Rise of Private Equity in Africa
Changing Landscape and Imminent Challenges with Cases from Kenya

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The rise of private equity in Africa is a phenomenon observed both in the data and on the ground. There are encouraging trends which show growing PE activity in Africa’s frontier markets. While some of the data sources still vouch for the primacy of South African PEs, growth of African frontier markets like Kenya, Nigeria and Ghana have inevitably made these countries new favorites among investment firms. Moreover, in terms of sectors, there is also a move away from extractive industries to more consumer-driven industries on the continent. Although in terms of value, sectors such as mining, telecommunication and infrastructure still make up the majority of private equity deals in Africa, consumer-driven sectors such as agribusiness and financial services, among others, are leading the way in terms of number of deals. Furthermore, these sectors are expected to grow much faster and attract more PE investments in the region.

While there is lot of hype surrounding PE expansion in Africa, a closer analysis of deal structures and some of the challenges that fund managers face is usually missing. Through both primary and secondary research, the author found that most private equity activity in Africa is focused on smaller deals. There are some high-value and high-profile deals, like
the Fan Milk 400 million USD acquisition mentioned and emphasized in most trade publications. However, the rise of private equity has more to do with the steady increase in these smaller deals. According to an AVCA report, deals of 10 million USD and smaller comprise the majority of PE activities, in terms of number of deals. Primary research in Kenya showed that among the private equity firms interviewed, most were investing in the SME sector (50,000 – 2 million USD). Those that had investments larger than 2 million USD were mostly established fund managers with multiple offices throughout the region.

An issue that remains unaddressed is the presence of impact investors and commercial investors in this SME investment space, which is seeing a flurry of activity. There has been no analysis of how they impact each other’s operations and pricing of deals. Usually, reports separate these two classes of investments and do not explicitly mention how they chose their sample of investors. However, as is evident from cases in Kenya and elsewhere, impact investors are also investing in the 50,000-2 million USD deal size space. Commercial and impact investors are inevitably operating as competitors within this investment
spectrum. As such, it is increasingly more important to understand how each of these investors is affecting the other’s pricing of deals. It would be informative to compare historical equity returns for PE firms and impact investors on similar deals as defined by deal size, sector and markets, among others. Similarly, a comparison of interest rates charged by both of these entities on loan products would show how they value risks. While pricing details about deals might be quite difficult to obtain, future studies should still attempt to understand the different ways such actors structure and execute deals.

Moreover, many reports on private equity do not explicitly state the challenges firms are facing finding the right companies to invest in and ways to support them operationally. Qualitative interviews highlighted that fund managers had a difficult time finding SMEs of the right size with proper management structures. Even after finding portfolio companies to invest in, they only minimally commit themselves as minority shareholders and do not offer much in the way of operational guidance. High costs of involvement were cited as one of the reasons fund managers are reluctant to get involved in business operations. Firm representatives, however, acknowledged that many of their portfolio companies did not
only require strategic investors but investors that could guide them operationally. Many fund managers had co-invested in portfolio companies and could use more understanding of and collaboration with investment partners and possibly ways to share resources to help those companies operationally. Grant-making bodies and foundations are showing interest and getting involved in providing resources to firms, especially impact investors, to provide the operational assistance these portfolio companies seem to need. But a continuing search is required for a sustainable model to systematically support SMEs in their operations by involving fund managers and building better operational incentive structures for management.

African PE Exits in comparative perspective

Finally, African governments must be more involved in helping the PE space grow in their countries. Incentives and policies have to be put in place to attract venture capitalists to spur innovation and entrepreneurship, beyond the technology sector within the region. They could also help by incentivizing and motivating prospective domestic LPs like pension funds to actively participate in the private equity market. Furthermore, government-run investment promotion offices should be involved in decreasing information asymmetries within the PE sector. They could act as the first stop for both PE investors and portfolio companies, and thus decrease the information gap for investors looking for opportunities and companies looking for suitable investors. Also, African governments themselves will need to build their capacity to handle this alternative investment class, whether as promoters of investments or regulators of activities within the sector. Their influence in setting legal codes and standards would protect fund managers, who need to develop their knowledge of the domestic legal structures that impact PE investments, and the portfolio companies themselves.