ECONOMIC EMPOWERMENT

An important deal driver

The 2014 KPMG *and Savca Venture Capital & Private Equity Industry Performance Survey* confirms a significant increase in the overall value, number of deals and average deal size of BEE transactions in the 2013 calendar year. And an economic impact study by the Southern African Venture Capital & Private Equity Association (Savca) and DBSA confirms that portfolio companies have improved BEE credentials and enhanced corporate governance structures.

"Private equity is an ideal enabler for economic empowerment because it provides a mechanism for the transfer of ownership," says Garth Willis, a partner at Capitalworks. "Deals are structured to enable management teams with limited capital to participate in the ownership of a business — and the same mechanisms can be applied to facilitate empowerment."

Trinitas Private Equity founder Andrew Hall says nowadays many BBBEE players have access to capital, which enables them to invest on the same terms with private equity funds, with no limitations and lock-ups. This assists in funds generating higher returns for their investors without the need for providing subsidies to funders.

Imbewu Capital Partners CE Gcina Zondi says it has become easier to source empowered capital for private equity deal-making. The challenge for private equity funds is to find suitable portfolio firms rather than empowered investors.

Large institutional investors are doing their part to speed up BBBEE and employment equity. Says Savca CEO Erika van der Merwe: "Big institutional investors such as the Public Investment Corp (PIC) make sure that the funds into which they invest adhere to the principles of responsible investing."

Employment equity remains top-of-mind among stakeholders in the sector. "There has been a notable improvement in representation of black professional staff in the industry," says Hall. Black staff members at private equity firms have increased from 20% in 2012 to 36% in 2013.

Says Zondi: "Employment equity is crucial to achieve transformation objectives, but we must approach transactions with an understanding of the limited pool of skills in sectors of the economy. Our approach is to work with management by, for example, assisting them to find appropriate black candidates to take the business forward."

Gcina Zondi
It's now easier to source empowered capital for private equity deal-making

Willis says a commercial balance must be struck between return and the need for empowerment. "Investors require a commercial return, management needs to be appropriately incentivised, BEE needs to be incorporated in a meaningful way and the seller wants a full price upon exit," he says.

It is easier to meet empowerment objectives in private equity rather than listed equity deals because the former rely on leverage as opposed to dividend flows for financing. "This allows for improved cash flows and a more sensible repayment of the financing arrangements," says Stephen Brown, a director at RMB Corvest. "The price-to-earnings ratios are generally lower in private equity deals too, making pay-off periods shorter than listed company deals."

It remains difficult to manage foreign investor expectations. Willis reflects on an acquisition of a mining services business from a Swiss shareholder who asserted that it was not necessary for the company to be empowered. "Soon after our acquisition we introduced a BEE shareholder, enabling the firm to broaden its customer base," he says.

Brown says foreign investors accommodate BBBEE in their private equity transactions by either allowing a 25,1% BEE shareholder or divesting of their SA ownership in favour of a principal/agency relationship.

Hall says private equity is "patient capital" that does not need to generate a return out of yield: "There is a greater emphasis on capital appreciation in the underlying portfolio companies — and any BBBEE capital structure must recognise that." ■

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