Private Equity: Helping Fill Africa's Financing Gap?*

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- Private equity investment for Africa and the Middle East is booming, reaching USD 5 billion in 2007.
- Risk premiums have been falling significantly for African private equity investments.
- With the commitment of African governments to foreign investment, the African private equity boom is set to continue.

All but the largest of companies in Africa still have great difficulty raising capital at competitive rates through conventional channels, such as borrowing from banks or issuing public securities. Such firms are constrained in their competitiveness and growth when necessary capital for new investments is unavailable or unaffordable. Private equity may serve a useful role in filling the gap between self-financing and conventional capital market activity for the continent's dynamic and growing private enterprises.

Drawing attention as an effective and innovative vehicle for private-sector development on the continent, private equity has benefited from improvements in African investment environments and enjoyed some spectacular successes (such as the private-equity backed African telecommunications pioneer Celtel's USD 3.4 billion buyout in 2006) which have fuelled a boom in the sector.

The recent global boom pushed up demand for African assets to new heights. Low correlations with global markets, high liquidity and the commodities boom all fuelled investment, but also contributed to pushing non-primary sector opportunities into the background.

In this context, private equity has tended to work against the grain of international investment, focusing its attention less on raw materials and extractive industries than on consumer-related and communications sectors[1]. Such investments arguably have a stronger impact on Africans' daily lives than large extractive projects, bringing private equity to stand out as a dynamic and diversified complement to classic sources of foreign investment in Africa.

Private equity, through its investment in local firms and enterprise, can perhaps play a catalytic role more efficiently than other forms of foreign investment where spillovers are not guaranteed. By bringing outside funds and expertise to work with local firms, private equity works to raise efficiency in the sectors and industries in which it engages and effects a direct transfer of skills to the countries in which it operates.

Private-equity investment in Africa has been strong, with funds rising by nearly 200 per cent[2] in 2006, to USD 2.3 billion. This brought the sub-Saharan Africa (SSA) share of global private equity funds to 7 per cent , which although well behind Asia (58 per cent), held up well compared with other emerging regions (Latin America: 8 per cent; Middle East / North Africa: 8 per cent; CEE / Russia: 10 per cent). Funds focusing on North Africa / Middle East grew by 50 per cent over the period (Figure 1).

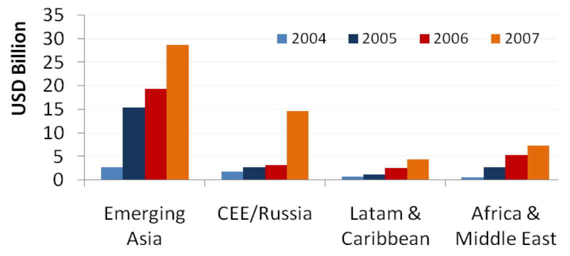
African funds, while still small by international standards, have been rapidly increasing in both

[1] African Venture Capital Association, South African Venture Capital Association, 2007.

[2] Idem.

size and reach: Pamodzi, a South African private-equity firm, launched the continent's largest (at USD 1.3 billion) pan-African fund in 2007. International financial institutions have also developed their own vehicles: Citigroup launched a USD 200 million fund early that same year.

Figure 1: Developing world private equity
funds raised 2004-2007



Source: EMPEA, Private equity fundraising review (2008)

South Africa

The South African private-equity industry, mirroring the country's financial predominance, is the largest on the continent, at 1.7 per cent of GDP – a figure comparable to that of many developed markets (Europe: 1.5 per cent; UK: 3.7 per cent; North America: 2.8 per cent)[3], and 17th in the world in terms of investment activity (2005). South Africa saw a 409 per cent increase in managed funds in 2006, to ZAR 11.2 billion (USD 1.6 billion). South African funds manage over 80 per cent of total SSA private-equity capital, followed by Nigeria with 10 per cent.

Channels for Investment

Developed economies, particularly the United States, remain the major source of capital, accounting for 50 per cent of total funds raised for African investment in 2006 (Europe 9 per cent). A quarter of the funds raised for the continent are South African, continuing a trend of growing local sourcing. For the first time, a third of the capital raised in South Africa was also sourced through foreign pension and endowment funds, revealing institutional investors' growing appetite for, and confidence in, African assets.

Public funds, particularly from European development finance institutions, are also important sources of capital. Seeking to foster private-sector activity, these government-backed agencies have historically been important guarantors of private investment funds on the continent. Representative of this field are France's Proparco, Dutch FMO and Britain's CDC (formerly Commonwealth Development Corporation), with USD 845 million committed in Africa since 2004 through 12 African fund managers (see the next article for further details).

An Improving Investment Environment

Over recent years, African governments have made serious progress in adopting market-friendly policies, improving investment environments and taking energetic steps to stimulate foreign involvement. New measures promoting foreign investment were introduced by 40 African countries in 2006. Foreign participation in the telecoms industry was allowed in Botswana, Burkina Faso, Burundi, Cape Verde, Ghana and Namibia. Important reforms of the banking sector took place in the Republic of Congo, Egypt and Nigeria. Morocco legalised foreign ownership of large tracts of land. Several countries eased registration and taxation constraints on new businesses and established special investment zones.

Furthermore, private equity companies themselves have become much more attuned to the realities of investing in developing countries, often employing local managers and basing their offices within their countries of operation.

In the Emerging Markets Private Equity Association (EMPEA) *2008 LP Survey*, Africa ranked fifth out of ten regions / countries in attractiveness for investors. This strong and sustained increase in investor confidence is indicative of the change in perception which Africa has enjoyed over recent years, passing from backwater to the oft-touted "last investment frontier". Furthermore,

[3] Funds under management at December 2006 for South Africa, December 2005 for Europe/USA.

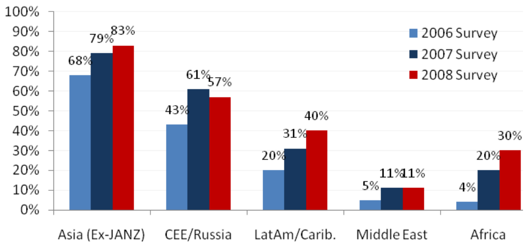
private equity is also contributing to attracting many young and highly qualified Africans back to work in the region, bringing with them both human capital and high aspirations for the continent.

According to the same survey, Africa has grown enormously in private equity investors' investment strategies, moving from barely registering at 4 per cent in 2006 to being an integral part of 30 per cent of investors' strategies in 2008 (Figure 2). In terms of planned investment strategies, investors' desire for increased diversification of investments works to Africa's advantage, with over 50 per cent of private equity investors including Africa in their medium-term (three to five years) investment strategies.

Africa also compares favourably with other developing regions in terms of expected returns on investment, reflecting the exuberant mood of the sector towards the region. The perceived risk premiums (Figure 3) assigned to the Africa region in the same EMPEA survey also registered a sharp decrease over the 2006-2007 period, falling from 8.9 to 6.7 per cent. Furthermore, return expectations of African funds rose slightly over the same period, in contrast to expectations for other regions such as Asia, the Middle East and CEE, whose funds registered a slight decline.

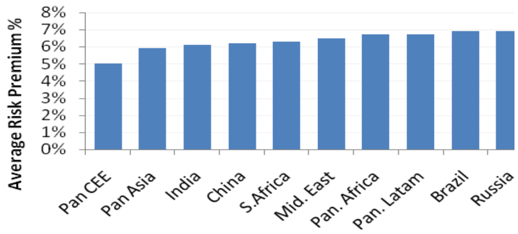
Although it should be noted that this is not the first private equity surge in the developing world – the first half of the 1990s saw a short boom in Latin American private equity – the context for investment in Africa today is better grounded than ever before. Private equity in particular, with its consumer-oriented investments supplying fast-growing domestic African markets, is contributing to the major shift in perceptions of Africa from investment backwater to frontier of opportunity.

Figure 2: Current Investment Strategy - Investing



Ex-JANZ: excludes Japan, Australia, New Zealand
Source: EMPEA 2008 LP survey

Figure 3 : Assigned Risk Premiums, 2008 EMPEA Survey



Source: EMPEA 2008 LP survey

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