

# An undeniable attraction

Africa investor partners with the University of Navarra's IESE Business School on their index for LPs considering Africa and reveals that Africa's attractiveness is growing

**S**ince 2006, IESE Business School annually gathers data and aggregates it to a composite index, the *Global Venture Capital and Private Equity Country Attractiveness Index*, which measures the attractiveness of countries and regions for investors in venture capital (VC) and private equity (PE) assets. Our index, which is sponsored by E&Y, takes a top-down approach by assessing how socio-economic criteria affect the expectations of efficient deal making.

We summarise the factors that shape national VC/PE markets into one single score by grouping 51 criteria into sub-headings and then into six "key drivers" of VC/PE country attractiveness. These drivers, applied to our sample set of countries, build our index: economic activity, depth of the capital market, taxation, investor protection and corporate governance, human and social environment, and entrepreneurial culture and deal opportunities.

Space limitations prevent us here from a discussion about the choice of these key drivers and about the exact data composition of our index. However, the index builds on strong experience gained in international economic comparison, and that it is optimised for the purpose of VC and PE investors.

## Africa rising

At first sight, our index confirms the idea of the African continent as a geographic region that could hardly be more diverse in terms of its historic evolution, of cultural and ethnological variety and of political and economic development. This diversity is beneficial as it creates opportunities for sophisticated investors who gauge precisely, and is expressed by the world-wide ranking positions that African countries take: from number 26 for the Republic of South Africa, followed by the Republic of Tunisia (49), the Kingdom of Morocco (53), by the Arab Republic of Egypt (56), and by several

other African countries, until we reach rank 116 of the Republic of Burundi. We calculate a score for each country and compare it to the United States, which leads our index with 100 points. Figure 1 presents the ranking among the 31 African countries covered.

The ranking provides a representative snapshot of the attractiveness of African countries for institutional investors. The index provides aggregate information that matters for limited partners and is based on commonly accepted data sources.

Many African countries are evidently very attractive for investors that aim to allocate capital to the VC/PE asset class. Says John van Wyk, the co-head for Africa at emerging markets private equity firm Actis, "I tell our investors that I think Africa is still probably the best-kept secret because we continue to make superior returns."

Other African countries might not yet have reached sufficient socio-economic maturity to support the VC and PE

investment model. However, instead of trying to distinguish, we rather focus on recent developments to detect those countries with a large momentum in their deal supporting environment.

We have seen strong improvements for Rwanda, Ghana, Tunisia, Mozambique and Zimbabwe but, unfortunately, both Burkina Faso and Nigeria have dropped in rankings. South Africa has not changed its ranking and maintains its leading position among the African countries. However, we should stress that according to our index methodology, the scores are calculated relative to the other countries of the sample. This means that those countries that gained or lost ranking positions did not necessarily improve or worsen their investment conditions in absolute terms. They may simply have outperformed or been outperformed by others in the international competition to attract capital resources.

Rwanda remarkably increased economic growth expectations and improved conditions to provide investors confidence. Ghana caught up with excellent growth expectations and improvements in its entrepreneurial culture and deal opportunities. And despite Tunisia's short term growth expectations decreasing due to effects of the Arab Revolution, the country greatly improved investment conditions with respect to its capital market, investor protection, corporate governance legislation, and legal enforcement possibilities.

Mozambique enhanced all key driver scores but especially its growth expectations, investor protection, the human and social environment, and entrepreneurial culture and deal opportunities. Zimbabwe has impressed with a strong growth outlook and accelerated financial market activity. However, it should be noted that this activity is still on a very low level in international comparison.

Unfortunately, Burkina Faso lost five positions, even with great growth expectations. This mainly results from a downgrade of its entrepreneurial environment relative to neighbouring countries. Nigeria dropped eight ranks, which is caused by a weaker development of its capital market and a deterioration of its innovation capacity and of several doing business indicators

compared to its peers. Nevertheless, Nigeria appeals with strong economic growth expectations. In fact, almost all African countries attract investors with extraordinary growth expectations.

"I've been investing in African businesses for more than fifteen years," says Davinder Sikand, Senior Partner at Aureos, the small and mid-cap business of the Abraaj Group, "and one of the challenges has been to educate the market about the role of private equity and the advantages of outside investors in helping to strengthen and grow a business. This is still an on-going process but there has been a really

positive, widespread welcoming of private equity by African entrepreneurs, many of whom actively seek private equity backing to grow their businesses."

## The next step

Next, we take a closer look at the characteristics of selected African countries. We compare the key driver scores of South Africa, Tunisia, Nigeria, and Burundi with the average of all covered African countries in Figure 2.

This underlines the previously noted observation about the diversity and the growth expectations in Africa. However,

Ranking (in brackets) and scores (to the right) of the african countries covered by our index

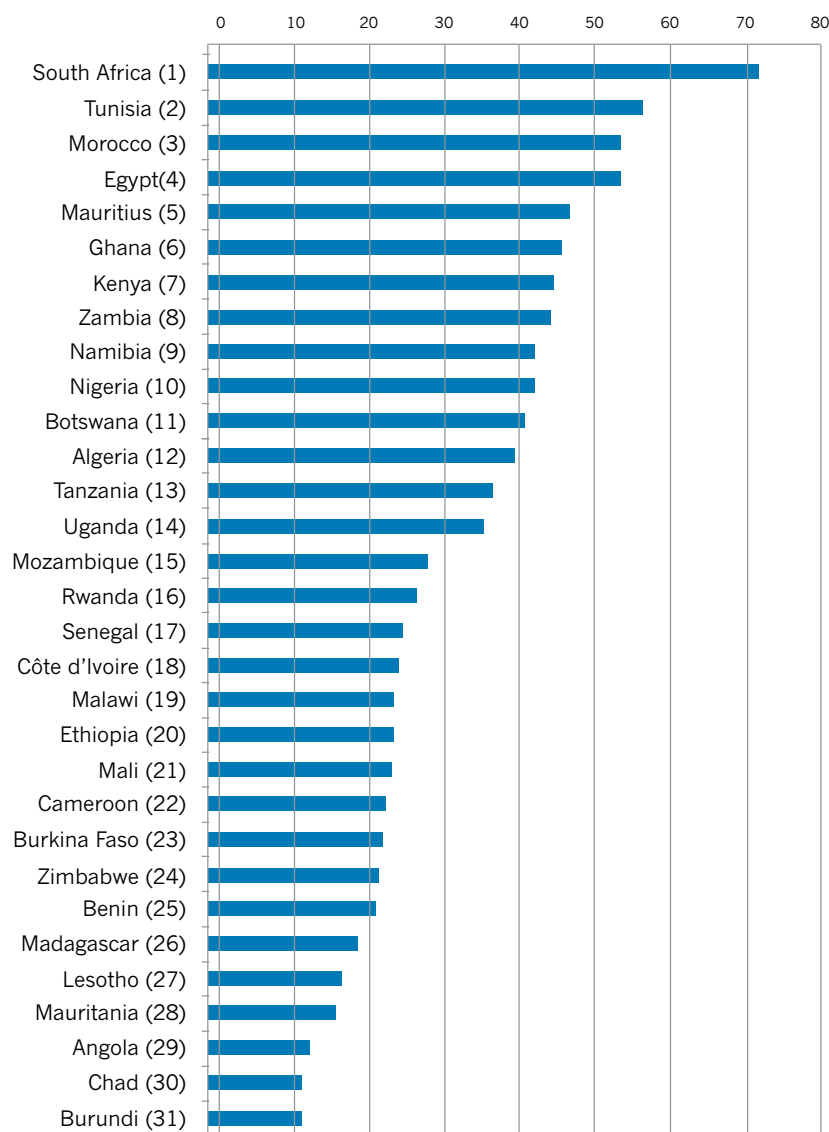


Figure 1

## SUB-HEADINGS OF OUR INDEX FOR SOUTH AFRICA, TUNISIA, NIGERIA, AND BURUNDI

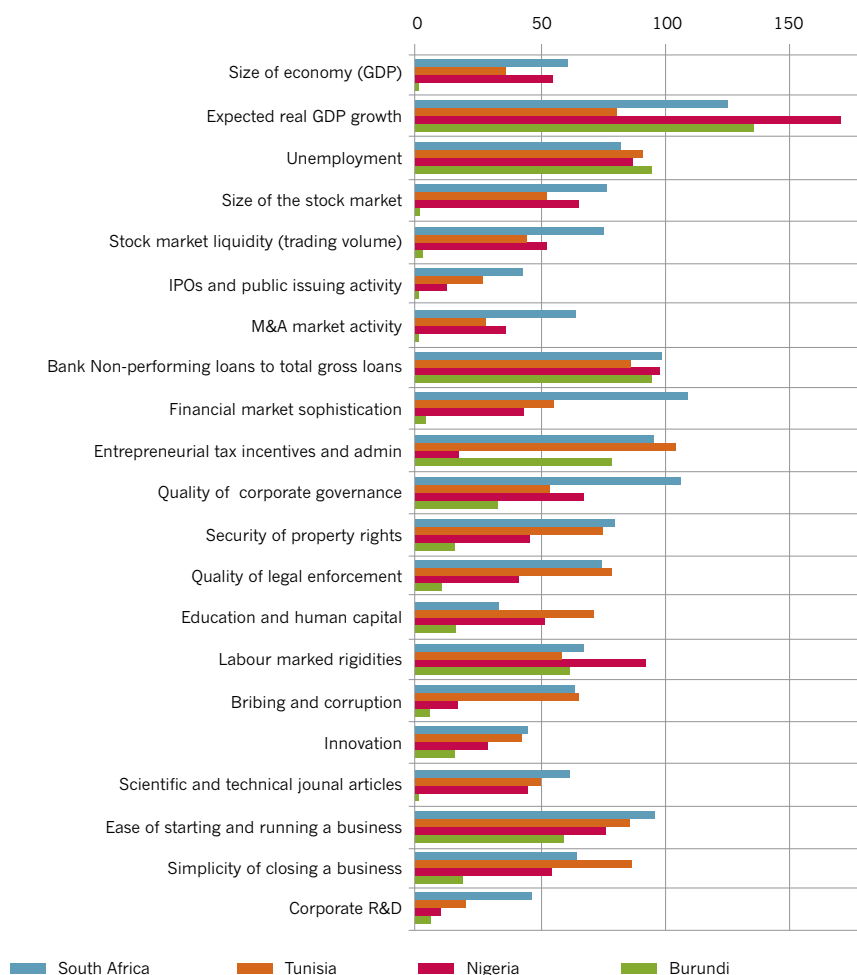


Figure 2

there is no unique pattern of other “general strengths or weaknesses” of Africa. We are aware that the selected four countries only insufficiently represent the continent. However, they cover the ample ranking and at least range from north to south, from small to big, or from former British, French and other countries’ colonies.

The figures reveal several strengths of South Africa. The country has a strongly developed capital market culture and a strong legal environment that protects investors’ interests. However, the country suffers from a high unemployment rate and cannot provide access and quality of education to the average citizen on the level of, say, Tunisia. Comparatively, Tunisia cannot keep up with respect to its capital market, short term growth outlook

or investor protection legislation and enforcement possibilities.

The highest economic growth among the four selected countries is expected for Nigeria. “There is much excitement about Nigeria, the continent’s most populous country and an oil producer,” says Alex-Handrah Aime, a Johannesburg-based director at Emerging Capital Partners. Nevertheless, Nigeria ranks even below the African average when it comes to protecting and enforcing investors’ rights and to providing a quality human and social environment with access to education. Nigeria is also exposed to a higher than average level of perceived bribing and corruption.

The Republic of Burundi lags behind its peers with respect to five out of six key drivers. Even the anticipation of its

economic growth cannot outweigh the perceived deficits with respect to an almost non-existent financial market, protection of investors, the human and social environment, and its innovation capacity. Nevertheless, Burundi (but also South Africa and Tunisia) provides some tax incentives. First, a larger than average difference between personal and corporate tax rates spurs start-up activities; second, administrative requirements for tax payments are considered below average.

This observation can be made for most emerging countries compared to developed peers. They offer tax incentives to spur entrepreneurial activity and to attract investment. However, tax rates and the burden of taxation are regulated by politicians and subject to rapid changes. In addition, taxation is not as important as the other key drivers of VC/PE attractiveness. Therefore, in our index, taxation receives a smaller weight and does not substantially affect the ranking.

### Additional factors

Africa strongly appeals to international risk capital by exceptional economic growth and catch-up expectations that require funding. Nevertheless, economic growth is not the only important determinant for VC and PE allocation decisions. When it comes to the establishment of sophisticated VC/PE relationships between institutional investors, VC/PE funds, and investee corporations, additional factors need to be considered.

Institutional investors urgently require legal protection of their contractual claims and law enforcement possibilities. For their allocation decisions, they assess the chances of quality deal flow and the ability of general partners and entrepreneurial managers to turn them into success stories. These success stories materialise in environments with large pools of qualified, educated, motivated and innovative people in favourite doing business conditions. These conditions also include low levels of administrative burdens and perceived corruption.

Finally, the success of the VC/PE intermediary relationship also depends on the liquidity of debt and exit markets, and on the presence of deal supporting institutions (e.g. law firms, consultants, auditors, investment banks, or M&A boutiques). We consider all these determinants with



## WHAT MAKES AN ATTRACTIVE INVESTMENT FOR PRIVATE EQUITY IN AFRICA?

The number one thing that fund managers are looking for in Africa is strong management teams, says Rachel Keeler, co-founder of Africa Assets, a research and consulting firm for private equity and venture capital in sub-Saharan Africa. "They want to work with people who know their business, know their markets and can effectively navigate the many unique risks posed by doing business on the ground in Africa." Davinder Sikand, Senior Partner at Aureos, agrees. "Aureos likes to work with mid-sized businesses that have a strong management team in place," he says, "but which need to diversify their access capital or markets."

Management capacity in Africa is somewhat limited, Keeler says, which is why you see many funds going after the same good deals. "GPs are also looking for high growth businesses that can scale. Outside of Nigeria, individual African markets are somewhat limited in size. The best companies are those that are leaders in their respective fields and plan to expand by serving multiple countries, which also spreads risk." Keeler emphasises that many funds are also focusing on SMEs as an engine for growth and a greater number of available deals, because really large companies are few and far between in Africa.

In addition, "a business with the right corporate governance in place is going to achieve a better exit value," says Sikand. "Every GP goes into a deal thinking about eventual exit routes," agrees Keeler. "Because capital markets are shallow across the continent, the most likely exit will be through a strategic sale. So companies that will be attractive to trade buyers are also attractive to PE fund managers."

our index, which assesses the chances of successful deal making.

"This is a key turning point for the industry," says Michelle Essomé, CEO of the African Venture Capital Association (AVCA). "It is becoming more institutionalised. We

are seeing managers across a variety of investment styles, sectors and geographies, who are also building their track records. What is needed now – and this is a key focus for AVCA – is to attract more institutional capital, both international and

local African to the asset class."

"This is an extremely useful tool," says Hubert Danso, CEO of *Africa investor*. "Ai Capital advises institutional investors on allocation in Africa and this index provides encouraging results for Africa."

Some African countries are already highly ranked in the global comparison and others gained strong momentum in their development in recent years. Nevertheless, several others are probably not yet mature enough to support the VC/PE business model – and a great opportunity exists for policy makers and regulators to realise and change the deficits to attract international risk capital to spur their development. In order "to not miss the train," investors should prudently gauge those countries' evolution and time their allocation respectively. Thereby, our index can help. **Ai**

**Dr Alexander Groh (groh@em-lyon.com) is Professor of Finance at EMLYON Business School, France, and Dr Heinrich Liechtenstein (hl@iese.edu) is Associate Professor of Financial Management at IESE Business School, Barcelona – University of Navarra, Spain. More information on the index is available at <http://blog.iese.edu/vcpeindex/>**



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**Duncan Owen** Co-founding and Managing Partner | Email [duncanowen@phatisa.com](mailto:duncanowen@phatisa.com)

**Stuart Bradley** Co-founding Partner, Fundraising & Investor Relations | Email [stuartbradley@phatisa.com](mailto:stuartbradley@phatisa.com)

For more information on Phatisa, funds under management and our service offering, visit [www.phatisa.com](http://www.phatisa.com)

\* The **African Agriculture Fund**, a food-focused pan-African private equity fund. Currently at US\$ 162 million, with a final closing target of US\$ 300 million.

The **Pan African Housing Fund**, a real estate private equity fund focused on housing in Africa. Final close is targeted to raise US\$ 40 million by end Q3 2012.

