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Fundraising

With abundant natural resources, GDP growth expected to rise again from 4.7% in 2013 to 5.4% in 2014, and over 300 million people now having discretionary spending power, sub-Saharan Africa should be primed for a flood of private equity (PE) investment. The reality, though, is that PE investment remains at modest levels and the capital raised by African-focused funds is low, especially when compared with the BRIC countries. Raising money for African-focused funds remains challenging and here are some of the reasons why.

DFIs (development finance institutions) remain significant investors into African-focused private equity funds. Having a marquee DFI as a key investor can significantly help raise additional funds, enabling funds to reach their proposed targets with the DFI being a sign of approval or quality. But this can come at a cost, with tighter controls and restrictions around what the fund can and cannot do, as well as additional reporting requirements (such as ensuring compliance with the DFI's ESG principles).

It is perhaps the lack of alternative investment sources that forces African focused funds down the DFI route. While South Africa, Namibia and Botswana have changed pension legislation to allow pension funds to increase their allocation to private equity, they remain the exception rather than the rule across the continent. Certain institutional investors will remain sceptical about investing into a country or continent if the local investors are not prepared to also invest into funds dedicated to the country or region.

Also, Africa is given a bad image by the press. It is rare to see good news stories, such as the growing political stability. Instead, the press focus on civil war, famine and humanitarian crises, not to mention terrorist activity. For those investors that have travelled to Africa, the bad news stories will probably be in marked contrast to their first-hand experiences. However, for those that do not travel, the stories only add to their risk assessment of investing in an African-focused fund.

Moreover, while sub-Saharan Africa is huge, there is no consistent legal system or language, not to mention significant political differences and lack of infrastructure. In addition to this diversity, due diligence providers are not generally considered to be satisfactory, so global firms are brought in on transactions to satisfy international investor requirements. All this adds to the cost of doing deals, which makes the level of return less certain.

After making a commitment to a fund, investors want to see their capital deployed. However, there is very limited venture or seed capital investment in sub-Saharan Africa, which typically provides a steady pipeline of small to mid-market deals. Local businessmen typically have had little exposure to private equity, so do not seek it out when they exit or look to raise additional capital.

Conversely, there are numerous private equity firms operating at the high end of the PE market in Africa – in part because they can absorb the costs associated with doing deals in the region. However, large deals are very infrequent and very competitive, which could lead to some funds overpaying for assets.

The lack of traditional institutional investors (whether African or international) has encouraged African fund managers to seek alternative sources of finance. Family offices, high-net-worth individuals and sovereign wealth funds now form part of the pool of investors these fund managers often turn to for commitments. African PE does not always fit the standard "2 and 20" (2% management fee and 20% carried interest) model or the 10-year fund life, and these alternative investors can typically take a longer view, which institutional investors are not prepared to take.

Private equity in Africa is only in its infancy. African-focused fund managers have needed to be flexible and resourceful, coming up with alternative sources of funds and alternative products to meet challenges of raising money and doing deals in Africa. Whether or not these products will survive, only time will tell, but where there are opportunities institutional investors will always follow.

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This article was first published in Africa AM Asset Management

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