



Going Direct: The Case of Teachers' Private Capital

Threatened by looming shortfalls, pension funds are searching for riskier private enterprise investments to fund the gap. With its innovative approach to new markets and risk-adjusted returns, the Ontario Teachers' Pension Plan is a model worth emulating.

For decades the relationship between private equity (PE) firms and pension funds has been a symbiotic success story. The pension funds had the capital and PE firms offered some of the best returns on their portfolio. But with a funding gap looming, pension funds are reassessing their investment approach and - with an eye to cutting back on fees and taking control of their investments – forging ahead with co-investment partnerships and direct investment deals of their own. It's an attractive idea, but will the cost of bringing in talent to address their lack of experience in M&A markets, be pricier than the fees they're trying to avoid?

The Ontario Teachers' Pension Plan, "Teachers", has been at the forefront of this industry shift since 2001 when, faced with falling interest rates and a declining ratio of working teachers to retirees, it moved to accelerate the pace and efficiency of its private equity platform, Teachers' Private Capital (TPC), by aggressively expanding both direct and indirect PE investments.

Today with C\$130 billion (US\$125.28 billion) in assets, it is the largest single-profession pension plan in Canada, investing and administering the pensions of 303,000 active and retired teachers. In terms of 10-year returns TPC is a world leader, according to CEM Benchmarking Inc, recording a 10

percent average annualised rate of return and C\$60.5 billion in cumulative value added above benchmarks since 1990.

Teachers' journey in building its PE expertise has been a gradual one, as noted in INSEAD's case study [Going Direct: The Case of Teachers' Private Capital](#), as it steadily shifted from co-investing alongside general partners (GPs) to independently pursuing direct deals and leading large-scale buyouts. It faced disappointments along with its successes and was plunged into the public spotlight with its ambitious 2007 bid to buy out telecom giant, Bell Canada Enterprises (BCE). The C\$35.1 billion deal (C\$51.7 billion including assumed debt) would have been the biggest leveraged buyout in global history, according to Thomson Reuters Financial. While ultimately unsuccessful, Teachers' active pursuit gained the company much credibility as a respected partner and formidable rival to established private equity funds.

Teachers' CEO Jim Leech attributes the success of the fund's PE platform to the strength of its structure, its professional board – made up of industry experts rather than politicians, bureaucrats or union representatives – and its attention to governance with a top-down approach.

Visit [INSEAD Knowledge](http://knowledge.insead.edu)
<http://knowledge.insead.edu>

“The CEO has the freedom to operate as a real business, as opposed to a stereotypical model of pension plans where all decisions have to be made by the [board],” Leech noted during one of several interviews for the study. It was this structure, and the fund’s willingness to embrace innovation and take well-considered risk, which enticed him to put off retirement plans in 2001 to head Teachers’ Private Capital division before taking on the role of CEO in 2007. Under his leadership Teachers’ pioneered the disintermediation approach (that gradually gained wider adoption among institutional investors) and saw the total amount invested in direct and co-investments increase almost four-fold from C\$3.3 billion in 1990-2001 to C\$11.5 billion in 2001-2011. Leech reorganised the PE team, creating regionally focused groups and increased exposure to Asia. He separated the Direct Investments team from a dedicated Fund and Co-Investments team to manage relationships with GPs and participate with them in all major steps of the investment process. As the team grew in scale and scope, Leech remained involved in all larger transactions.

A path of its own

It was 2001 when Teachers’ started investing directly in infrastructure and timber – something unheard of in the industry and in 2005 gained Wall Street’s attention with the US\$450 million purchase of Alliance Laundry Holdings, North America’s leading manufacturer of commercial laundry equipment, beating established fund managers such as Kohlberg Kravis Roberts & Co. (KKR).

This fearless attitude in forging new paths is a strategy it continues to pursue. “We are the first pension plan that bought an operating real estate company, we are the first pension plan that got into infrastructure, and the first to get into derivatives and commodities etc. It was all pretty exotic at the time but today it’s pretty normal across the bar,” notes Leech.

“What we are looking for is diversification. We’re looking for asset classes that are not necessarily correlated to each other. We’re looking for higher yields at reasonable risk levels.”

This desire to diversify encouraged it to seek investments outside the Canadian border. By 2011, local assets had shrunk to 17 percent of Teachers’ PE portfolio and in 2012 it announced its intention to increase exposure to India and Latin America while identifying the U.K., Benelux, Germany and Scandinavia as other priority regions for future investments.

Relationship investing

Teachers’ has also been an active and vocal

Visit **INSEAD Knowledge**
<http://knowledge.insead.edu>

shareholder in public equities and vigorously advocated good governance. It was in a position to practice what it termed “relationship investing”, encouraging companies to increase shareholder value by good corporate governance, setting strategic priorities and meeting long-term performance criteria.

The fund’s active management extended to its investments in private companies. It built up operational expertise internally by creating a portfolio management group to apply best practices in operations and governance consistently across portfolio companies and would not shy away from introducing new management teams and business plans when necessary after purchasing new assets.

Global financial crisis

While the global financial crisis put a halt to its plans to buy out BCE, Teachers’ itself was well positioned during this period having no exposure to sub-prime mortgages, but with ample liquidity. “If you get caught with the need to raise money, the only thing you can sell are your best assets often at a discounted price,” Leech explains. “Our liquidity meant when others were caught in this position... we were able to buy some good investments at prices that were advantageous.”

Teachers’ success in direct investing, says Leech, has been 23 years in the making. It’s a reflection of the time and energy spent building up systems and teams capable of conducting large transactions all over the world.

“If you’re going to compete with the best in the world in PE you can’t go in with third stringers, you’ve got to go with teams that are equally competent and that means highly educated, highly experienced professionals.”

While talent like this comes at a price - Teachers’ investment professionals are paid similar to professionals in top notch independent private equity firms - the firm has been able to keep total investment management costs significantly lower than the fees that it would have paid to external PE managers to invest on its behalf under the traditional model.

Looking ahead

Going forward, the questions remains whether Teachers’ can extend its track record of outperformance in an environment of increased competition among investors.

Can it maintain its culture of prudential risk-taking while avoiding undue risk to the assets of the pension plan? It must also decide whether to take

advantage of the improving economics of private equity funds (i.e. reduced fees) or continue on its independent path, hiring external managers to invest tailored segregated mandates.

As it turns its eye to emerging markets it will need to develop relationships with the right external managers to prepare for the day when those markets garner greater significance on the global investment map.

Claudia Zeisberger is an Affiliate Professor of Decision Sciences and Entrepreneurship and Family Enterprise at INSEAD. She is also the Academic Director of the ***INSEAD Global Private Equity Initiative***, while ***Michael Prahl*** is the Executive Director of the Initiative.

Follow us on twitter [@INSEADKnowledge](https://twitter.com/INSEADKnowledge) or Facebook <https://www.facebook.com/Knowledge.insead>.

Find article at <https://knowledge.insead.edu/economics-finance/going-direct-the-case-of-teachers-private-capital-2887>

Download the Knowledge app for free



Visit **INSEAD Knowledge**
<http://knowledge.insead.edu>