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SHORT-TERM TRAP

## Long-Term Investing, Short-Term Thinking

OADS, BRIDGES, and high-speed telecommunications equipment have something in common: they are in constant need of repair and upgrade. But who wants to plan and pay for such critical workaday infrastructure projects? Likewise, the slow but inexorable pace of rising seas caused by climate change threatens coastal civilizations worldwide, but attempts to prepare for or mitigate the problem have fallen short. Faced with longterm problems like these, governments are often slow to contribute capital—but the problem is not a lack of money, says LovettLearned professor of finance Victoria Ivashina. What's missing is a compelling longterm view about the necessary investments. "It's not enough to say you're going to [think] long-term," says Ivashina. "There's a certain level of long-term discipline required."

Institutional investors—pension funds, sovereign wealth funds, and endowments, among others—have trillions of dollars to invest. The Organization for Economic Cooperation and Development estimates that pensions in nations under its purview had more than \$35 trillion in assets in 2015. Life insurers in those same countries had about

\$15 trillion. These investors, who manage pensions, provide retirement security, and even support decades-long research projects, have long-term orientations. They would seem to be the perfect partners in projects that require commitments spanning decades. Often, though, argue Ivashina and Schiff professor of investment banking Josh Lerner in Patient Capital: The Challenges and Promises of Long-Term Investing, such institutions are saddled with perverse incentives that push them to chase short-term goals, potentially jeopardizing millions of people's retirements and leaving drug development, infrastructure, and other innovative projects unfunded. If, on the other hand, institutions and their private-equity partners invest their money judiciously, Ivashina and Lerner state that they can spur change while stabilizing long-term growth for themselves.

Part of the problem, the coauthors explain, is that institutional investors and the privateequity funds they work with rely on metrics that prioritize the short term. Internal rate of return (IRR), a common benchmark, measures the annual yield of a fund's investments; the quicker a private-equity manager grows an investor's money, the better the IRR. But the number can be gamed, Ivashina explains. A private-equity manager can use a credit line to fund an investment, deferring payment for as long as possible, in order to decrease the time between investment and payoff. Acquiring a firm, then selling it as quickly as possible—flipping—can also boost IRR. These tricks are meaningless at best, and often hurt long-term growth for the investors.

There are strong incentives for privateequity managers and institutional investors to engage in these schemes that boost IRR. Inching into the top IRR quartile (or that of any other easily manipulated metric) can earn institutional and private-equity fund manag-

If pension-fund managers are rewarded for favoring the proverbial hare over the tortoise, they will do so. To solve this problem, and help inculcate the discipline necessary to drive the long-term investment needed to address critical societal problems, Lerner and Ivashina suggest compensation schemes that de-emphasize short-term rewards. Giving a pension-fund manager some type of carried interest—a share of an investment's profitsor the option to invest alongside the fund are strategies that might encourage more scrutiny of short-sighted tricks. Another might be to use an alternative performance measurement known as the public market equivalent (PME), which computes the ratio of an investment's private return to what a like sum would have yielded in public markets. No statistic is perfect, the authors acknowledge, but some align more with a long-term outlook.

Extrinsic incentives can go only so far, however. Some of the most successful funds pick employees with a deep connection to their mission. The Canada Pension Plan Investment Board (CPPIB) and Yale Investments Office (YIO), two exemplars of long-term investment, both embrace this strategy, Lerner and Ivashina note. CPPIB often recruits prominent Canadian investors who have had successful careers elsewhere, paying them well to ensure that millions of Canadians retire comfortably. Most of YIO's investment professionals are graduates of the university, and often accept below-market salaries to bolster their alma mater's endowment. In both cases, intrinsic incentives encourage employees to focus beyond the short-term.

But sticking to a long-term vision is also made more difficult by media scrutiny. News organizations barely covered a major hit to Harvard's endowment in 1973, Ivashina and Lerner write, largely because networks like CNBC and Bloomberg didn't exist. But 35 years later, Harvard felt compelled to publish a statement detailing its losses within weeks after the collapse of Lehman Brothers. This scrutiny makes it easier to stick with investments that appear safe from the outside, even if the likelihood that they will pay off is low. Private-equity investment often re-

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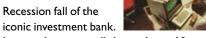
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wards innovative strategies—breaking into new or underdeveloped markets—but media coverage can make it harder to justify risky decisions if they don't pay off. In addition, the industry's pay scales attract attention. Though most institutional investors make less than those dealing in private markets, their high salaries relative to non-investment personnel often spark public shock and outrage when institutions publicly file their financial statements. Some top institutional managers move to the private sector, where they will be paid more and scrutinized less. "It's a bit of a difficult spot" for institutional managers, Ivashina said. "They subscribe to the mission, they take a pay cut, and yet they still face the critique that it's unfair."

Pressure to follow short-term strategies and stray from a mission can come from internal sources, too. "Good governance," Ivashina and Lerner write in their book, "is the first line of defense to ensure that good judgment is exercised and patience prevails." Some boards include a significant number of government appointees, ex-of-

ficio officers, and employees—each group representing different priorities. A policy of monthly meetings might push the group toward frequent short-term changes, especially if there is high turnover among board members. Lerner and Ivashina suggest instead a board composed of mostly financial experts who have relatively long tenures and meet infrequently. That way, members will have a chance to form a team dynamic over time and patiently pursue a long-term mission. To prosper for decades and deliver solutions to the most critical problems, they emphasize, patience is more than a virtue it pays. ∼JACOB SWEET

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SURVEILLING CERVIDS

## From One Animal to an Ecosystem

UROPEAN ROE DEER are much smaller than any deer Americans are used to seeing. At 45 pounds and just over two feet tall, an adult is closer in size to a greyhound than to its larger cervid cousins. And unlike highly social species like red deer or elk, roe deer like to be solitary. They spend most of their lives alone, within a range of one square kilometer—and the reason why is a mystery. These animals are built for movement: they can sprint at 30 miles per hour. "What makes them stay in such a small space for their entire lifetime?" asks Nathan Ranc, a fifth-year graduate student in organismic and evolutionary biology (OEB). And how do they choose their home territory?

These questions underpin all of ecology,