Private Equity Steps Up in Africa

With GDP growth in Sub-Saharan Africa at 4.4% in 2012 (and a third of the countries there growing at more than 6% annually), Africa has come into its own economically. The continent has proven more resilient that most regions during the financial crisis (it had little debt) and today has many of the world's fastest-growing economies. An expanding middle class has helped drive internal growth, which has bolstered the services sector and muted, at least somewhat, reliance on its resources. Foreign direct investment has been increasing significantly. Some characterize this as a long-awaited emergence that's finally arrived, and the new dynamism has lifted many areas of the economy — including private equity (PE), which could be poised to enter a new level of sophistication.

To learn more about the prospects for private equity in the region, Knowledge@Wharton spoke with three experts for a two-part podcast:

- *Michelle Kathryn Essomé, chief executive of the African Venture Capital Association (AVCA);*
- *Michael Rogers, global deputy sector leader for private equity at EY;*
- *and Stephen M. Sammut, senior fellow and lecturer at Wharton.*

An edited transcript for part one of the podcast appears below:

Knowledge@Wharton: Africa has become a hot region as the economies there not only pick up steam, but grow in a way that looks like a long-term upward, economic trend. Some characterize this as a long-awaited emergence that's finally arrived. With that growth has come a growing middle class that's often supported by increased political stability.

Michelle, would you offer a brief overview of the new economic and business profile of Africa when it comes to things like GDP growth, increasing investment, economic reforms and the like?

Michelle Kathryn Essomé: I'm going to start off with a quote by [George] Soros which sums up what you've just said: "Africa is one of the few bright spots on the global, gloomy economic horizon." And I think that's really coming to fruition and really getting out there in the market. Africa is a large continent — 54 countries, a billion people, collective GDP of US$2 trillion, with seven of the 10 of the fastest growing countries. Seventeen countries are ranked ahead of India in ease of doing business, so [that means] higher economic growth than the eurozone. A lot of structural reforms that have been put in place are coming to fruition. And one very positive thing is, as a continent there was no credit crisis, so no credit bubble. Banks, for example in Nigeria, are relatively healthy. And this emerging middle class that's more and more affluent wants all of the things that we want in the Western world — all of the iPads, etcetera. So [it is] a very, very attractive investment opportunity.

Knowledge@Wharton: Michael, how is all of this translating into activity in the private equity sector from your vantage point?

Michael Rogers: I think it's showing that, from a private equity perspective, the industry is in its infancy. And we're starting to see the very foundations and fundamental development of the industry as we know it in some of the developed markets. It's interesting that a few years ago people would have asked private equity firms, "What's your China strategy" — five, 10 years ago people were looking at that. For Latin America, during the last three or four years, you have to have a Latin American strategy. We're now seeing the funds thinking about this [for Africa].

Not everybody is there yet, of course. But we see on the horizon many of the funds beginning to try and take a position, make investments there. Some have located folks there and have put people on the ground in the African continent. We see the growth coming due to the reasons mentioned in some of the comments that were made just earlier about the demographic growth of the population, the increased consumerism, etcetera…. It's on the front end. As a result of that, many people [are wondering]: Is it hard to invest there? Can you realize exits? That sort of thing.

Our study that we just put out [Harvesting Growth: How Do Private Equity Investors Create Value?] demonstrated that there are a lot of exits. We counted 118 realizations over the last five years in our study. And many of those were in South Africa, but a big portion was in other regions in West and East Africa. So we see that it's going to become an attractive market, not only because of the underlying demographic, but also because funds have proven that they can come in, make investments, help from a social responsibility perspective, grow businesses and ultimately exit them in a profitable fashion. And that is what will really drive private equity from our perspective.

Knowledge@Wharton: Everyone's going to have to change their thinking because in the past, when you thought of Africa [and business] you thought of South Africa and maybe Nigeria because of the oil.

Stephen M. Sammut: This is a very important point. I've been going to the continent for 10 to 12 years and the changes are quite palpable. But even a dozen years ago, things had already reached a level of stability in most of the countries. And unfortunately, the particularly American view of Africa has been colored by the media and by movies, and people really do not understand the dynamism of those societies, how motivated the populations are and what the quest is for a new life.

And over and above that, when we say governments have matured, it means not only in terms of democratic processes, but [also in terms of] insight into policies that encourage foreign direct investment. And consequently, more and more limited partners, pension funds, endowments and the like have the confidence that Africa is a very sound place to invest. Is this true of all countries in Africa? Well, no; it's 54 countries, as Michelle said. But the vast majority has arrived at, or is still trending in, the right direction.

Knowledge@Wharton: Can you think of one specific deal, or an example of a kind of a deal, that's been done recently that would not have been able to have been done 10 or 12 years ago?

Sammut: I can give you the classic example. I think this was the dividing line in the minds of private equity professionals, and that was the creation of a company called Celtel, one of the first cell phone companies in Africa, by an extraordinary entrepreneur and person named Mohammed Ibrahim. He found ways of creating, building and expanding his company without having to go down the pathway of payoffs and corruption. And he proved to everyone, because he had Western investors involved in the fund, that you can do business in Africa the way you do business elsewhere. And there has been a parade of venture capital funds and private equity funds, especially, that have followed his principles and examples, and we're seeing some very exciting growth.

Knowledge@Wharton: When was it that became apparent to people? How many years ago?

Sammut: I would say maybe half a dozen years ago.

Essomé: I think that was an absolutely perfect example, Stephen. Another important point just under the purview of private equity is that we all know that the industry was given birth by the developmental finance institutions — IFC (the World Bank's International Finance Corporation), FMO in the Netherlands, CDC in the U.K., etcetera. So that funding comes from the tax dollars of individuals, though there's a strong focus on governance. And these institutions have been investing in Africa directly before there was a private equity market. So, they're very astute and intelligent around dealing in frontier markets, ensuring that there's transparency and accountability, and that things are done in an institutional fashion that we want and expect in the Western world. So there's a long track record.

The industry is very much maturing in the fashion of doing the right thing. That's still evolving. It is still a frontier market. There are many things that are yet to be done. But people don't necessarily have to — quote, unquote — worry about investing with certain GPs or worry about transparency in governance, because that's really not an issue, given that the DFIs [development finance institutions] make up 75% of the LPs in private equity — they are really, really focused on it and that's very much imbedded in the ethos of the industry. And, in the study that we did on exits, we see that ESG — environmental, social and governance — monitoring and reporting was really a contributor to value creation.

Knowledge@Wharton: How much PE money will go into Africa this year and next year? Where is it coming from? And what kinds of companies are getting the investments? What are some of the trends there? What countries are seeing most of the investment?

Essomé: For 2011, US$1.3 billion; for 2012, US$1.4 billion. It trails the rest of emerging markets and obviously the developed market. It's really a drop in the bucket. That's probably a tenth of what a global PE firm would manage. In essence, it's a maturing market — it's ten to 15 years old. We're overcoming a lot of, we call it, the 'CNN effect.' There's a big campaign that we still have to do, and I say that anytime you're doing anything in Africa, whether it's for the private sector or charity, you need to educate whoever your listener is. There's still a lot to be done. People are afraid.

Whether I think that will increase: That will depend upon us getting out the stories around returns. If we get the message out that you can make three or four times your money, and you have all of the other issues around ESG, and that there are exits, that will bring more comfort. But it's a big task for all of us working in the private sector in Africa to really embark upon.

Rogers: I think that we're starting to see folks focus not only on geographic funds linked to Africa specifically, but we're also seeing sector-targeted funds within the continent as well. We're starting to see folks raise capital to focus on consumer growth type industries, much needed infrastructure type ideas, as well as real estate and agriculture funds. So, when people can target and buy industry by geography, that will start to raise the amount of funds that have shown interest in investing in Africa — especially going back to the stabilization of the market and the evolution of business a little bit.

Sammut: I think there will be some further developments. One of the things that came out in the study that AVCA and EY did was that the trade sale exits — that's to say the acquisitions of companies from private equity portfolios — still trended more towards local acquisitions as opposed to multinationals coming in. My suspicion is that we're going to start seeing that change. And I base that on numerous conversations I've had with corporate CEOs in the U.S. and in Europe who also now are thinking in terms of, "We have to have an Africa strategy." In many instances, they're going to see the best approach to entry through acquisition as opposed to building something from scratch.

Once there is a Western corporate presence, which will be matched by Indian corporate presence and Chinese corporate presence that may well open the floodgates. And so Africa maybe has 5% of all money that's going into emerging market private equity now — expect that to change.