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MASTER OF MANAGEMENT IN FINANCE AND INVESTMENT

Topic:

Does Sub-Saharan Africa Require A New Private Equity Model: A case study of South Africa and Nigeria

THESIS

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Abstract

Private Equity in Sub-Saharan Africa has grown significantly over the last decade. This growth was supported by an improved middle-class, macroeconomic factors, infrastructure and foreign direct investments. The case study provides an overview of Private Equity in Sub-Saharan Africa by focusing on South Africa and Nigeria. Where lessons from developed nations underpin the opportunity for Sub-Saharan Africa government policy makers to provide progress in the depth of capital markets, regulatory and governance of firms, investor protection and access to public information. Though my study is an empirical paper, the need for further research is required for the Private Equity market in Sub-Saharan Africa to become robust, enable massive inflow of capital and create an optimistic business environment for institutional investors.

Declaration

I, Thabo Moloto, declare that this research report is my own, unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Management in Finance and Investments in the University of the Witwatersrand, Johannesburg. It has not been submitted for any other degree or examination in this any other University.

Thabo Moloto
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List of Abbreviations and Acronyms

AVCA	African Private Equity and Venture Capital Association
BCG	Boston Consulting Group
B-O	Buy-Out
CEE	Central and Eastern Europe
DC	Developmental Capital
DFI	Development Finance Institutions
DPI	Development Partners International
E&Y	Ernst and Young
EMPEA	Emerging Market Private Equity Association
ESG	Environmental, social and governance
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GP	General Partner
IFC	International Finance Corporation
IMF	International Monetary Fund
IPEV	International Private Equity and Venture Capital Valuation Guidelines
IPO	Initial public offering
IRR	Internal rate of return
JSE	Johannesburg Stock Exchange
LBO	Leveraged buy-out
LDC	Less Developed Countries
LP	Limited Partner
MBO	Management buy-out
MPT	Modern Portfolio Theory
MSCI	Morgan Stanley Capital International
ODI	Overseas Development Institute
PE	Private Equity
PEVCA	Private Equity and Venture Capital Association
RSA	Republic of South Africa
SARS	South African Revenue Service

SAVCA	Southern African Venture Capital and Private Equity Association
SEC	Securities Exchange Commission
SME	Small and medium enterprises
SSA	Sub-Saharan Africa
UK	United Kingdom
UNECA	United Nations Economic Commission for Africa
USA	United States of America
VC	Venture Capital
VCC	Venture Capital Company

CHAPTER 1: INTRODUCTION

1.1. Background of the Study

Private Equity (PE) is the provision of equity and debt capital by financial investors, over the short, medium and long term, to non-quoted companies with high growth potential (Southern African Venture Capital and Private Equity Association [SAVCA], 2018). According to Lovejoy (2007), “PE investing is the business of investing in privately held companies or those that are taken private in the process”. PE covers not only the financing required to create a business, but also includes financing in the subsequent development stages of its life cycle. PE may refer to investments in various stages of the business life cycle, but the essential investment remains the same: it is the provision of capital, after a process of negotiation between the investment fund manager and the entrepreneur/owners, with the aim of developing the business and creating value (Berger & Udell, 1998).

The PE model was developed in the United States of America (USA) in the 1970s and 1980s and was focused on fostering entrepreneurial activities within the biotechnology, telecom and other high-tech sectors (De Lima Ribeiro & Gledson de Carvalho, 2008). The USA model was the benchmark for many institutional investors and fund managers in the early years of PE. The model has rapidly changed across the world, where ultimately the relative size depends on the supply of funds and demand for PE/Venture Capital (VC) (De Lima Ribeiro & Gledson de Carvalho, 2008).

The demand factors are those related to the number and the quality of entrepreneurs seeking capital, which are (i) reduction in the capital gains tax; (ii) entrepreneurship activity; (iii) innovative efforts; (iv) Gross Domestic Product (GDP); (v) labour market rigidities; and (vi) interest rates. Supply factors are those that push investors into the PE/VC asset class, which are (i) pension funds to investment in the asset class; (ii) growth of the pension market; (iii) reputation of the PE/VC firms; (iv) accounting standards; and (vi) long-term against short-term interest rates (De Lima Ribeiro & Gledson de Carvalho, 2008). These factors are further supported by (i) Initial Public Offerings (IPO); (ii) stock market capitalization and (iii) government programmes (De Lima Ribeiro & Gledson de Carvalho, 2008).

Developed nations, such as the USA, Germany and Japan, have had a long history of PE, mainly supported by the determinants of strong demand from cooperative entrepreneurs, a sympathetic public policy environment, a reliable legal system, political and economic stability, and well-developed financial markets (Leeds & Sutherland, 2003). The developed nations differ from the emerging markets' PE fund strategies regarding the implementation process, where the fund structure, funding source, types of investments and exit strategies are relatively rigorous (Lerner & Schoar, 2003).

PE in Sub-Saharan Africa (SSA) has attracted investors from different regions of the world over the last decade. Today, SSA fund managers continue to allocate funds to businesses that have well-capitalised balance sheets and proven management experience (Berger & Udell, 1998). This is mainly dependent on the stage at which the enterprise currently operates. The three different types of investing for which PE firms can decide to act vary from Venture Capital (VC), Developmental Capital (DC) and Buy-Out (B-O). Enterprises pursue PE investing for different strategic reasons, be it to increase working capital, effect corporate expansion, develop emerging technologies, advance products, maintain their competitive advantage, buy into other businesses, or restructure a business and its shareholding (Metrick & Yasuda, 2001). PE is not only a cash incentive-driven model, but it also has a social development perspective to add to a country's economy in ways such as foreign direct investment (FDI), job creation, skills growth and efficiency (Alsina, Alam, & Hunt, 2018).

While the narrative of 'SSA Rising' is that the SSA fund managers can identify opportunities which can benefit invested firms and the country's production growth with superior returns, this will aid the entire population to benefit from economic development, the wider society in value and where it can aid economic development. This envisaged outcome will be based on structural reforms boosted by infrastructure development across major cities on the continent, which would bolster returns over the long term (EMPEA, 2018). A 2018 survey conducted by the Emerging Market Private Equity Association (EMPEA) ranked SSA as the fourth most attractive emerging market region behind India, Southeast Asia, and South America (excluding Brazil).

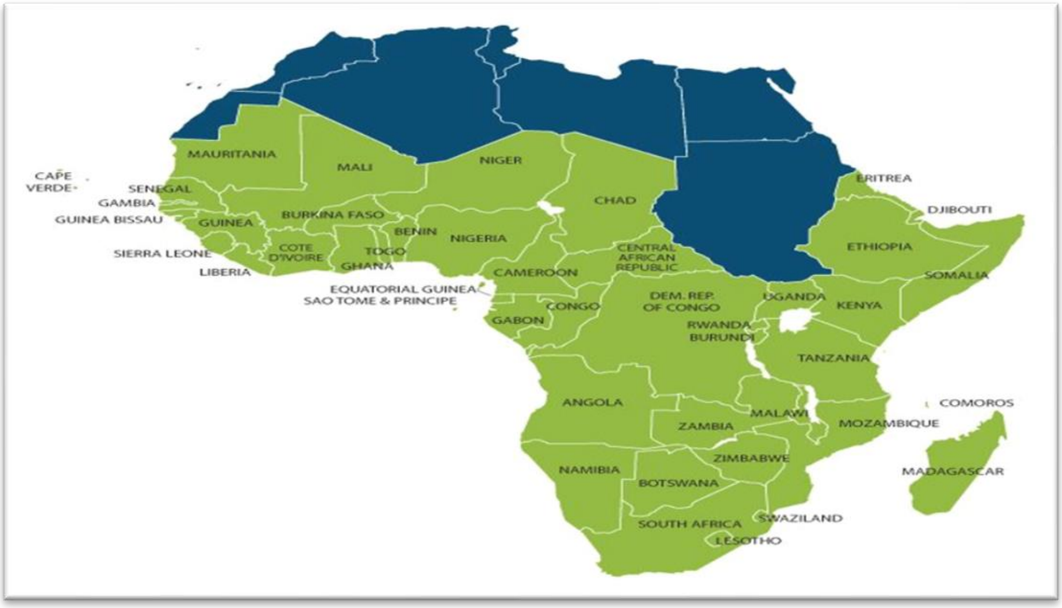

Figure 1: Sub-Saharan Africa Map

Source: Riscura, (2018)

Therefore, looking at the history and current PE market on the SSA continent, I have identified South Africa and Nigeria as case studies for the SSA PE market for the following reasons:

- Both countries constitute 45% to 55% of the SSA PE market;
- Growth in funds under management;
- Size of the economy;
- Legal and regulatory systems;
- The Venture Capital and PE Country Attractiveness Index; and
- A vibrant consumer and product innovative market.

This is also supported by the ongoing global financial downturn, which has seen limited partners (LPs) look to diversify outside of the developed nations, where the metric of return-on-investments in SSA has outperformed the developed nations during the last decade (Babarinde, 2012).

SSA giant Nigeria has had a major resurgence in its PE industry over the last decade, with growth mainly supported by oil revenue and non-oil revenue, the financial sector, and the consumer sector. While Nigeria is the largest and most attractive market for PE in the sub-region, accounting for 45% of deal volume and 63% of reported deal value from 2007 to 2015

H1 (African Private Equity and Venture Capital Association [AVCA], 2017), Nigeria does have its pitfalls, where business regulation and corporate governance issues have become an important impediment (Global Doing Business Report, 2019).

South Africa remained the most developed PE market, not just in the sub-region, but on the entire continent. Funds under management in South Africa's PE industry grew from R115.8 billion as at 31 December 2011 to R158.1 billion as at 31 December 2018. South Africa's total share is 90% of the funds under management in the Southern African sub-region and 37% in the entire continent (SAVCA, 2018). This further indicates the maturity of the PE market of South Africa. What has worked well for South Africa has been the developed financial system and strict regulations, which have yielded massive growth in the PE industry (SAVCA, 2018).

This case study attempts to understand why SSA fund managers in South Africa and Nigeria cannot attract LP funding, by focusing on entrepreneurs who have created product innovation that is able to attract funding and market growth. This should be supported by growth in assets under management, the sheer economic size of both economies and the evolving PE model from the '70s to the current PE model trend. This chapter introduces the problem statement and the need thereof.

1.2. Problem Statement

Entrepreneurs anywhere in the world look to access funding from investors; this could be in the form of debt or equity instruments, in order to pursue and grow their production lines (Ojah, 2009). SSA has been identified as the next frontier PE market in terms of emerging markets, and this is highlighted by the growth in assets under management from South African and Nigeria (Matean, 2014). However, most SSA fund managers adopt a similar deal structure that targets businesses that have revenues of above US$100 million and proven business experience (Boston Consulting Group [BCG], 2016). In SSA, the majority of the firms are still in their infancy stage, which requires start-up capital and working capital in order to grow their respective consumer markets (Egeli & Sylvester, 2000).

Although this paper is a conceptual (review) paper, it aims to enhance the conversation that addresses entrepreneurs' issues of access to capital and what fund managers should assess before funding these firms. These determinants of the current South African and Nigerian PE model need to be understood as they have the potential to re-examine the decision-making of LPs and general partners (GPs) as the model of PE in SSA evolves, which could benefit other SSA countries on the continent and local firms planning to invest in the continent.

1.3. Objectives of Study

The objectives of the study cover the following:

- To uncover South African and Nigerian growth in PE/VC investments over the last decade;
- To trace the relationship between product innovation and entrepreneurship in order to ascertain likely demand for PE funds; and
- To consider SSA governments to participate in cultivating a PE model.

1.4. Research Questions

Flowing from the above objectives and the theme of the paper, we seek to answer the following questions:

- What is South Africa and Nigeria's current most pervasive PE model?
- Are South Africa and Nigeria PE fund managers, given their current investment strategies, achieving adequate returns for their LPs?
- Are SSA governments providing enabling policies for the promotion of PE?
- If this current model is not the correct model, what other alternatives are there for South African and Nigerian GPs to consider?

1.5. Overview of the Research Method

This research (master degree thesis) aims to answer the above questions, by reviewing and comparing the developed nations' current PE model to that of South Africa and Nigeria, which I have indicated as the chosen case studies. This will be based on the six determinants, as discussed above in sub-section 1.1.

Therefore, the general research overview will focus on (i) research design; (ii) historic approach; (iii) current approach; (iv) comparative approach; (v) PE valuation method; and (vi) research method limitations which are detailed in section 4 below. The secondary data was retrieved in order to provide the reader with the conceptual understanding of the questions raised in sub-section 1.4 above.

However, valuation of PE firms typically follows an approach based on (i) income approach; (ii) market approach; and (iii) asset-based approach in benchmarking deal evaluation. I did encounter limitations while addressing the research questions, due to the closed and confidential nature of the PE/VC market.

1.6. Outline of the Report

Chapter 2 provides the background overview of private equity in SSA, and in South Africa and Nigeria. Chapter 3 examines the literature review. In Chapter 4, I observe the methodology approach and valuation techniques used by GP. Chapter 5 provides the research analysis, which will support the potential research to be done in the PE/VC industry of SSA. Chapter 6 draws some high-level (broad) conclusions and recommends whether SSA requires a new PE model.

CHAPTER 2: BACKGROUND OF THE STUDY

2.1 What is Private Equity?

Institutionally, private equity is the provision of capital and management expertise given to companies to create value and, consequently, generate big capital gains after the deal. Usually, the holding period of these investments is defined as medium or long-term (Caselli, 2010). The literature further identifies venture capital as a sub-category of private equity. Venture capital is typically concerned with financing high growth, high-risk, often high-technology firms that need capital to finance product development and must, by nature of their business, obtain this finance in the form of equity rather than debt (Black & Gilson, 1998). Private equity therefore can be regarded as a broader term which also encompasses later stage investments as well as buy-outs and turnaround investments (Cumming & Johan, 2006). Throughout this research paper we use the term private equity as a broader term and venture capital for specific reference to the venture capital industry. This excludes angel finance, the informal private equity market, which is generally not regarded as an institutional level investment (Meyer & Mathonet, 2005).

Entrepreneurs anywhere in the world aim to access funding, be it via an equity or debt instrument, to advance their product innovation (Ojah, 2009). As an alternative investment class, private equity has been able to increase the value chain of a business and/or organisation across its lifespan (Ahlstrom & Bruton, 2006). Private equity capital in entrepreneurship primarily includes venture capital, corporate venture capital, angel investments, crowd funding and accelerators (Drover, Busenitz, Matusik, Townsend, Anglin, & Dushnitsky, 2017). These applications or investment funding mechanisms are presented in detail in Table 1 below.

Table 1: Private Equity Investment Stages

Category	Stage of Business	Typical Allocation
Venture Capital	Seed Capital	Funding of research, evaluation and development of a concept business
	Start-Up and early	Funding for new companies being set up for the development of those which have been in business (1 – 3 years)

Category	**Stage of Business**	**Typical Allocation**
Development Capital	Expansion and development	Funding for growth and expansion of a firm with breakeven or trading profitability
Buy-out	Leveraged/Management buy-out or buy-in	Funding provided to enable management teams or other strategic partners, either existing or new, as well as their backers, to acquire a business from existing owners, whether a family or firm
	Replacement Capital	Funding is provided for purchasing of existing shares from other shareholders

Source: KPMG (2015)

Many PE funds make use of the limited partnership legal structure. This involves two types of partners: a) GPs, and b) LPs, where the partnership is typically a fixed-line investment vehicle, in which the GPs have unlimited liability and the LPs or investors have limited liability, but are not involved in the day-to-day operations of the firm. Typically, the GPs will receive a management fee and profits above the hurdle rate, while the LPs will receive the net income and capital gains (Brown, Charkin, & Haywood, 2015).

2.2 An Overview of Private Equity in Sub-Saharan Africa

Campbell (2012) restates the lessons learnt in investing in Africa over the past decade; she positions that private equity investments in Africa have been active for many years with solid track records emerging in the last decade. Reviewing historical returns, successful deployment of private equity in Africa has applied best practice that has been proven in emerging and developed markets. Campbell (2012) indicates that the most important areas of application are identifying risks, defining the path to liquidity, and anticipating changes in legal and governing frameworks. When dealing in PE, the key risks independent of the unique transaction deal risks are country risk, currency risk and industry risk. Sub-Saharan Africa frontier markets present unique risks when it comes to political and cultural risk, even when compared to South Africa and Nigeria. Perhaps the most tangible difference is the development of the rule of act.

Most researchers have focused on the PE industry and corporate governance implication in the USA and the United Kingdom (UK), while such research in emerging economies such as Africa and Asia remains light, review-based and less significant compared to those on developed economies except Hearn and Piesse (2013) and Leeds and Sunderland (2003). However, I deem it necessary that more research must focus on emerging economies in Africa as “the continent remains ripped and will continue to offer higher returns on private investments compared to similar investments in developed economies” (Boston Consulting Group, 2016).

The optimism about SSA during the early parts of the recent two decades reached new heights as economic growth, commodity boom, and investments in basic infrastructure contributed to economic development. This generated substantial investor confidence from many LPs, who looked to diversify their investment capital into regulated and experienced fund managers on the continent (Bridge Ventures, 2014), and further supported by the new wave of the SSA middle class. Hurley Doddy, the Managing Director of Emerging Capital Partners, mentioned the following during the Avanz Capital Report on the PE climate in SSA embracing the lion: “In comparison to other emerging economics, SSA is still a largely underserved market of nearly one billion people (14% of the world’s population) and is hugely diverse. It is easily forgotten that the continent spans 20% of the world’s land mass – more than Europe, India, US and China combined” (Avanz Capital, 2012, pp. 1-22).

The fundraising activity over the last decade has grown significantly. Total PE funds raised by SSA-focused funds between 2007 to 2014 were $22 billion, and in 2015 to 2016 were $6 billion (21% of total funds raised between 2007 to 2014) (Deloitte, 2017). The activity during the 2015 to 2016 period indicates confidences from LPs into the continent, where the majority of those funds were raised from insurance companies (22%), asset managers (19%), Development Finance Institutions (DFIs) (19%), and endowment funds (16%) (Preqin, 2019). Although this cycle was affected by the commodity drop and slow economic growth. SSA PE fundraising levels remained higher during that period.

GPs in the SSA region typically have long-term perspective aimed at value creation, which encompasses the LPs’ return objective. Many times, LPs are more comfortable to invest in a fund where the fund managers have a track record in the region and have the capability to find opportunities which are aligned to the LPs’ vision.

The fund managers require on-the-ground knowledge and strong local presences. This is supported by Runa Alam, the chief executive of Development Partners International (DPI), who indicates that growth and execution on the continent is driven by market knowledge, which provides fund managers with the right to know-how, price and risk management teams which can weather the storm during tough periods of the investment cycle (Alam, 2018). The investment strategy chosen should be flexible to generate returns and corporate targets for the GPs and ultimately for the LPs. LPs, in return, should be able to understand that the investment strategy for SSA fund managers is different from their counterparts in the developed market.

Typically, fund managers in SSA, compared to their colleagues in developed nations, tend to invest in a long-tenor and with a mixture of senior and mezzanine debt rather than equity (AVCA, 2016), and prefer small and medium-sized enterprises (SMEs) in order to develop before offloading them to large trade buyers (Siddiqi, 2018). The EMPEA report on SSA in 2010 indicated that SSA is under-funded, as the International Finance Corporation (IFC) SSA portfolio showed a 21.73% return between 2000 to March 2010.

Many funding strategies are structured as either generalist funds, specialist funds, secondary funds and funds of funds, which target opportunities within mid-market and small-sized firms in SSA. In targeting such firms, fund managers preferred the following top five sectors in 2010 as compared to 2017.

Table 2: Top Five Sector Preferences

Sectors – in 2010	**Sectors – in 2017**
Business Services	Financial Services
Information Technology	Consumer Goods
Industrial and Mining	Healthcare and Pharmaceuticals
Telecoms, Media and Communications	Manufacturing and Industries
Consumer Discretionary	Agricultural and Agribusiness

Source: Avanz Capital (2012); Deloitte (2017)

The capacity to enhance growth in the SSA PE industry among South Africa and Nigeria has seen performance where, according to AVCA, fund managers reported returns to LPs of 2.5

times to 3 times on their SSA portfolios; when comparing this to the United States and Europe, this exceeds the average of 1.9 times during the 2018 period.

This is supported by the 2014 EMPEA publication (pp. 8-9) on SSA pension funds, which indicates the following: "Long-term savings vehicles such as pension funds are uniquely positioned to manage the long investments term and limited liquidity of PE investments to capture what appears to be a significant performance premium and diversification benefits".

I do believe that with the extensive support of the pension fund industry, the fundraising allocation could harvest the SSA PE industry and transpire regional growth, where opportunities present themselves on the basis that more liquidity is provided to fund managers, which will assist in their investment mandates in order to have less reliance on international investors' capital. This will provide fund managers with enhanced investment strategies which are built to pursue product innovated ideas from entrepreneurs during the investment life cycle. This, in turn, will greatly enhance economic development and growth. During the period of 2007 to 2017, according to Ernst and Young (E&Y) and the AVCA report on how PE investments created value (AVCA, 2017), the following sectors generated significant value for fund managers:

Table 3: Sector Value Performance at Exits

Sectors	**2016 – 2017**	**2007 – 2017**
Industrials	22%	19%
Consumer Staples	15%	13%
Materials	13%	11%
Consumer discretionary	12%	12%
Financials	12%	19%

Source: AVCA (2017)

Performance related to the above table is based on financial returns in the four regions, namely Southern Africa excluding South Africa (88%), West Africa (53%), East Africa (49%), and South Africa (79%), where fund managers achieved exit performances in the different sectors (AVCA, 2017).

2.3 An Overview of Private Equity in South Africa and Nigeria

The use of developed nations' PE/VC models has been questioned regarding the efficiency of supplementary use for countries such as South Africa (Lingelbach, Murray, & Gilbert, 2008). The view from Lingelbach et al. (2008) specify that developed nations' PE/VC models, proposed by Gilson (2003) does not provide reasonable clarification for emerging countries such as South Africa and Nigeria. Lingelbach et al. (2008) indicate that each country should provide a model which suits its current economic condition.

De Beer and Nhleko (2008) describe South Africa's private equity as the most sophisticated of all emerging economies. This is supported by industry reports by SAVCA (2018); this description is based on the notion that the industry is well-defined through various stakeholders. Furthermore, the industry has grown significantly since the 1980s through the management buy-outs from multinationals from South Africa (De Beer & Nhleko, 2008), while in the case of Nigeria, private equity funds are few and cater primarily for the needs of expansion of established business and private companies (Klonowski, 2013).

The Nigerian private equity market remains relatively resilient, despite challenges such as global oil and commodity pricing and currency volatility. There is particular interest in the financial services and industrial sectors (which together attracted 50% of all deals and 66% of all capital deployed in Nigeria in 2015) and consumer goods (EMPEA, 2014). The growth in private equity in South Africa was highlight by further contribution by the global trend which provides an attractive asset class to investors (KPMG, 2015).

The annual LPs' survey in AVCA (2018) indicated that Nigeria (ranked 1st) and South Africa (ranked 4th), were the most attractive countries for PE investment in SSA over the next three years. This provides a strong indication of LPs' stance on these two markets, which capture 45% to 55% of the SSA PE market.

SSA fund managers are now looking to grow their fundraising allocation from local pools of capital, which are extensively large and create tremendous opportunities for fund managers to tap into, for instance Nigeria's Contributory Pension scheme has grown to $18.9 billion assets under management, exceeded in size on the continent by South Africa ($309 billion) (Riscura, 2018). The support of the financial regulation market in South Africa has seen the birth of

Treasury Regulation 28 (Republic of South Africa [RSA], 2011), which encourages pension fund investments into PE in order to boost investments.

The Nigerian Securities Exchange Commission (SEC) published guidelines in order to increase share capital required for GPs seeking registration with the SEC (Dagogo, 2012). Furthermore, the SEC also issued rules establishing the Investor Protection Fund, which is a legal entity. It has been set up in order to mitigate financial losses suffered by investors due to the insolvency, bankruptcy, negligence, or embezzlement of funds by capital market operators, in relation to securities or any property entrusted to, received, or deemed to be received by operators (Dagogo, 2012).

A relative review of PE financing in the USA, Europe and Asia revealed certain critical success factors that may provide lessons in the use of private equity to grow Nigeria's industry as an emerging market (Klonowski, 2013). These factors include attractive fiscal and legal framework, stock option plans to attract and retain talents, pool of management experts and strategists that can support entrepreneurs to run venture capital-backed companies, linkages with research institutions and technology parks, intellectual property rights protection, efficient exit mechanisms for investors, second chance to entrepreneurs whose businesses went bankrupt, corporate venturing, and research and development to promote high-technology industries without downplaying the strategic importance of the low-technology industries in the economy (Dagogo, 2012).

CHAPTER 3: LITERATURE REVIEW

3.1 Theoretical Review

Private equity infiltration can be explained using the Modigliani and Miller (1958) trade-off theory and the pecking order theory of Myers (1984). The trade-off theory suggests that businesses are financed using either debt or equity capital. However, debt funding is unappealing as it puts financial burdens on businesses in terms of interest and principal obligations. Due to these pressures, businesses prefer equity financing. This makes private equity funding a major and attractive source of financing. According to the pecking order theory, there are three sources of funding businesses. These are internal, debt, and equity funding. When private equity activity is increased in a nation, businesses benefit from equity funding. This boosts economic growth and expansion with less financial pressure in the form of interest and principal repayments.

The appeal of PE financing to a country or region can be explained by the neoclassical theory of investment performance developed by Jorgenson (1971) and the Modern Portfolio Theory (MPT) of Markowitz (1952). The neoclassical theory of investment behaviour theory posits that businesses invest if their current capital stock is smaller than the optimal capital stock, and disinvest when their current capital stock is sufficiently larger than the optimal capital stock. In studies of PE investments, this theory refers to the idea that PE investments tend to cluster in countries of economic, technological or regulatory advancements (Yan, 2011).

The demand side comprises businesses seeking financing. This means that the demand for private equity as a source of financing should be higher in times of positive economic prospects (Dias & Macedo, 2016). The supply side consists of private investors looking for investment opportunities with attractive risk-return characteristics. These are based on some attractive and unattractive macroeconomic and institutional forces such as GDP per capita, inflation, real exchange rates, banking sector development, capital markets, rate of savings, and corruption. In their international allocation strategies to minimise risks, private equity investors make their international allocation decisions by investing in countries that have low macroeconomic and institutional risk profiles with the aim of increasing their returns (Dias & Macedo, 2016).

Groh and Liechtenstein (2009) in a survey to LPs ask about the relevance of diverse distribution criteria when investing in emerging private equity markets. The survey comprehensively deals with socio-economic drivers that respondents consider significant for allocation decision. The 75 investors that responded to the questionnaire included corporate investors, government agencies, banks, pension funds, insurance companies, fund of funds (29 out of 75 respondents), endowment funds and other splits between North America, Europe and rest of the world by domicile. The questionnaire considered the six main drivers of PE funding: economic activity, capital markets, taxation, investor protection and corporate governance, human and social environment, and entrepreneurial opportunities. Their results showed that on average, corporate governance principles and protection of investors' rights were the most important criteria for LPs investment decisions in emerging markets. The ranking of decision criteria effectively reveals the investors' dependency on the subsequent chain of agents. Investors rely on the quality of GPs they invest in. The GPs themselves rely on the managers of corporations they finally back. If investors' claims are poorly protected, if they doubt the quality of their investees, or if they doubt integrity in a host country in general, then they refrain from investing.

La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1997) indicate that the legal landscape provides a strong determining factor in the size of the capital market and the ability of the local firm to receive capital from international LPs. Glaeser, Johnson, and Shleifer (2001) suggest that common-law countries have a greater benefit in enforcing their commercial law rights. Cumming, Fleming, and Schwienbacher (2006) indicate that countries with good quality laws provide a positive impact in the facilitation of PE transactions; therefore this will assist in the governance and accounting standards of the PE market, while Lerner and Schoar (2003) analyse developing nations' PE structures and conclude that the choice of securities is driven by the legal and economic circumstances of the country.

Gompers and Lerner (1998) examine the USA PE market and conclude that the regulatory environment plays a critical role for pension funds and overall economic growth, while fund-specific performance and reputation affect fundraising; therefore concluding that entrepreneurs gain more opportunities when the economy is large and growing, while Van Pottelsberghe and Romain (2004) believe that PE activity is linked to GDP growth.

Bottazi and Da Rin (2002) claim that policymakers should provide a wider set of policies in order to improve the PE market in developing countries. Armour and Cumming (2006) support this view and show that government programmes rather hamper the growth of the PE/VC market.

3.2 Determinants of Private Equity and Venture Capital

The first theory is the Financial Intermediation Theory or the Financial Intermediary's Theory, put forth by Schumpeter (1911) and later supported by Bencivenga and Smith, (1991). The conventional view of the theory states that the development of intermediaries tends to lead the development of the financial markets; the development of the financial sector leads to the development of the economy. Private equity and venture capital are specialised forms of financial intermediation. This is because private equity funds act as financial intermediaries that assemble funds from limited partnerships to invest in portfolio companies in some countries or regions based on some risk-return analysis of the macroeconomic and institutional situations. The second is the Calderon-Rossell Model which explains the behavioural structural theory of stock market development which considers economic growth and stock market liquidity as the main determinants of stock market development (Fonkam, Akume, & Sama, 2019). According to this theory, stock market development is a function of income level and stock market liquidity as the baseline.

Bernoth and Colavecchio (2014) completed a study that explores the macroeconomic determinants of PE investment in Europe, focusing on a comparison between Central and Eastern European (CEE) and Western European countries. The study looked at data from 13 Western countries and three CEE countries. It tested whether the economic environment, financial market circumstances, labour market conditions, and the political, legal, and social environment of a country are driving forces of PE activity, as well as to what extent such forces differ in Eastern and Western countries. The first finding of the study was that the PE industry is cyclical in its nature and the faster the country is growing (where growth is measured by GDP), the more PE investment is attracted, as a fast-growing economy is more likely to provide opportunities for entrepreneurs.

Jeng and Wells (2000) indicate that one needs to understand the determinants of venture capital funding across 21 countries. The study considers the importance of IPOs, GDP growth, market capitalisation growth, labour market rigidities, accounting standards, private pension funds, and government programmes on venture capital financing. The study found that IPO activity was the biggest driver for venture capital investment. Private pension fund penetration was also found to be a strong driver, but not in all the countries. Government policies and the regulatory environment were also considered to have a strong impact. The study also showed that the different drivers have different effects on the different types of venture capital. For example, the IPO activity is a big driver for late stage venture capital financing but has no impact on early stage financing (Jeng & Wells, 2000).

Oino (2014) studied the macroeconomic and environment determinants of private equity in emerging Asian markets. By using the extreme bound analysis, the results showed that while GDP growth and market capitalisation did not result to be substantial, private equity was more accessible in countries with well-developed stock markets. Bernoth and Colavecchio (2014) studied the macroeconomic determinants of private equity investment by comparing 16 Central and Eastern European (CEE) and Western European countries from 2001 to 2011. By applying the extreme bound analysis, their results suggested that GDP per capita, commercial bank lending, inflation rate and equity market capitalisation were significant determinants of PE activity.

Schumpeter (1911) explains that a well-developed financial system can facilitate technological innovation and economic growth through the provision of financial services and resources to investors who are ready to invest in new products. The above argument of Schumpeter (1911) was later advanced as the McKinnon-Shaw hypothesis, which is a policy analysis tool for developing countries with a strong recommendation for high capital accumulation and decentralised financial intermediation (De Gregoria & Guidotti, 1995). The McKinnon-Shaw hypothesis explains that misallocation of resources, interest ceilings, poor investment and inefficiency are usually associated with the policy of financial repression that was prevalent in the 1960s and 1970s in the Less Developed Countries (LDCs).

Oni (2017) carried out a study on the determinants of venture capital supply in Sub-Saharan Africa from 2006 to 2015. The objective was to determine the variables that influence venture capital supply in eight Sub-Saharan African countries (Botswana, the Ivory Coast, Ghana, Kenya, Mauritius, Nigeria, South Africa and Uganda). By using Panel data models of pooled, fixed and random effects, the results showed that there is a significant positive relationship between initial public offering, market capitalisation and private equity supply.

3.3 Valuation Criteria in Private Equity and Venture Capital

The PE/VC investment process can be divided into the deal, origination, screening, evaluation, and structuring phases (Gompers, Gornall, Kaplan, & Strebulaev, 2020). The evaluation criteria of PE/VCs and their importance change throughout the investment process (Petty & Gruber, 2011), and include the personality and experience of the entrepreneur, product and business model characteristics, and market and financial characteristics (Franke, Gruber, Harhoff, & Henkel, 2006).

According to the finance literature (Brealey, Myers, & Allen, 2007), the valuation process of the firm is complex because of the diversity of factors that come into play. It goes far beyond pure financial considerations of balance sheets, income statements and the financial forecasts. For example, industry characteristics, such as intensity of rivalry, entry and exit barriers, and firm characteristics, such as its development stage and competitiveness, are qualitative rather than quantitative factors which significantly influence firm value. To gain insight into these factors for valuation purposes, we need to look to other theories than finance for directions. In particular, the entrepreneurship and strategic management literatures provide us with considerable insight on the antecedents of firm performance and how value is created in an entrepreneurial process (Wright & Robbie, 1998).

Further studies by Quindlen (2000) define that the valuing process for early-stage investments is a motion of art and science. GPs often use discounted cash flow, earnings multiple and net asset value to perform valuations in their investments decision (Ge, Mahoney, & Mahoney, 2005). The evolution of valuation methods should differ per each country, largely based on the level of maturity of each market (Manigart, De Waele, Wright, Robbie, Debrieres, Sapienza, & Beekman, 2000). Its critical to understand the various valuation techniques by PE/VC firms. When compared with stock market exchanges, it is also key to provide assessments of access to public information between developed nations and emerging markets (Diller & Kaserer, 2009).

Finance theory teaches that the value of a "firm should equal the discounted value of its expected future cash flows”. The value of a "firm should increase if investors learn that its future profitability will be higher” (Lerner & Schoar, 2004). Similarly, if they learn that the firm will be less risky than originally foreseen, i.e. its cost of capital declines, the valuation should rise.

Tyebjee and Bruno (1984) published initial studies about investments decision, as this concept is closely linked to the sound importance of the evaluation process in the PE/VC investments decision. Results provided for was the link between the entrepreneur and firm management team when reviewing new transactions. This yields to the advancement of the developed nations’ PE/VC market, as indicated by Wright and Robbie (1998).

However, further findings from the USA (Kakati, 2003) and European VC (Farag, Hommel, Witt, & Wright, 2004) indicate that the entrepreneur and management team are important in providing decision-making for the investments. This is supported by Van Deventer and Mlambo’s, 2009 paper for South Africa. Other features which contributed to the literature are that entrepreneurs, management background and experience are critically important during the evaluation rather than market and product features (Pintado, De Lema & Van Auken, 2007). Therefore, it seems that there are similar characteristics between developed nations and emerging market countries such South Africa and Nigeria (Van Deventer & Mlambo, 2009).

One of the problems for both venture capitalists and entrepreneurs lies in determining the economic value of an enterprise. This represents one of the more challenging discussions an entrepreneur can have with his investors (Quindlen, 2000). The situation is exacerbated by the fact that there is little guidance on the subject available in academic literature. Wright and Robbie (1998) conclude that “little work is available on valuation of venture capital investments”.

CHAPTER 4: METHODOLOGY

4.1 Introduction

The research methodology is focused on a conceptual development of private equity in SSA PE, covering aspects which provide detailed understanding of the developed nations' success in private equity as compared to South Africa and Nigeria. This was solely based by the fact that developed nations have had a long history of PE and the success which has contributed to their respective countries' economic benefits (Gilson, 2003).

In addressing the questions raised in sub-section 1.4 above, it was critical that the methodology described in Chapter 3 provides a clear and concise analysis for the reader. It was significant that I provide the reader with the valuation approach of GPs as this gives guidelines to PE/VC firms and the different stages of PE funding, as outlined in sub-section 3.3 above. However, throughout the analysis of the secondary data obtained, there were limitations which I have noted in sub-section 4.4 below.

4.2 Research Design

Dul and Hak (2008) describe a research design as an arrangement of conditions for the collection and analysis of data in a manner that aims to combine relevance with the research purpose. The SSA PE industry model has since the beginning of PE been based on the developed nations' model, but the differences have been in the lack of government policies which play a key catalytic role in order to drive PE in the rest of the SSA region. My research reports cover the following objectives such as:

- Growth of Venture Capital/Angel Funding;
- Investor Protection and Cooperate Governance;
- Regulatory and Information landscape; and
- Depth of Capital Markets.

The economic literature of the above objectives covers the key foundations of government policies which need to be unpacked in order to create a positive environment. Each of the above objectives are based on what will attract GPs into the SSA region (Banerjee, 2008).

Although the market of PE/VC deals is forever changing, the economic literature always indicates the requirement of governments to play a more active role (Cumming & MacIntosh, 2006). The developed nations' PE industry has largely been promoted by their respective governments in order to achieve its key objective. The USA has had a long history of PE/VC as compared to the European Union (EU) and/or Asian countries.

4.2.1 The Historic Approach

The ideology of PE/VC was created in the 1970s and was driven by the USA through the development of product innovation via investing in biotechnology and telecom (De Lima Ribeiro & Gledson de Carvalho, 2008), while the EU gave attention to PE/VC in the 1990s (Landström, 2007). Where the SSA PE/VC is relatively new, in the case of South Africa this can be seen as the leader in the PE/VC market of SSA, with a robust market compared to the rest of SSA. The government has created various policy amendments over the last decade (SAVCA, 2018). The rest of SSA is seen as the last frontier PE/VC market and this is largely driven by the question I cover in my research paper.

4.2.2 The Current Approach

The current market approach has changed after the key crises, such as the internet bubble and financial crisis in 2008, therefore GP and LP had to become agile to market conditions and changes for them to maintain the same attraction from institutional investors (Gilson, 2003). Governments also had to adjust policies in order to provide an optimistic business approach. The SSA has proved to be resilient after 2008, with good investment returns for GP and LPs in the market (Banerjee, 2008). This notion should further enhance the government position to focus on creating further market-friendly policies.

4.2.3 The Comparative Approach

The comparative approach is crucial as this provides an indication to South Africa and Nigeria on what is still required for the PE/VC government policies and the lessons learned from developed nations.

4.3 Private Equity Valuation Method

The valuations for PE firms are usually computed in one of three ways, which are illustrated in Figure 2 below:

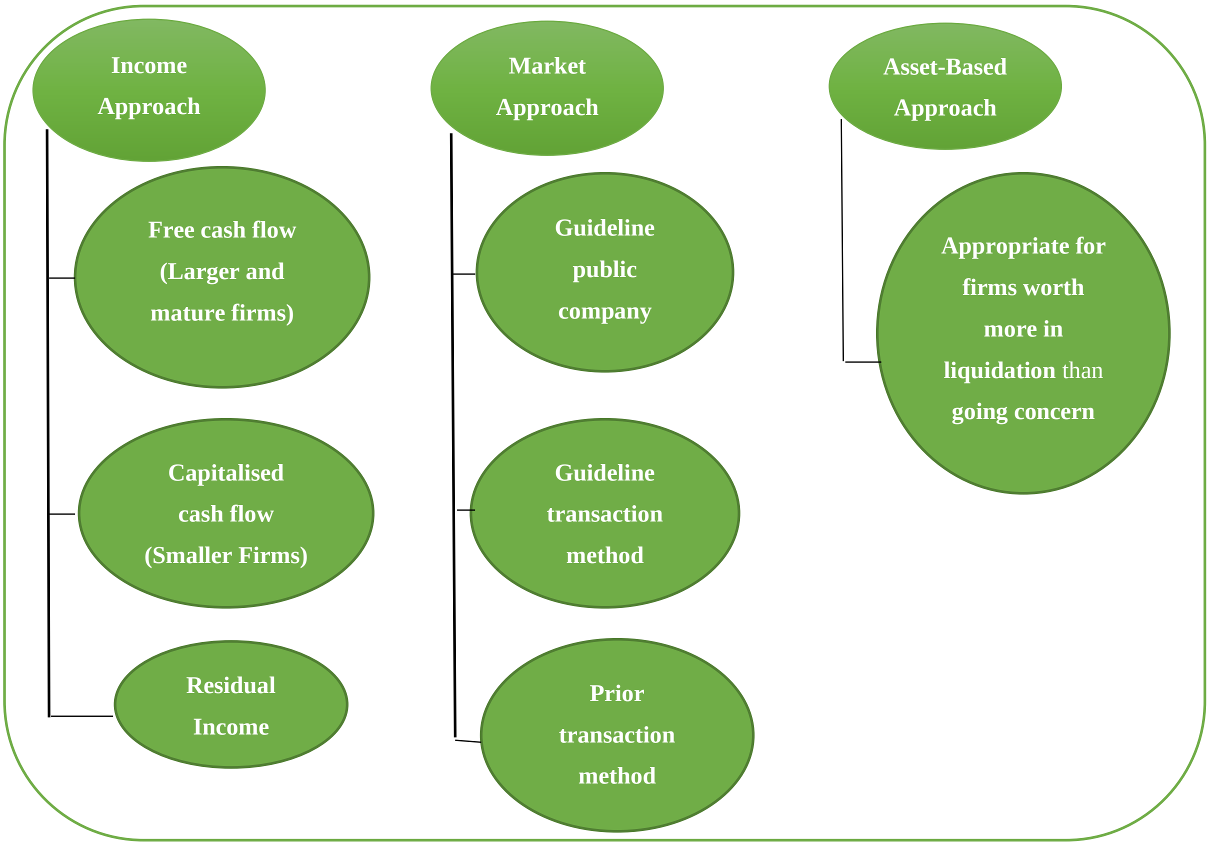

Figure 2: Private Equity Valuations Approach

Source: International PE and Venture Capital Valuation Guidelines (2015).

The above valuations method is primarily what many PE fund managers use when evaluating a potential firm for acquisition. This method is used as the benchmark but should not be relied on for its specific purpose and reference to the actual deal evaluation, since each valuation will depend on the life stage of the firm and the type of PE investments that it deserves (IPEV, 2015). The free cash flow for a firm is an important key indicator for any investment made on each transaction. Most investors are always looking to justify the investment made from their transaction.

The formula used by many fund managers to evaluate the value of the equity is as follows:

$$\boxed{V_f = \sum_{t=1}^{\infty} \frac{FCFF_t}{(WACC - gf)^t}}$$

Where:

V = Value of the firm,

FCFF= Free Cash Flow of Firm,

WACC = Weighted Average Cost of Capital,

gf = Long Term Debt growth, and

t = time/period.

Table 4 gives an indication of how each risk over a period of seven years has gone through various stages and time periods, from a fund manager's appetite.

Table 4: Private Equity Financing Stages

Financial Stage	**Period (funds locked in years)**	**Risk Perception**	**Activity to be financed**
First Stage	3 – 7	High	Start commercial production and marketing
Second Stage	3 – 5	Sufficiently high	Expand market and growing working capital need
Third Stage	3 – 7	Medium	Market expansion, acquisition and product development for profit making company
Fourth Stage	4 – 7	Low	Facilitating public issue

Source: IPEV (2015)

The PE financial stages give private companies and entrepreneurs an indication of what GPs are looking to invest their capital in.

4.4 Research Method Limitations

The private equity and venture capital industry is a closed industry, especially in Africa, where obtaining enough data and required information becomes difficult as the industry is still in its infancy stage. The constant reporting and analysis of Nigeria's private equity and venture market and in-depth analysis of fund managers across the region would have assisted greatly.

CHAPTER 5: FINDINGS AND RESULTS

5.1 Introduction

In answering the questions raised in sub-section 1.4 above, the review analysis in sub-section 5.3 below indicated the need for further research of PE/VC market in Sub-Saharan Africa. South Africa and Nigeria were used as case studies based on the economic size and elements provided for in sub-section 1.1 above. The methodology provided in Chapter 3 above supported my thesis paper in order to comprehend what has happened in the past decade in the PE/VC market of Sub-Saharan Africa and assisted in formulating the policy implications.

5.2 Secondary Data

The data used in this paper is obtained from various publicly available secondary sources:

- Southern African Private Equity and Venture Capital (SAVCA) research reports;
- Private Equity and Venture Capital, Nigeria (PEVCA) research reports;
- An overview of the African market through the Sub-Saharan Private Equity and Venture Capital Association (AVCA) and Emerging Markets PE Association (EMPEA);
- Statista Research;
- The Riscura Fundamental report provides quarterly updates about PE inflows and rate of returns which the PE firms have made into the specific sectors;
- The review of publications, including journals and relevant papers; and
- Other related information such as Preqin PE reports, the Boston Consulting Group and the Bain Global PE report.

5.3 Developed Nations' Key Determinants of Private Equity Market

Private equity in general, and venture capital in particular, is a form of finance usually provided by professional investors to young innovative companies, to which they also act as advisors or even managers, with the main goal of taking them to an initial public offering (IPO) or a trade sale (Popov & Roosenboom, 2009). The swift implementation of innovation by entrepreneurial firms in the developed nations has substantially contributed to the strong competitiveness and expanded economic growth (Bottazi & Da Rin, 2002). Developed nations, such as the USA, Japan, Germany and the UK, are characterised as having well-oiled private equity markets.

This is based on the high number of private equity transactions, assets under management, efficient institutional infrastructure and mature capital markets (Klonowski, 2013; Ojah, 2009).

We go further by underpinning the following key determinants of developed nations' private equity industries. These determinants either have a stronger impact on young and start-up corporations, while some of them affect established businesses, and others are valid for all corporations (Groh, Liechtenstein, & Lieser, 2015).

5.3.1 The Growth of Venture Capital/Angel Finance Funding in Developed Nations

The birth of venture capital in the developed nations was based on financing technology-based companies from the USA, where the financing mode of choice was largely driven by the product learning and innovation elements in the '80s and '90s (Bergermann & Hege, 1998). This trend was further supported by the UK, Japanese and German companies, notably growing their venture capital industries in the '90s through their policy agenda and tech-based innovation (similar to the USA) (Bottazi & Da Rin, 2002).

Through the early 2000s, the rapid increase in venture capital through the developed nations was evident, as funds raised in the developed nations increase from $25.3 billion in 2004 to $68 billion in 2018 (Statisa, 2018). Some of the well-known high-growth companies in the USA, including Federal Express, Oracle, Apple Computers and Intel, were initially financed with venture capital funding. This funding boom enticed other institutional funders, such as pension funds and insurance companies, to be drawn into the asset class and to recognise the importance of early bridge financing (Leeds & Sunderland, 2003).

Although the venture capital industry in the developed nations was a success largely on the back of research and development, patents and the human endowment (Schertler, 2003), Baughan and Neupert (2003) argue that the elements of bureaucracy in the form of excessive rules and procedural requirements which required approvals and numerous documents may burden new ventures and entrepreneurial action.

5.3.2 Depth of Capital Markets in Developed Nations

The aspect of the private equity cycle is stirred by the importance to plan a profitable exit successfully within a certain timeframe. In the developed nations, a well-functioning capital market provides the fundamental basis for the success of the entire private equity industry (Leeds & Sunderland, 2003). While Black and Gilson (1998) provide a difference around the bank-centred approach and stock market-centred approach, both are central in what permits an exit from a venture capital firm, through an IPO and the debt funding objectives from a bank. According to empirical research, exits achieved through IPOs tend to increase shareholder value, as compared to selling shares to strategic investors or management buy-out (MBO) structures (Leeds & Sunderland, 2003).

The cyclical nature of the capital market activity shows that returns on the venture might not necessarily be aligned to the IPO, purely on the basis that this could be traced by the fund internal rate of return (IRR) (Jeng & Wells, 2000). This narrative is also supported by Kaplan and Schoar (2005). Capital markets in developed nations have been criticised for high fees from their advisors, as the element of agency costs and underwriters becomes apparent (Chemla, 2005).

5.3.3 Regulatory and Information Landscape in Developed Nations

Regulatory institutions anywhere in the world are important in order to keep the rule of law in check, and the private equity landscape is no different. The main objective of any fund is to maximise returns, in order to ensure that taxation of profits in income or the capital nature of the fund and LPs are fully aligned (Wright, Gilligan, & Amess, 2009).

Many countries have various tax structures. In relation to the private equity market, we see that capital gains tax has been a major source of influence for the LPs’ decisions (Gompers & Lerner, 1998). In the majority of these countries, whether developed or developing, the structuring is based on what is the most tax-efficient structure that provides relief for when the LPs exit or the manner in which the funding was made available (Cullen & Gordon, 2002). Therefore, avoiding a double taxation and overall tax burden to the LPs and GPs becomes critical (Wright et al., 2009).

We also need to understand the relationship between the country’s tax rate and overall return on the investment. This is important due to the burdensome tax laws, which can deter investors (Watson & George, 2010). Therefore, a more flexible tax structure to reduce red tape will enhance an increase in LPs’ investments into the GPs.

5.3.4 Investor Protection and Corporate Governance in Developed Nations

Legal structures and the judicial systems are imperative in influencing investment inflow from investors (Groh et al., 2015). This will further strengthen the extent of the country's capital market and the ability for companies to increase their funding capability (La Porta et al., 1997). Therefore, the law statute is critical in recognising other elements such as (i) capital structure; (ii) dividend pay-out; and (iii) repurchasing of shares and protection of shareholders (Winton & Yerramilli, 2008).

Creating a legal system that allows for private equity investors to take advantage of capital markets, on the basis that an active and liquid secondary market is sustained for corporate control, becomes central (Ojah, 2009). An active capital market in developed nations has been a great advantage to many entrepreneurs as it allows for greater participation for mergers and acquisitions, banking, and public capital markets, which in turn provide a good view on deal-making activities (Groh et al., 2015).

The nature of corporate governance through the legal origin, information availability and accounting standards provides clear harmonisation around investor confidence and therefore builds greater participation from investors, business and other stakeholders (Cumming et al., 2006). Developed nations have been able to build efficient institutions which cater for corporate governance, and these institutions provide the basis for the rule of law and shareholders (majority and minority) to have rights. Therefore, developed countries are in a better position to enforce contracts, provide effective MBO and leveraged buy-out (LBO) funding structures (Glaeser et al., 2001; Ojah, 2009).

5.4 Factors Affecting the South African and Nigerian Venture Capital/Angel Funding Industry

Small and medium enterprises (SMEs) act as catalysts in the economic development of the developed and developing countries (Amissah & Gbandi, 2014). After years of disregard, the African private equity market has received lots of attention, mainly due to investors and fund managers looking to diversify outside of the developed markets, where the opportunity for higher returns has become attractive (Babarinde, 2012). This growth has been driven by the two leading giants of Africa, namely South Africa and Nigeria.

The elements of private equity and venture capital are relatively at their infancy stage when compared with their developed nations' counterparts. Although South Africa has had a longer history of private equity, Nigeria has increased its funding allocation in the private equity arena over the last decade, which has seen a massive drive in deal flow for the Private Equity and Venture Capital Association (PEVCA) (PEVCA, 2018). South Africa has recently launched a section 12J Venture Capital Companies (VCC) structure in terms of the Guidelines issued by the South African Revenue Service (SARS) (RSA, n.d.), which provide potential investors or companies with a concession of a tax rebate in order to increase activity in the venture capital industry (SAVCA, 2018).

Although we have seen progress regarding funds allocation, direct capital inflow, new regulation and increased deal flow in both markets, there is still major red tape in the way of allowing LPs to remain excited about the prospects of South African and Nigerian markets (Leeds & Sunderland, 2003). The comparison will be made with the developed nations to uncover the structure and special fitting features of the funding platform that is the right kind of private equity market for South Africa and Nigeria, which in turn will have an impact on the rest of the African market (Ojah, 2009).

5.4.1 Growth of Venture Capital/Angel Finance Funding in South Africa and Nigeria

Previous studies have questioned the effectiveness of adapting the USA VC model to other countries like South Africa and Nigeria (Lingelbach et al., 2008). The essence of venture capital funding indicates a fund available to entrepreneurial firms with attractive product concepts that are yet to attain significant acceptance by the wider consumer market (Ojah, 2009). In their findings, Lingelbach et al. (2008) indicate that the outdated simultaneity and VC models, proposed by Gilson (2003) and Gompers and Lerner (2000) respectively, do not reasonably explain VC development in emerging economies such as South Africa and Nigeria.

South Africa and Nigeria both have vibrant SME markets, where most of the informal sector still resides and acts as a conduit to the growth of employment and economic growth. These elements should contribute considerably to attracting venture capital funding in the short term (Callier, 1991). The notion that when the USA sneezes, the rest of the world catches a cold, also applies to South African and Nigerian markets, based on the African continent. Therefore, the creation of venture capitalists in Africa should allow for the economic roles to be based on markets where bridge funding is suitable to the entrepreneurs.

The essence of venture capital in South Africa and Nigeria should be characterised by the function of more risks and losses to maximum profits and not on a lender-model, which provides difficulty to entrepreneurs due to the conventional funding and terms required by commercial banks (Callier, 1991).

5.4.2 Depth of Capital Market in South Africa and Nigeria

The lack of capital market activity in the African market is a clear indication of weak activity in the venture capital-type private equity funding (Popiel, 1988). The notion that every aspect of the private equity cycle is driven by the importance to successfully exit a business over a certain period, becomes key in advancing the growth of capital markets in Africa (Leeds & Sunderland, 2003).

In Africa, IPOs are rare because of the relative under-development of the equity markets on the continent (Babarinde, 2012). Even in South Africa, which boasts the largest bourse in Africa in terms of market capitalisation when combined with the number of listed companies, IPOs are the exception. It is well-known that organised capital markets, such as stocks and public debt, are largely a recent feature among the African markets (Aryeetey & Nissanke, 2003).

Ojah's (2009) views are that a thin capital market activity (excluding South Africa) exists in Africa and, therefore, a vehicle for venture capital or where conventional financial intermediaries are prevalent should benefit entrepreneurs to ultimately receive managerial support and scalability opportunities from the fund managers. Megginson (2004) agrees that venture capital-backed funding will receive favourable market reaction when performing an IPO.

5.4.3 Regulatory and Information Landscape in South Africa and Nigeria

The regulatory and information environment is a major concern in many African business landscapes, and this is due to the lack of regulatory institutions which allow government officials to intervene in the local system of the private equity industry in Africa (Barbarinde, 2012). The South African system, through various institutions, has placed greater reliance on ensuring that the private equity industry requires strict balances in order to allow for the industry to provide exposure to fraud and money laundering prior to an acquisition (Portmann & Mlambo, 2013).

The element of accuracy and transparency of financial and operating information symmetry provided to investors becomes critical (Banerjee, 2008). This is also supported by Cumming and Johan (2006), who view regulatory harmonisation as a base to build a culture of institutions to work closely together in order to root out a form of corruption and provide clear laws which will increase investor confidence in the private equity market. As Africa's private equity market moves into a direction of high inflow of capital, further scrutiny will be undertaken by investors around the regulatory and available information.

5.4.4 Investor Protection and Governance in South Africa and Nigeria

Smith and Ueda (2006) base protection of investors as an element where the judicial system is represented by the courts in order to legitimately enforce mechanisms which support the investors. This objective should be able to demonstrate positive private equity activity (Silveira & Wright, 2006). Therefore, for many African countries (excluding South Africa), this base should be understood in order to lay the foundation for greater participation in the private equity market.

This narrative should be based on investor protection and corporate governance, which will support minority shareholders, creditors, the pace of new security issues, corporate ownership structures, and dividend policies to the LPs and fund managers (La Porta et al., 2000). However, the challenges that arise from such policies will afford shareholders the opportunity of altering their investment strategies or withdrawing from the countries. Therefore, for the private equity industry of Africa to attract more LPs and fund managers, the rules of the game must be in place.

5.5 Research Questions

5.5.1 What is South Africa and Nigeria's current most pervasive Private Equity model?

The current private equity structure to which both countries have prescribed has been structured as *en commandite* partnerships, meaning when parties agree to carry on the partnership in the name of one or some of the partners, while the partners whose names are not disclosed, with LPs either in Europe, USA, Asia-Pacific and Africa, are comfortable to invest (Adongo, 2012). When it comes to sector focus, most of the funding sectors were primarily driven by consumers, financials, industrials, education and infrastructure, and information technology. These sectors will continue to be part of any new GPs' investment strategy going forward.

The funds raised on the continent have been led by South Africa and Nigeria over the last decade, although South Africa's private equity market is the most developed market. This has yielded significant potential for other players in Africa, such as Nigeria, Egypt and Kenya, to take the lead in their respective regions. While we note that many LPs view Nigeria to be the most attractive private equity market in 2019, the African private equity market still faces similar underlying risks (AVCA, 2019).

During my observation of the current Sub-Saharan private equity model, it was clear that risks such as regulation, strong institutions, investor protection and corporate governance, are very important to institutional investors. The low levels of capital market and IPO activity are also of concern, as most GPs look to sell-out to other trade players and private equity firms.

Effectively, as the African market looks to create a new forward-looking approach around the private equity market, it becomes critical that support from the DFIs through their respective governments and universities is forthcoming in order to create products which cater for the African market, as private equity in Africa looks to extend itself in order to build financially sustainable businesses for the long term.

5.5.2 Are South African and Nigerian Private Equity fund managers, given their current investment strategies, achieving adequate returns for their LPs?

GPs in both South Africa and Nigeria have had successful exits during the last decade. This is evident in the high returns which they have gained when comparing it to their local stock markets. In the South African case, fund managers achieved 12.70% growth in private equity returns during the period of 10 years versus the 12.50% from the Johannesburg Stock Exchange (JSE). During the 5-year base, these levels for GPs achieved 10.20% versus the JSE return of 5.80% (SAVCA, 2018). In Nigeria, returns achieved during the last 5 years were based on budgeted targets by GPs. The GPs achieved slightly below their target of 22% versus 19%

(PEVCA, 2018). Both South Africa and Nigeria's internal rate of return (IRR) performance has contributed to the surge of LPs on the continent.

These growth performances have provided a basis to confirm that the current investment strategies which Africa's GPs have embarked on are still attractive to LPs across the world. In the Ernst and Young (E&Y) 2018 exit report (AVCA, 2018; E&Y, 2018), they mentioned that growth from private equity firms in Africa has outperformed their public markets. This performance was measured by the Morgan Stanley Capital International emerging investable market index (MSCI), and the results indicated that GPs' firms during the period of 2007 to 2017 increased their returns on a cross cash-in-cash-out by 70% (AVCA, 2018; E&Y, 2018).

Although we are fully aware that stock market development in Africa is a concern, we are also encouraged by growth yields in Africa's GPs and their investment strategies which they have embarked on.

5.5.3 Are SSA Governments providing Enabling Policies for the Promotion of PE?

The historical nature of private equity funding in Africa has always been achieved through government agencies such as DFIs, and this has been the key feature of enabling entrepreneurs and product innovators to access funding at ground-level basis (George & Prabhu, 2000). The notion still exists for DFIs to play an integral role in funding early-stage businesses for those firms to enter their respective markets and contribute to the larger economy (Yaron & Schreiner, 2001).

Governments diverted enormous amounts of capital through these institutions in the early years of private equity in Africa. The idea was that DFIs could make a significant contribution to the entire value chain of GPs, by enabling capital inflow from investors to fund the GPs and increase organisational effectiveness (George & Prabhu, 2000). Entrepreneurs anywhere in the world still face the daunting task of raising capital, more so in Africa, where private equity firms view early-stage funding as high risk (Bradley, Ritter, & Jordan, 2003).

The eco-system of DFIs through government policy is of a critical nature when promoting growth in Africa for private equity, as the nature of promoting investments, underwriting, board seats and technical assistance is what the early-stage firms require (Barger & Kuczynski, 1996).

The role of government policy is well-defined in legal systems and fiscal control mechanisms for funds and capital markets for the private equity industry (Barger & Kuczynski, 1996). Therefore, when African governments promulgate regulatory frameworks for the private equity market, these policies should be reviewed and understood based on tax incentives and exchange control which influence the decision-making of LPs.

5.5.4 If this current model is not the correct model, what other alternatives are there for South African and Nigerian GPs to consider?

What is evident is that the African private equity industry is immense in an underdeveloped eco-system. We can define an underdeveloped eco-system as a lack of supporting institutions, corporate governance, risks elements, asymmetric information and poor quality of accounting standards (Groh et al., 2015).

As mentioned previously, South Africa’s market is advanced as seen by assets under management, financial regulation and capital market activity, thus providing a more ample exit route for many private equity firms wishing to list on the public market, where the basis of growth for entrepreneurs and firms could be the best option. In the recent SAVCA publication of the venture capital industry report of 2018, the industry leaders have recognised the importance of venture capital and have gone further by introducing tax incentives for individuals and corporates to fund the route of a section 12J fund (RSA, n.d.; SAVCA, 2018). The tax incentive fund structure is to allow individuals and corporates to invest in section 12J funds in order to create a basis of growth for early-stage/angel funding businesses that look to obtain bridge funding and not to rely on expensive funding from banks where stringent requirements become a burden for these businesses (Ojah, 2009).

Nigeria also had a vibrant venture capital market during 2018; the country topped the Africa list by concluding 138 deals at a value of $535 million, followed by South Africa (107 deals at a value of $352 million) and Kenya (73 deals at a value of $217 million), indicating that the opportunity to drive economic development through venture capital is a key model to which the Africa market aspires (Phillips, 2019). The USA has the most developed venture capital market, and this yielded massive growth for its economy over the last 30 years (Gornall & Strebulaev, 2015).

What governments on the continent need to note is that venture capital funding has a great ripple effect, as it has the potential to drive economic development and improve research and development, promote invocation which ultimately creates a source of wealth creation (Phillips, 2019).

The results identified in sub-section 5.4 above are summarised as follows:

- The legal structures, such as *en commandite* partnerships, were identified as the right legal mechanism for PE/VC funding for institutional investors in Africa. However, supply factors risks were identified for corporate governance, regulation from government, IPO, low capital market activity, state institutions and investor protection.
- IRR in the PE/VC market of South Africa and Nigeria achieved adequate returns for GPs and LPs; this was benchmarked against the JSE and targeted IRR by fund managers.
- The eco-systems which contribute to the nature of PE/VC market in Africa become critical in fostering growth for entrepreneurs and allowing their products innovation to reach scalability to the consumer market.

CHAPTER 6: CONCLUSION

6.1 Conclusion of the Study

Studies have shown that venture capital and private equity influence employment dynamics, innovation, and productivity (Kortum & Lerner, 2000). The research questions were aimed at exploring alternative measures by revealing views where private equity and venture capital have aided African GPs and institutional investors. This was based on the following elements:

- LPs are confident that the GPs will execute their investment strategy.
- GPs' sector focus is aligned to the LPs' mandates.
- Securing LPs' investor protection, the right regulatory and legal framework are in place.
- The depth of the capital market can attract exit routes for investors.

What became apparent was the lack of venture capital funding throughout the continent compared to the rest of the world. PEVCA and SAVCA have only started reporting on venture capital activities where most funding has been based on high-tech businesses that have the possibility to grow, leaving a high equity gap between the different GPs on the continent, due to the nature of the investment size, with ±$20 million to $35 million being the typical investments on the continent. This is still relatively high for the region, where the ability to grow product innovation to the African consumer market becomes a huge opportunity in view of the growing middle class.

African GPs have recorded significant growth in funds raised over the last 6 years and this will most likely increase, while economic growth in the Sub-Saharan region is projected to increase more than any other region in the world economy (AVCA, 2018). This automatically gives the LPs a new frontier haven in which to invest. The concerns that require a further frontal focus is based on growing the markets in the rest of the Sub-Saharan region. South Africa and Nigeria have constantly led the pack and it is for that reason that I have chosen both these countries.

The results from the analysis of the data lead us to conclude that from the sampled exit transactions, trade sales and buy-outs were the most likely modes of exit for GPs which, based on the literature review, show that an active IPO market should be the certain basis of return on investment from many GPs. This in fact provides a basis for further development of many stock exchanges across the continent.

A major challenge for many GPs on the continent has been the lack of activity of institutional regulatory systems through financial development and capital market activity, through which growth in the private equity market will allow many entrepreneurs to build onto the eco-system which has a deep focus on the knowledge of attracting liquidity. This primarily might not be the issue for South Africa, but across the rest of the region this is a concern as the lack of sophisticated capital market development hinders the opportunities for entrepreneurs to grow their capital base in their region.

The study goes further to identify the private equity and venture capital models that will work for the Sub-Saharan region. In my analysis from my results, the model where product innovators are able to attract angel funding/bridge funding is a subset of venture capital, where entrepreneurs are not faced with high banking costs through the traditional funding and the GPs can play a vigorous role in the portfolio companies through value-add support systems. An element of bringing on board management consultants who can aid the business strategy of the entrepreneurs should be a key focus.

However, the African GPs' private equity and venture capital industry should learn critical lessons from their developed nations' counterparts in order to progress fund raising and capital funding to growth-linked strategies. In this case, these were the outcomes of these lessons:

- Investor Protection and Governance: Government policies will need to be at the forefront in providing instruments that aid investor attraction to the Sub-Saharan market, with the element of corporate governance being implemented through many firms.
- Depth of Capital Market: Financial regulation should be able to drive the mechanism of agreeing to policies that open the economy and capital markets in order to attract investors.
- Regulatory and Information Landscape: Accessibility to company information allows for flexible tax regimes and exchange controls.

Therefore, a hands-on-approach is essential in order to achieve an operational performance and new resurgence in how GPs on the continent view the next wave of growth in private equity and venture capital in the coming decade.

6.2 Suggestions for Future Research

Several issues were identified during this research which could be improved upon in future research. The following suggestions are made for further research:

- There is a need to further study the changing nature of the private equity and venture capital industry with respect to the allocation of funds between early-stage and later-stage deals. Given the importance of early-stage or start-up funding in enterprise development and economic growth, the observed shift in investment activities by venture capital funds towards late-stage deals in Sub-Saharan Africa is a cause for concern and warrants further investigation.
- The creation of further research in respect of product innovation from entrepreneurs receiving funding from venture capital firms that engage on the correct funding capital structure that addresses the Sub-Saharan regions, although this process would invariably be hampered by a lack of data since the industry kept relatively secret, therefore making it difficult to obtain information (Gompers & Lerner, 2001).

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