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From big to great

The world's leading institutional investors forge ahead

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Executive Summary

Over the past several years, leading institutional investors have opened offices around the world and built large teams with new talent specialties. What's next for the world's largest investors? How will they stay on their strong trajectory? What do the changes in the macro environment mean for them? How will they manage the increasingly complex internal structures they have set up?

To answer these questions, we have surveyed 27 large pensions and sovereign wealth funds that collectively manage $7.4 trillion in assets, and interviewed leaders of these institutions in depth. Our research shows that institutions have a strong desire for a more strategic approach to portfolio construction. They plan to elevate liabilities to a central role in asset allocation. And they want to broaden investment capabilities to include new asset classes, investment strategies, and approaches to value creation, all with a view to driving greater risk-adjusted returns for beneficiaries.

Delivering on these strategic priorities will require new capabilities. Institutions we surveyed identify seven areas in which they plan to invest: (1) developing a high-performing culture across the organization; (2) evolving the risk-management function to assess and manage risk embedded in illiquid assets; (3) improving the value proposition to attract top talent; (4) building a strategic approach to reputation and branding; (5) turning the research function into an "insight engine"; (6) "de-biasing" the investment decision-making process; and (7) creating an advocacy strategy to develop a voice commensurate with asset size. Developing these capabilities will be difficult, requiring substantial commitment and resources, but the payoff will define the leading institutional investors over the coming decade.

From big to great

The world's leading institutional investors forge ahead

Over the past several years, leading institutional investors have built significant organizations, opened offices around the world, and built large teams with new talent specialties. And with rapid growth in assets and strong returns since the global financial crisis, most are now heavyweights in every sense, recognized as essential players in the global financial system. Some of the largest pensions and sovereign wealth funds manage over $1 trillion. As US senator Everett Dirksen is alleged to have said, "A billion here, a billion there… pretty soon you're talking about real money."

What's next for these behemoths? Institutional investors get full credit for their size from the financial system. But what will they do with their new bulk? Our new research suggests that some leading institutions will break away from the pack, and cease to be simply colossal pools of aggregated investment demand and agglomerations of talent. Leaders will live up to their name and become truly great institutions, with deep and permanent capabilities deployed against a broad range of investment practices.

We surveyed over 50 senior executives at more than half of the top 50 pensions and sovereign wealth funds worldwide, which collectively manage $7.4 trillion in assets (Exhibit 1).

Exhibit 1

We surveyed 27 large pensions and SWFs that collectively manage $7.4 trillion in assets

SOURCE: SWF Institute; McKinsey analysis

We also interviewed leaders of these institutions in depth, and solicited the views of our colleagues around the world who work with leading investors. The research revealed two themes that turned up again and again. First, the world's leading investment institutions are intent on evolving into true institutions that are more than the sum of their parts. Second, a re-examination of the portfolio construction process has become the top priority for many of the CEOs and CIOs we interviewed.

This report is intended primarily to present these research findings. But we will also attempt something more. We found a strong tendency of institutions to endorse leading practices, even before they allocate the necessary resources to implement these practices. In other words, institutions sometimes talk the talk before they walk the walk. Many of the leaders that we spoke with readily conceded this gap, and their ambition to close it. Accordingly, we have built on the current consensus, as revealed by the survey, to imagine what the leading edge of institutional investing might be like in five years' time, with the aim of helping institutions set the right aspiration.

Portfolio is the priority

The importance of portfolio construction is not a new idea – far from it. Various academic studies over the past two decades have found that approximately 90 percent of variation in returns over time are attributable to a fund's asset allocation decisions, and about 35 to 40 percent of the differences in performance between funds is due to differences in asset-allocation choices. What is new, however, is that traditional approaches to asset allocation are now seen as inadequate, and CIOs and CEOs are increasingly willing to rethink their process. Indeed, leading investors are not only questioning capital allocation across asset classes, but also the definitions of the asset classes themselves, and the decision-making process to get there. We found six ways that institutions will place new prominence on portfolio construction.

1. Putting strategy back into asset allocation

Until recently, strategic asset allocation (SAA) has been rather non-strategic. Most institutions used historical estimates of returns, correlation, and volatility, plugged in relevant constraints, and generated a frontier of portfolio options that theoretically matched their risk and return objectives. Because the estimates and constraints changed very little, last year's SAA became a powerful anchor for this year's allocation. Significant adjustments to the SAA have been rare, with the exception of a long-term trend among many institutions to shift an increasing portion of their portfolios to illiquid assets. Indeed, for most pension and SWF boards, the review of asset-allocation decisions has been more or less a rubber-stamping exercise.

Instead of working on the SAA, many institutions have spent the bulk of their time on the search for alpha through a number of means, including active management (both internal and external) and direct investing in illiquid asset classes. The work on beta has been mainly to reduce costs, often by internalizing management, with some exploration of enhanced-beta portfolios. Our interviews confirmed that institutions generally spend 20 percent of their time on beta, including the SAA, and 80 percent on the search for alpha.

In the biggest change to affect investing recently, leading institutions are realizing the implications of this mismatch. Low interest rates have added considerable capital to the global financial system, pushing up prices on all kinds of assets and effectively lowering risk premiums. Hitting "repeat" on the SAA from year to year has had the unforeseen consequence that institutions are not being paid for the risks they are taking. That's costly: the payoff from getting the SAA right is worth a decade of good deal-making to create alpha at the margin.

With risk premia so low, some investors have considered going to the extreme of allocating more of their portfolio to cash. A small number of players have already started doing this, with the Australian Future Fund in particular raising cash levels to over 20 percent of the portfolio at the end of 2015. However, most institutions have limitations that prevent them from doing this and are exploring other approaches such as factor-based investing, a rapidly accelerating investment style. By one estimate, the AuM dedicated to this approach have quadrupled over the past several years.

Even more important than risk factors is a shift in the 80/20 management approach. Institutions plan to rebalance their efforts by doubling down on portfolio-construction capabilities, given that these drive the vast majority of long-term returns. The most striking finding from our research is that almost 80 percent of institutions plan to reinforce their central portfolio-construction team, with most expecting to add three to five people. In interviews, leaders also said they expect a more dynamic decision-making process structured around top-down economic scenarios, which they hope will provoke more debate and move them away from a rote approval of the SAA by the executive committee and board.

Exhibit 2 summarizes the key shifts that institutions expect to see in the portfolio-construction process.

Exhibit 2

Portfolio construction by leading institutional investors in 2020

	From…	To…
Objective	▪ Deliver a base of beta returns aligned with risk/return objectives	▪ Become the engine of differentiated absolute returns ▪ Maximize the probability of meeting liabilities
Approach	▪ Backward-looking SAA driven by traditional process ▪ Anchored in last year's allocation ▪ "Why tilt?"	▪ Forward-looking house views on assets, risk factors or other cycles ▪ Clean-sheet approach ▪ "Where will we tilt?"
Decision process	▪ An isolated process focused on the office of the CIO	▪ Rigorous and participative annual strategic process
Capabilities	▪ Small teams of finance practitioners	▪ Analytical team led by thought leader with conviction

SOURCE: LP interviews; McKinsey analysis

In summary, by 2020 leading institutions will focus much more attention on the SAA, and will reshape it into a dynamic, forward-looking, keenly debated, and deeply researched document.

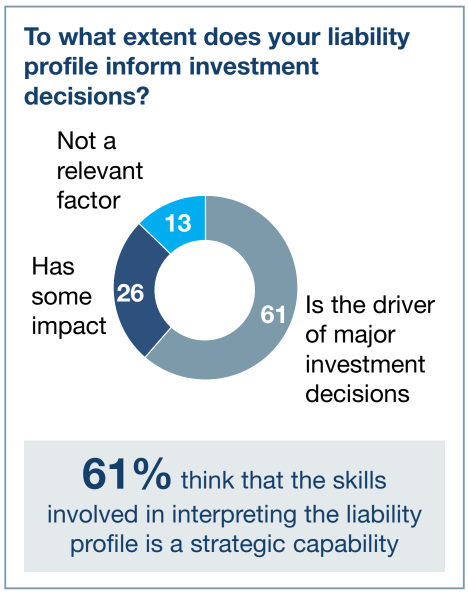
2. Start from liabilities, not assets

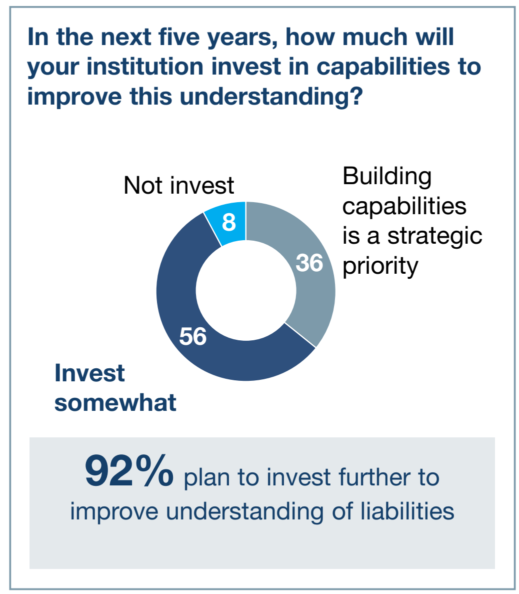
We found broad evidence that investment decisions – indeed, the SAA itself – will be increasingly driven by a deeper understanding of the liability profile. Seventy-five percent of respondents think that they already understand well (or in a distinctive manner) their liability profile. Yet 92 percent plan to invest further (Exhibit 3). (This is one example of the way that institutions' practices tend to lag their aspirations.) Over 60 percent say that liabilities are the driver of major investment decisions, a figure that is certain to rise as institutions invest more in understanding just what they owe to their stakeholders.

Exhibit 3

Institutions will shift toward liability-aware and liability-driven investing

Percent of respondents





SOURCE: LP survey; McKinsey analysis

What they do with that better understanding depends on the kind of institution. Big defined-benefit pension plans may be furthest evolved; they have an actuarial understanding of their depositors. But even these funds can learn more about the composition of their depositor base, to get beyond raw demographics and into depositors' preferences and their exposures from their other assets. Indonesian public servants, for example, already have exposure to the domestic economy from their homes, their work, their families, and their other investments; should their pension fund be overweight on Indonesian equities? Also, only a handful of leading institutions do a good job of proactively managing the duration risks that arise between their beneficiaries' needs and their investment activities.

Defined-contribution pension plans can use a better knowledge of their depositors to serve them with more suitable products, including target-date funds. Sovereign-wealth funds already use a long-term investment horizon, suiting their constituents' needs. But some may now need to think about how revenues are used across all national budgets. For example, many resource funds have to grapple with the collapsing price and volatility of commodities, especially oil.

National budgets based on revenues from $100 per barrel oil now have to be redrawn, with serious implications for reserve funds. Namely, SWFs will need to adjust their allocations to their state's funding needs, which in large part will be driven by oil prices.

In summary, leading institutional investors will fully develop and ground investment strategy in the liability profile to better suit the needs of their beneficiaries.

3. Move the portfolio goalposts

As they examine opportunities and seek returns, many institutions use the same set of definitions. For example, in private equity they might require 15 percent returns, over a maximum of 7 years. But when every investor uses the same definitions, they find the same deals. The result? An auction, in which the successful bidder often suffers from the "winner's curse."

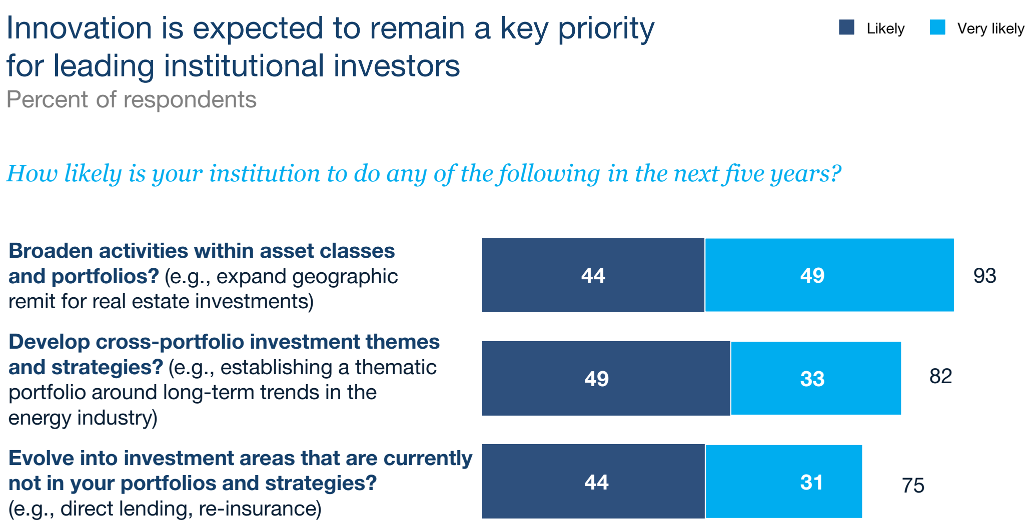
By 2020, leading investors will have found new sources of return to complement the traditional asset classes. If they have some flexibility within their investment policies and portfolio constraints, coupled with the right skills, institutions will be able to invest in opportunities previously considered "uninvestible," where returns have not yet been competed away. Thematic investors in particular are discovering that there are many opportunities that don't fit in the classical boxes (Exhibit 4).

Exhibit 4

Innovation is expected to remain a key priority for leading institutional investors

Percent of respondents

How likely is your institution to do any of the following in the next five years?



SOURCE: LP survey; McKinsey analysis

Some leading pensions are already putting these ideas into practice. Five years ago, the Ontario Teachers' Pension Plan established a long-term equities portfolio, with required returns significantly lower than its traditional private-equity threshold, and a holding period of at least 10 years. For this portfolio, it seeks deals that are off the beaten path, with stable cash flows that fit with depositors' needs. Similarly, Caisse de dépôt et placement du Québec recently established its global quality equities portfolio, which now represents over 30 percent of its total equities allocation. Here, CDPQ pursues investments that go beyond the traditional index approach espoused by most of its peers, to create a more resilient portfolio.

Another trend moving the goalposts is an increased flexibility in allocating capital within each portfolio. This leads to broader definitions of asset classes and looser risk "guardrails" for exposures to particular sectors, styles, or geographies. This also opens the door to more thematic investment opportunities and approaches, and creates the need for institutional "house views" that can inform this decision-making.

By 2020, leading institutions will own a broader range of assets, many in new markets, and will use more flexible structures to group and manage those investments.

4. The next chapter in illiquids

Twenty years ago leading institutions began to increase their investments in illiquid asset classes, especially private equity and real estate, to capture the outsized premiums these investments offered. Naturally, they primarily used external managers. Later, a handful of industry leaders developed their own teams to invest directly in illiquid assets; often these teams built their skills through co-investments with experienced managers.

Today, leading institutions have gone beyond direct investing to running a business. Some funds have built and acquired businesses that operate one kind of illiquid asset—real estate. These platforms add value beyond raw investment, by capturing the additional value that can be gained through operations. Real estate is a natural home for operating platforms; it has the lowest risk-return profile among the illiquid assets (which suggests that external management fees for real estate funds are not always easy to justify). Many institutions we surveyed expect to dip a toe into real-estate operations over the next five years (Exhibit 5).

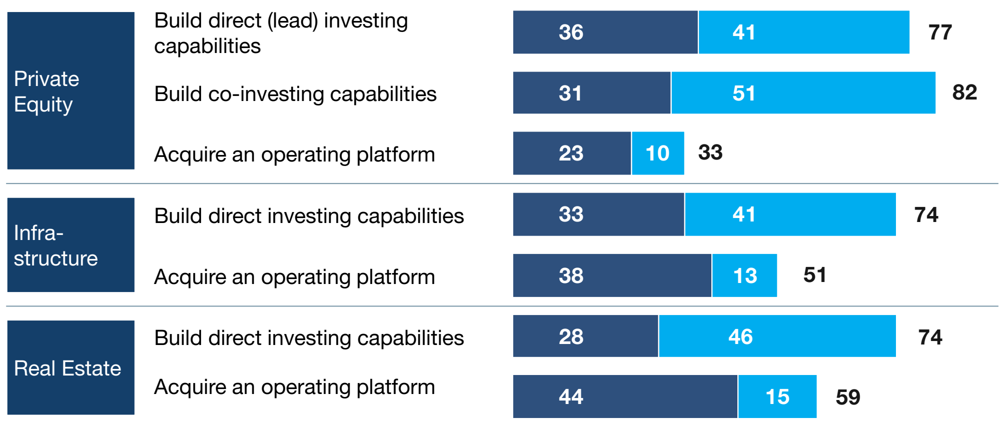
Exhibit 5

Building internal management capabilities will continue to be a focus

Percent of respondents

Likely | Very likely

How likely is your institution to do any of the following in the next five years?



SOURCE: LP survey; McKinsey analysis

But even while these institutions are playing catch-up, the leaders will surge ahead. In the next decade, we expect that leading institutions will expand the use of operating platforms to other assets, particularly infrastructure. That could allow the boldest firms to capture one of the most elusive prizes in investment: the “greenfield” infrastructure investment opportunity.

It’s not too hard to imagine one or two institutions evolving into conglomerates, with operating businesses in PE, real estate, and infrastructure, and a lean corporate center focused on optimizing capital allocation. Berkshire Hathaway operates such a structure successfully; other big investors could too.

By 2020, leading institutions will build or extend their operating platforms across new asset classes, and begin to crack the challenge of greenfield infrastructure development.

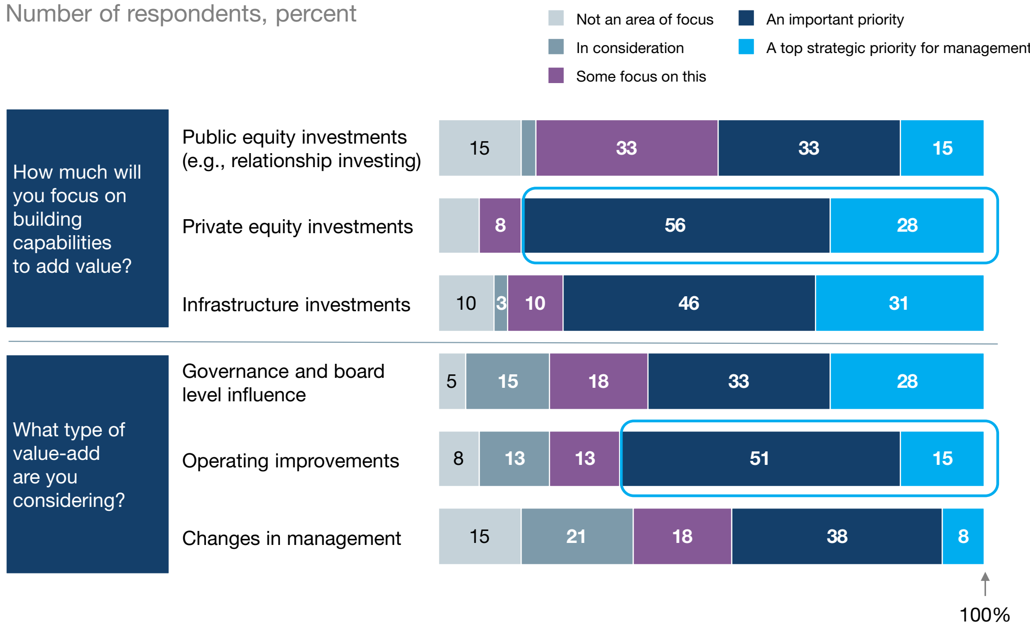
5. Influence for value

Leading institutional investors will more systematically drive value creation across the organization. The benefits of active ownership have long been apparent in private equity. Increasingly, leading investors realize that they can go beyond a board seat to deliver real value to their investments. To date this trend has been generally focused on illiquid investments, with 84 percent of institutions calling this an important priority for private equity, and 77 percent for infrastructure (Exhibit 6).

Exhibit 6

Leading investors will focus on active and engaged ownership, particularly in private equity and infrastructure

Number of respondents, percent



SOURCE: LP survey; McKinsey analysis

By 2020, leading institutions will take a more assertive role in the governance of both public and private investments. This will use the heft of their shareholdings to encourage value creation in their investments, through partnerships with activist investors and through greater internal capabilities. Some investors are already building value-creation teams and setting them to work. To be clear, however, they are deploying a "kinder, gentler" form of activism, and seek to provide friendly influence.

The first frontier for this evolution is governance, which runs a wide spectrum from simple proxy voting, to tabling resolutions, to influencing board composition, and finally to board representation and majority ownership in the case of some illiquid investments. As institutional investors have expanded their influence, their capabilities have in many cases not kept pace. Directors' knowledge of topics such as board effectiveness and board composition is still lacking and represents an opportunity for value creation across many portfolios.

In illiquid investments, leading institutions cannot hope to build portfolio value-creation teams that can cover the full breadth and depth of the issues that their disparate investments will need. A more practical model is a small central team of generalist operators or consultants, focused on three tasks. First, the team should systematically prioritize the opportunities in the portfolio by the potential impact and their ability to influence the outcome. For their chosen priorities, it should identify the support needed to deliver the expected value. Finally it should monitor progress, hold the management team accountable, and incentivize them for the desired results.

By 2020, institutions will increase the breadth and depth of their influence, across not only illiquid but also public investments, and will build a suite of new capabilities to leverage this influence.

6. Manage across portfolio silos

Institutions have traditionally divided their activities by asset class. Equities are equities, fixed income is fixed income, and never the twain shall meet. Imagine that a team in the infrastructure group finds an interesting deal for a new highway in India. The team will bring it to the investment committee for infrastructure, along with a thorough analysis of the cash flows and other economics of the deal. The committee will assess the proposal against the threshold for infrastructure investments, and make a decision. Neither the deal team nor the committee will likely refer to other asset classes, or to many of the macro factors that straddle them.

There are two coming shifts that promise to close these gaps. First, leading investors will develop a cross asset-class perspective to optimize the overall economics of each deal. For example, if the private equity team is looking at a transaction and raising financing, it can use the institution's fixed-income team to assess the attractiveness of the debt offering. The deal team can then use this assessment as negotiating leverage, or have its fixed-income team take a large allocation if it finds the structure attractive.

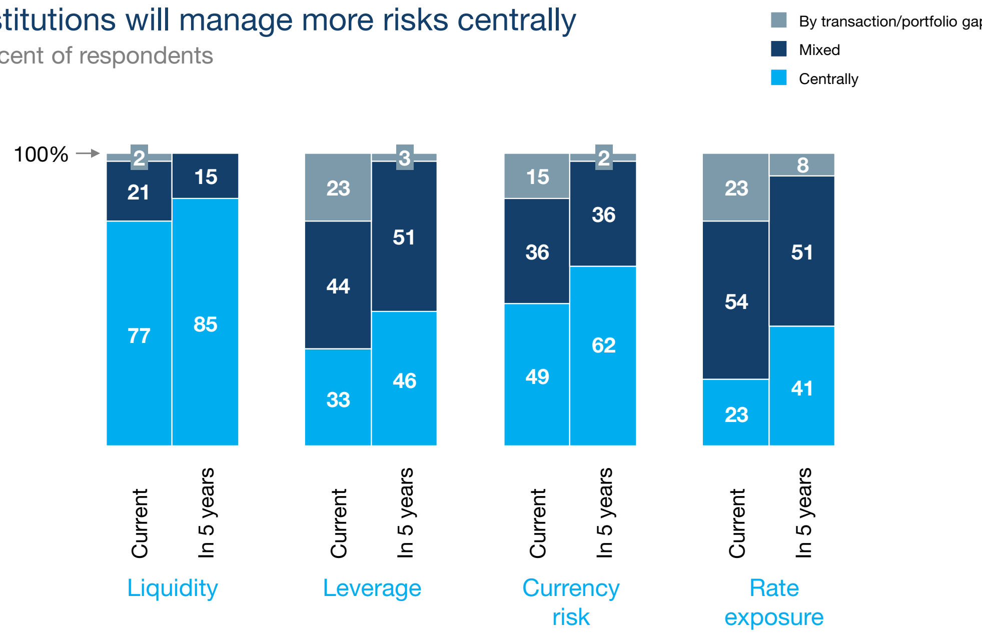
Second, institutions will improve their ability to assess exogenous factors, including macroeconomic variables and risks, as well as market idiosyncrasies that are relevant to a given transaction. Most institutions today are unable to compare opportunities in one geography/asset class combination vs. another. Consider again the highway infrastructure deal in India. How attractive is the investment climate in India, as opposed to say Brazil or China? What are the currency risks? What are the implications of India's current-account deficit, its politics, its land-use policies, its inflation rate? Many institutions have research groups that consider these issues, but have not found a way to properly feed their work into investment decision-making. To be sure, some investors have developed matrices that detail the required hurdle rates for each combination of geography and asset class. But these often miss out on market idiosyncrasies such as typical contract terms and the quality of partners available in one geography vs. those in another.

In 2020, leading investors will take a more orthogonal approach to portfolio management, considering the spaces between asset classes and the issues that arise there: overlays and hedges, liquidity, leverage, currency risk, and so on. Four potential key risks that could be managed centrally are liquidity, leverage, currency risk and rate exposure. Our survey found that each will be managed in an increasingly centralized fashion by 2020, with an increase of between 8 and 18 percent (Exhibit 7).

Exhibit 7

Institutions will manage more risks centrally

Percent of respondents



SOURCE: LP survey; McKinsey analysis

These issues will be more carefully managed and governed, with institutions establishing clear accountability and management responsibility for them, and changing performance measurement criteria to include them. Leading investors will also complement these formal structures with more fluid approaches, such as emerging markets committees to advise on these topics.

In 2020, leading institutions will bring to bear more sophisticated tools on currency, leverage and liquidity management, and bring a matrix lens to investment decision making.

From collecting skills to building institutions

Leading institutional investor CEOs and CIOs are focused on building a wide range of next-horizon capabilities over the coming five years. But this is not new. What is different in the recent discourse is that they don't want simply to attract or develop new types of skills and talent, and instead want to create leading-edge institutional-level capabilities, so that their investment outcomes are even better than what could be expected by a simple "sum" of their investment talent. Specifically, there are seven areas that stand out in our research as areas of focus (Exhibit 8). In the following pages, we offer an at-a-glance summary of the seven capabilities.

Exhibit 8

Seven priorities for leading institutions in 2020

Percent of respondents

SOURCE: LP survey; McKinsey analysis

Priority for 85% of institutions

1. High-performing culture: Develop a unique edge

The big idea

Every great investment institution has a clearly defined and strong culture. You can't be great without one – it is the only competitive edge that cannot be easily reproduced by others, and is vital to attracting the best talent and the most attractive deals.

Why it's important

Organizations have grown up in silos around their asset classes – each with its own portfolio, investment policy, operating processes, and so on. To successfully capture the next wave of investment opportunities that fall between asset classes, investors will have to build some bridges.

How to do it

Institutions can consider multiple approaches for developing a high performing culture.

1. Match a winning recipe
Organizational science can be used to rigorously diagnose the institution's current culture. A tool such as McKinsey's Organizational Health Index can not only provide a relative benchmark, but also identify which winning "recipe" appears most within reach. Research has shown that there are only four such recipes, and a singular focus on a target culture that fits an institution's DNA provides the best opportunity for success.

2. Incentivize change
Compensation can also be a focus of the effort to drive collaboration. So-called 360-degree reviews will look not just at how much money a person made for the institution, but how they made it. Compensation policies will be expanded to include incentizes for collaboration.

3. Tactical levers
Tactical approachs such as a house account - a pool of capital to invest in good deals that don't meet the thresholds of the nearest asset class and/or require cross-asset class collaboration - can be effective at enabling desired behaviors.

Priority for 69% of institutions

2. Risk: "Fixing" risk management for illiquids

The big idea

Risks are evolving, especially in illiquid assets. Traditional risk measurement approaches simply do not provide an adequate perspective on the risks for PE holdings, real estate, or infrastructure assets. Managers need to develop a new recipe to assess and manage these risks.

Why it's important

Many institutions have grown their exposure to illiquid assets significantly. In some cases exposure reaches 50 percent of AUM or more. However, these institutions admit that they don't have a proper measure of the risk in illiquids, which as the name suggests cannot be disposed of quickly in a crisis.

How to do it

Some institutions might use an absolute-risk perspective (complemented with some limited relative-risk measures). Some may consider looking to credit-risk assessments such as those used by banks to assess the probability of capital loss for key investments. Risk tools might evolve from a static value-at-risk measurement to advanced stress-testing practices, again as banks have done. In these scenarios, leading investors will integrate macro and geo-political factors, and others that they discover through dialogue devoted to finding emerging risks. In private equity, infrastructure, and real estate, advanced institutions can access better data on funds and their holdings, and assemble it into a dashboard that integrates all their illiquid investments, with an overlay of macro risk factors such as political risks, vulnerability to supply-chain disruptions, governance issues, and so on.

Priority for 67% of institutions

3. Talent value proposition: The glass is half full

The big idea

No one doubts the primacy of talent among an institution's capabilities. But attracting and retaining top people will only get harder as institutions extend their reach. Leaders must invigorate their talent proposition.

Why it's important

Investing is changing, and so are the people who do it. From industry veterans to turnaround specialists, institutions have radically altered the makeup of their talent pool over the past few years, a trend that will continue.

How to do it

For all but a few institutions, the proposition to talent will not be solely about money. Almost all institutions can offer their people a chance to participate in some of the biggest deals in the world, freedom from the burden of raising capital, and a chance to build something special. Institutions can identify top talent earlier in their careers, and entrust them with more responsibility (such as management roles, or a place on an investment committee). They can design programs to help young leaders build broader profiles, such as a three-year role rotation. They can stoke interest among millennial-generation managers with mobility programs that speak to their values of flexibility, agility, fairness, and innovation. Finally, they can borrow the techniques employed by leading private investment firms – from engaging executive recruiters even for more junior roles to cultivating closer relationships with investment banks as a source of well-trained, junior professionals. Diversity is another growing priority with many institutions implementing programs to attract and develop more women and visible minorities.

Priority for 64% of institutions

4. Branding: Build a reputation for greatness – and live up to it

The big idea

With lots of firms competing for the same investments, and the same talent, institutions need to stand out from the crowd.

Why it's important

Every big institution can write a sizable check quickly. Most can reasonably claim good governance and responsiveness. In a world of look-alikes, the brand will matter more than ever, and firms will need the skills to create a brand that works and communicate it.

How to do it

Leading investors will clearly define the attributes that not only characterize but also differentiate their organization, their people, and their culture. They will use those attributes to shape their brand and inform their proposition to all stakeholders: depositors, employees, governments and regulators, the media, industry analysts and influencers, and the general public. They will need more than a tagline and a public-relations campaign. The attributes that underpin the brand must be truly reflected in every process, especially those that engage their stakeholders. In our experience, the best way to achieve a target brand is to define it in terms that every employee will understand.

"After each meeting with the media, a prospective employee, another fund, a GP, a public company, what do you want them to say about your institution after you have left the room?"

Priority for 61% of institutions

5. Research: Build an insight engine

The big idea

Stronger research underpins each of the new investment practices that leading institutions will deploy by 2020.

Why it's important

The fundamental requirements of research are changing. New skills are needed, along with new approaches.

How to do it

There are two areas institutions are looking to reinforce research

1. Portfolio construction
To support changes in portfolio construction, research teams will need to generate macroeconomic views on cyclical and secular trends and derive concrete implications for current holdings as well as for future investments. This team will need experts in the macroecomomy as well as market professionals, and will also study cross-portfolio topics like correlations, credit conditions, and cycles/ risk premiums. Institutions might also build a shared service to develop market insights for portfolio managers - for example, medium- and long-term perspectives for those managers who customarily take a shorter view.

2. Thematic topics
The senior executive team should set the annual research agenda based on high priority areas for the institution (e.g, the Asian financial sector, the effect of e-commerce on other industries including commercial real estate, etc.)

Priority for 59% of institutions

6. Investment decision-making: De-bias the process

The big idea

Almost all institutions' investment processes are fraught with bias. Fixing them is a huge step forward for institutions that aspire to greatness.

Why it's important

McKinsey research has found that good (and bad) investment outcomes are mostly attributable not to the analysis that precedes an investment, but to the quality of the process and its adherence to standards of sound and objective decision making. Companies that actively work to remove bias from decision-making generate far superior return on investment —up to 6.9 percentage points— than others.

How to do it

Awareness of a bias does not provide immunity to it. Institutions can formalize processes across the full spectrum of the investment cycle to ensure consistent rigor (through checklists, required facts and analysis to support investment decisions, and so on). One leading institution appoints a separate team during the diligence of any major deal, whose sole objective is to identify the soft underbelly of the investment opportunity being considered, and help avoid confirmation bias. Another powerful tool is a systematic post-mortem review of poorly performing large transactions, with a focus not on what went wrong from a business perspective, but on how the decision process was managed. This team submits a separate risk memo to the investment committee in parallel with the deal team's memo. Senior leaders will have to make their support for this kind of constructive challenge quite visible, and when things go wrong, a rigorous review can pinpoint process flaws, which can then be addressed in a process of continuous improvement.

Priority for 43% of institutions

7. Advocacy: Create a voice commensurate with asset size

The big idea

With big stakes in critical sectors of national economies, institutions have much to gain and lose. Their interests are broadly aligned with other stakeholders, especially government. Institutions can do more to drive alignment.

Why it's important

Big institutions have investments in many countries, including stakes in important infrastructure and leading domestic companies, often in critical sectors such as agriculture, natural resources, and telecoms. But many have never formalized their relationship with local governments. For many, public affairs management amounts to an occasional call from the CEO to a government official.

How to do it

Investors might install a strategic public-affairs group to address their shortcomings. The group will likely hire a few experienced individuals who have earned the respect of regulators and state representatives. It will develop a clear strategy (including a map of stakeholders, a coverage map, an agenda, and so on). Its institutional knowledge will help it both mitigate regulatory change that might hurt its assets, and "be ahead of the parade" to identify and negotiate new investment opportunities. The group will need an understanding of the local political dynamics and the public policy agenda, and will require both internal resources and a diversified network of local partners. Furthermore, another implication of this approach is to institutionalize relationship management across the organization.

Building these capabilities will incur costs, of course. Big institutions have already spent significant sums to add people, offices, and capabilities. Great companies excel at finding the right corporate structures to control those costs – and the complexity created by growing in several directions. These approaches commonly center on a strong understanding of how the investment drive value. We strongly believe that the investments now required to reach greatness will pay for themselves, but institutions will need a clear-eyed perspective on which costs matter, in the sense of what they provide and the return they produce.

Institutions that continue their comfortable ways may be pursuing a strategy of hope over reason. The investment environment is subdued; "lower for longer" is the thinking not only on oil, but more broadly. After a decade of quantitative easing, and with the global economy slowing once again, low returns seem inescapable. Institutional leaders affirmed that they want to pursue the strategies mentioned in this report. The difference between leaders and laggards may well be the commitment and ability needed to execute on that vision.

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