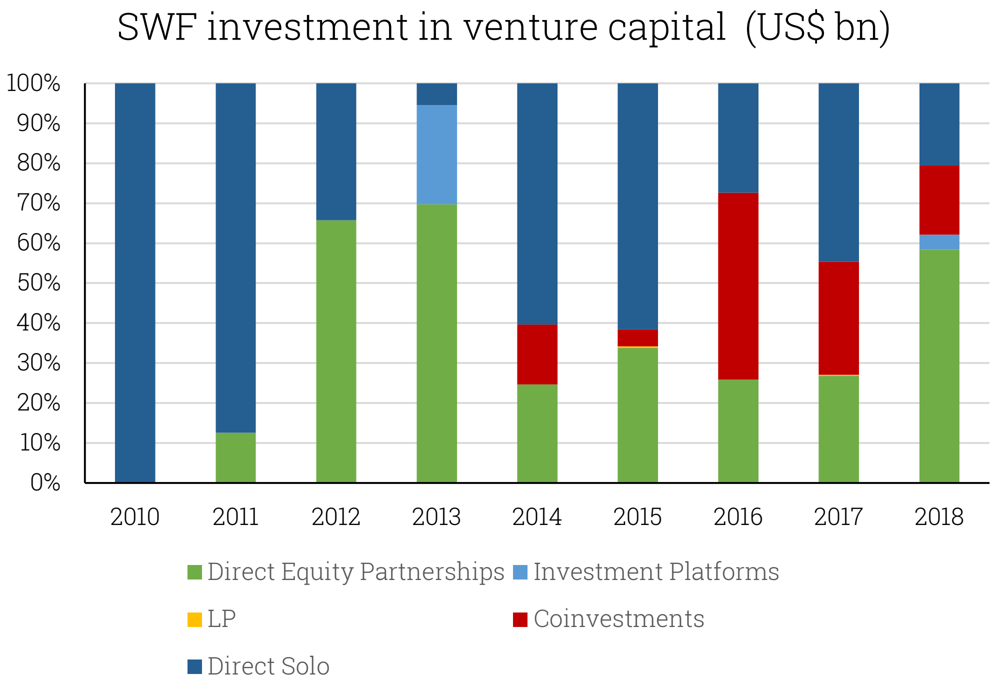
Source: Sovereign Investment Lab

Hunting unicorns

With 271 deals worth $37bn, SWFs' entry into high tech did not follow the conventional route of LP investments in VC funds, but typically occurred resorting to the new models of collaborative investments, namely direct equity partnerships and co-investments.





Source: Sovereign Investment Lab

Softbank Vision Fund: Overview

SoftBank

Approach and Key Statistics

Speeding up the Information Revolution through Investment

Approach:
Investment period of five years and a fund period of at least 12 years
Fund ensures strong personal relationship with investees: Softbank's CEO meets every founder before signing deal and ongoing regular meetings with the CEOs

Fund terms: First close in May 2017 with $93B
Second Close in December 2018 with $98.6B (est.) of funds
Major LPs: $45B Public Investment Fund of Saudi Arabia
$28B Softbank Group Corp. (incl. in-kind contributions)
$15B Mubadala
$1B Apple
Other LPs: Foxconn Technology Group, Qualcomm Incorporated, Sharp Corporation

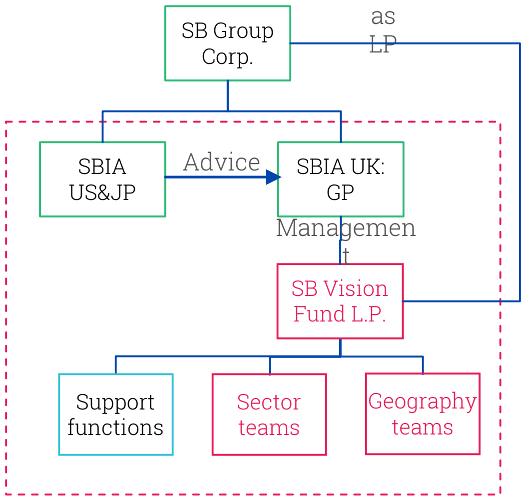
Portfolio: Currently invested in 60 companies
- across 3 continents: Americas (37), Asia (18), EMEA (5)
- categorized in 7 Sectors:

  Consumer (10)
  Enterprise (6) - includes other B2B services
  Fintech (6)
  Frontier Tech (7) – includes companies engaged in AI, ML and other technologies
  Health Tech (7)
  Real Estate (6)
  Transportation + Logistics (18)

Note: SB = Softbank; SBIA = SoftBank Investment Advisors
Source: Softbank websites; SWFI; Press Search; BCG analysis

Operating model and team

Organizational structure



SoftBank Group Corp. fully owns SoftBank Investment Advisers US, JP and UK

At the same time, Softbank Corp. is an LP of the Softbank Vision Fund

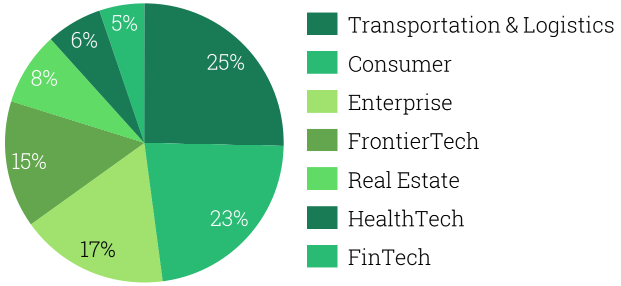
Leadership team

CEO	Rajeev Misra: CEO Softbank Investment Advisers
Chairman	Masayoshi Son (Founder and CEO of SoftBank Corp.) Ron Fisher (Vice Chairman Softbank Corp.)
Fund Team	28 (managing) partners and directors in investments (assigned to 1 region and one or more sectors) 8 (managing) partners for support functions

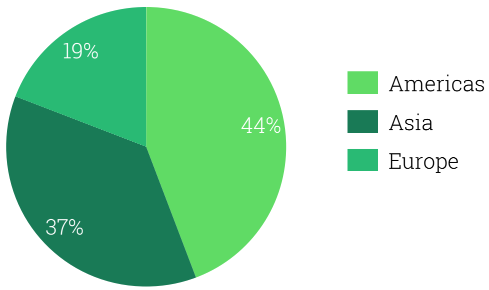
Softbank Vision Fund: Investment analysis[1]

Split of overall investments

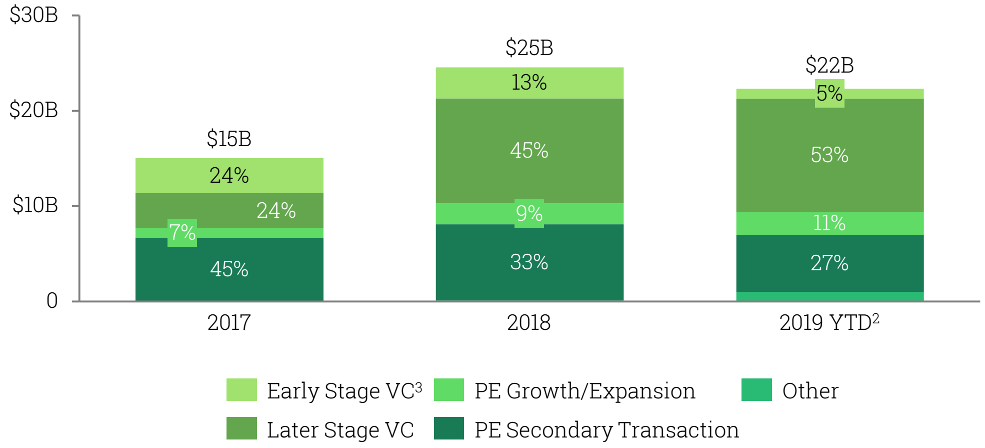
Sectoral split



Regional split



Development of investments by deal type



Investment Snapshot

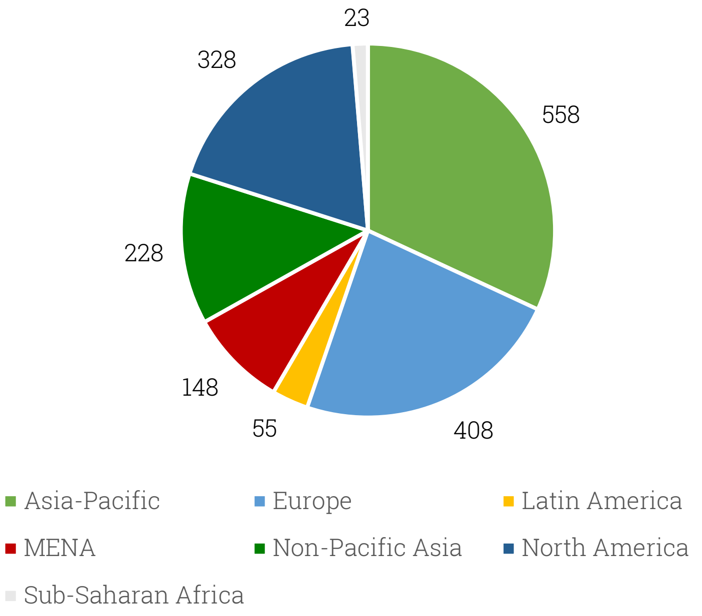
- 77 investments in 65 companies overall done between 2014 and 2019[2] , but very limited activity from 2014 to 2016 (3 deal records)
- On average, deals in Americas region are smaller than in Asia and Europe ($771M versus $1,084M and $1,486M)
- Deal sizes over time show no clear pattern: While in 2017, the average deal amounts to $834M, it is only $768M in 2018 and increases to $1,063M in 2019 YTD
- The average VC deal is done by 6 investors at a time, who acquire a 25% stake in the company for $609M
- Early Stage VC deals are with an average size of $542M smaller than later stage VC deals ($634M)
- There are 2 investors involved in the average PE deal, taking over an average stake of 14% in the respective company for $1,876M; Softbank Vision Fund rarely lead investor of deals involving other investors

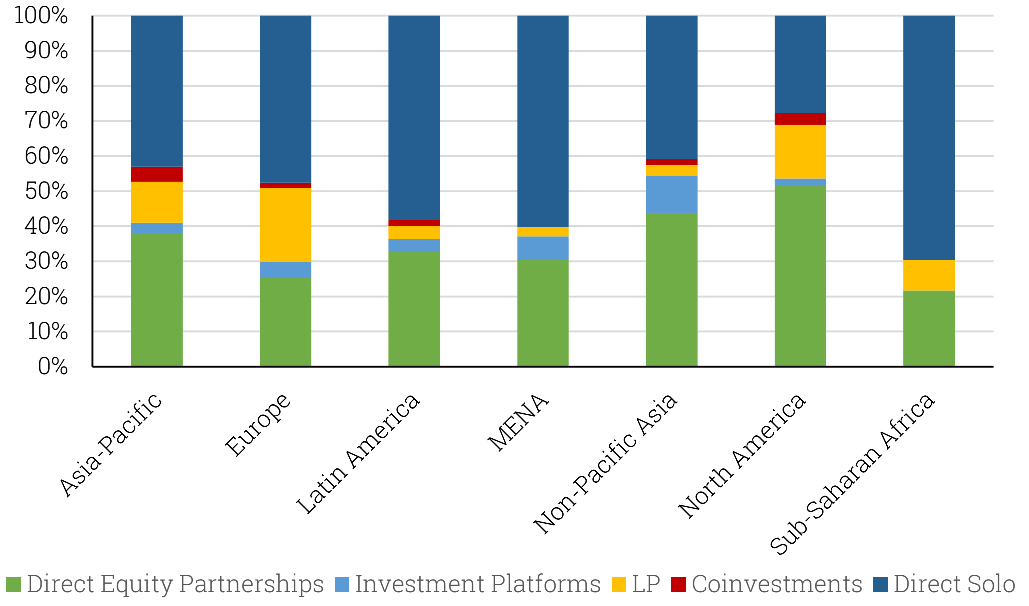
1. Based on overall deal volumes of investments where Softbank was involved 2. As of May 23rd 2019 3. Early Stage defined as Series A to C
Source: Softbank websites; SWFI; Preqin; Pitchbook; BCG analysis

SoftBank

Key fact #3: Geography matters…

Collaborative investing (direct equity partnership and platforms) is more pronounced in Asia and North America. Together with Europe, these target regions feature the highest share of LP activity. In the rest of the world, direct solo is the predominant model.





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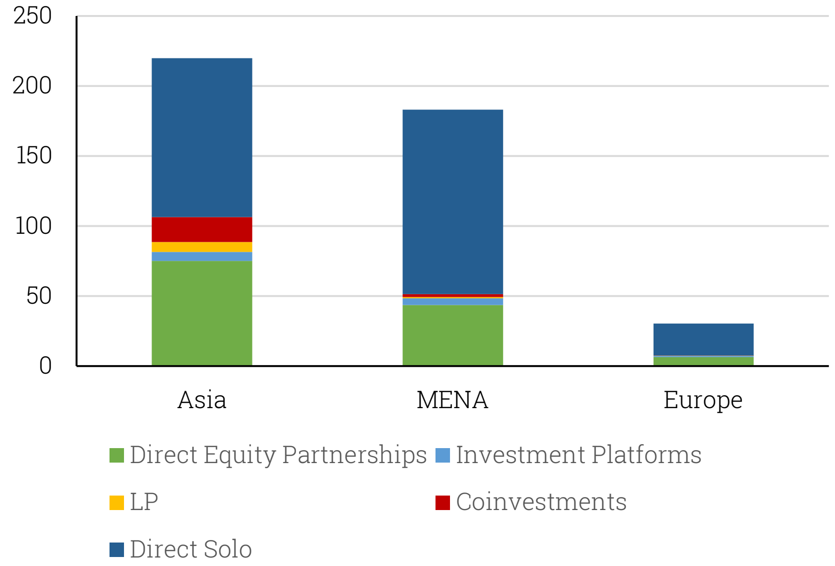
Source: Sovereign Investment Lab

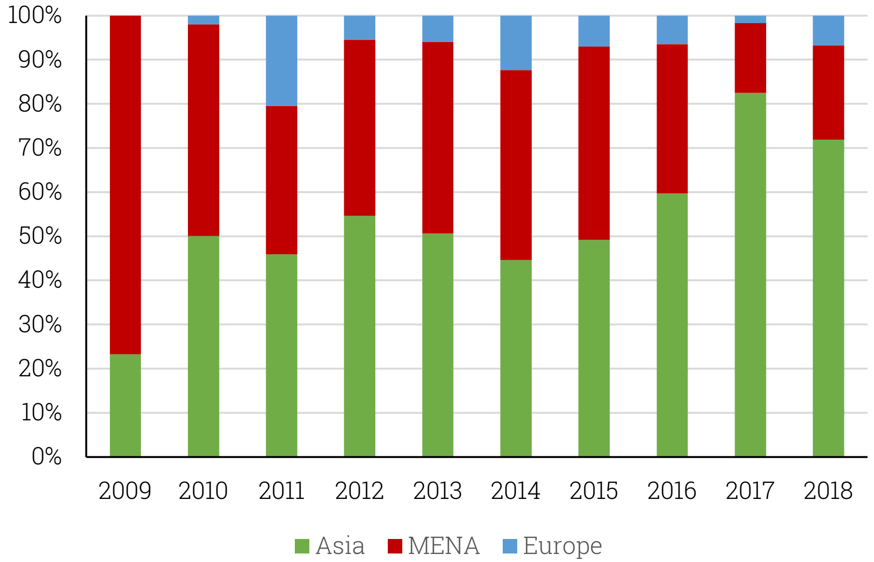
SWF investments by home region

Lower energy prices and diverging growth patterns had redistributive consequences on SWF investment. Asian SWFs dramatically increased their share during the last decade, and now account for 72% of total deal value, while MENA declined to 21%.

SWF investments in private markets by home region (US$ bn)



SWF investments in private markets by home region



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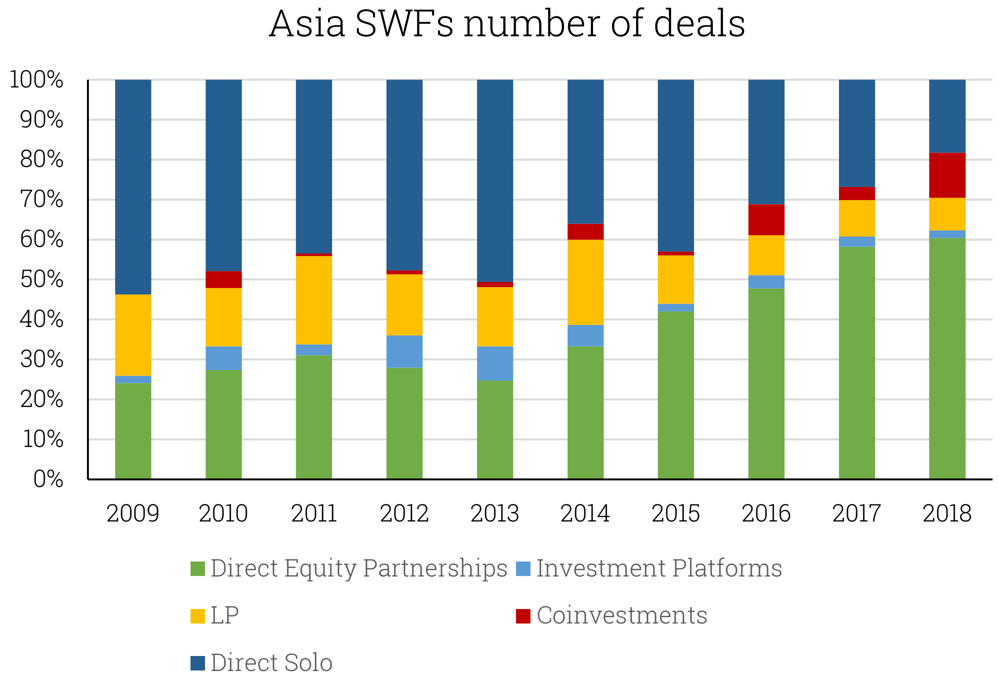
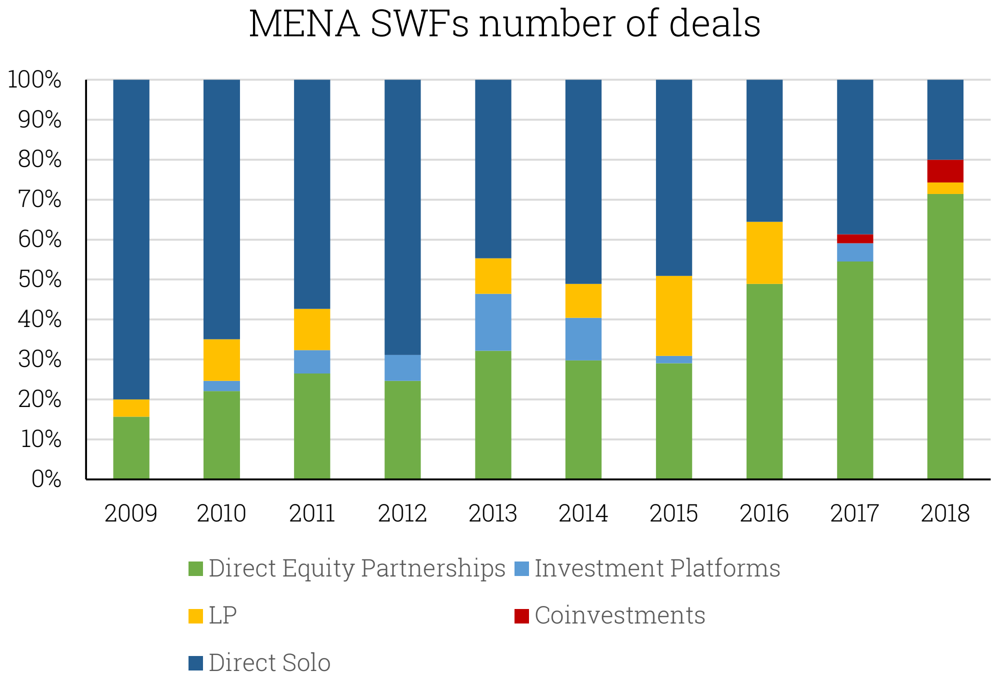
Source: Sovereign Investment Lab

Key fact #4: Structural factors at play…

in spite of two completely diverging trends of overall investment in private markets, the distribution over time among investment models is very similar. Neither geography, nor macroeconomic outlook explain how deal making in private markets evolved in recent times. Structural factors have changed the industry and steadily shifting incentives in favor of collaborative investment models predominantly in the form of direct equity partnerships and against solo and conventional LP models.





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Source: Sovereign Investment Lab

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WHAT’S NEXT?

Towards a post-crisis disintermediation?

Forced by regulation and market pressure, since 2009 the banking industry has embarked in a deep deleveraging process, increasing capital cushions and cleaning up balance sheets. Global systemically important banks have been thus pulled down from excessive short-term risk taking and pushed into safer grounds.

This process did not eliminate systemic risk. Rather, it just morphed and migrated out of banks into other sectors of the financial industry. A structural outcome of this mass migration of risk is the shrinking role of conventional, broker-dealer, bank sponsored intermediation and the increasing role of non-bank end users of capital, including pension funds, insurers, and SWFs.

The shift towards collaborative direct equity investment is thus part and parcel of a wider, structural change in the global financial system, with far reaching implications for SWFs and institutional investors alike.