African PE: Not that attractive?

By Anna Lyudvig, Africa Global Funds

Out of 120 countries, covered by the 2015 **Venture Capital & Private Equity Country Attractiveness Index,** South Africa and Morocco score highest, coming in at 37th and 50th, whereas Chad, Angola and Burundi are among the least attractive investment destinations in the world.

In its sixth edition, the index from IESE Business School and EMLYON Business School, measures the attractiveness of countries for investors in the venture capital (VC) and private equity (PE) asset classes.

The index, which covers 31 African countries, addresses the first level of investors' concerns from a top-down perspective and evaluates countries with respect to socio-economic criteria for international VC and PE allocation.

The authors [Alexander Groh, Heinrich Liechtenstein, Karsten Lieser and Markus Biesinger] say: "We provide a composite measure that determines the attractiveness of 120 countries to receive capital allocations from investors in the VC and PE asset class."

The composite measure is based on six main criteria: economic activity, depth of the capital markets, taxation, investor protection and corporate governance, the human and social environment, and entrepreneurial culture and deal opportunities.

At the very top of the chart are the United States, the United Kingdom, Canada, Singapore and Japan. The first emerging market in the chart - Malaysia, scores 12th, followed by South Korea (19th) and Taiwan (24th). As mentioned above, South Africa ranks only 37th.

And what about Nigeria with its growing economy, rising incomes and young, expanding population? While investors seek to capitalise on the combination between expected growth and the large populations, the largest African country ranks 82nd out of 120 countries.

The authors note that corporate governance indicators (with the exception of South Africa) and investor protection still remain obstacles in emerging markets. "Further, perceived bribery and corruption levels are high, while innovations and corporate R&D remain relatively low," they say.

Nevertheless, the authors say that emerging VC and PE provide interesting opportunities to investors, adding that it is the discussed lack of balance of the key driving forces that renders emerging VC/PE allocation decisions challenging.

“Exceptional growth opportunities come at the cost of disadvantageous conditions with respect to investors’ protection, usually less liquid exit markets, lower innovation capacity and higher perceived bribery and corruption,” they say.

The authors of the study urge investors to enrich the information provided with their own expertise and knowledge about the key driving forces and market conditions in the individual countries to make allocation decisions.

“Although we are aware that the stage of development in many of the covered emerging markets is not yet sufficiently mature to support VC or PE transactions, we expect improvements in the future,” they say.

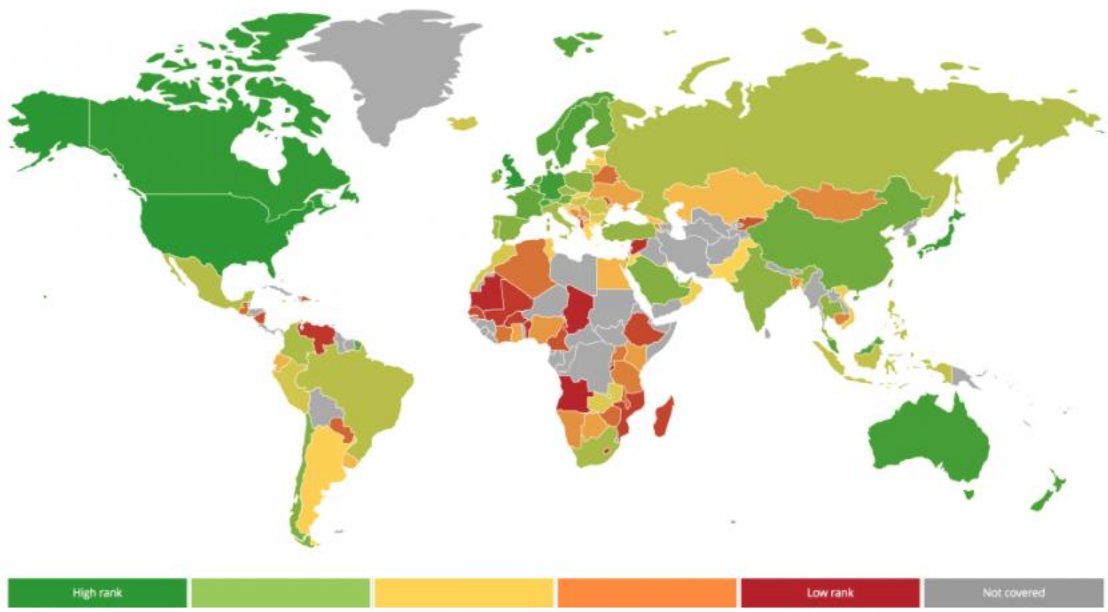
Overall, Africa appears largely red on the heat map. Zambia and Mauritius rank 52nd and 53rd, whereas Tunisia scores 68th, Egypt is on the 73rd place and Ghana ranks 78th. Interestingly enough, while East Africa is always on the investment radar, in the 2015 ranking, Kenya comes in at 80th, Tanzania at 90th and Rwanda at 100th.

Investors in VC and PE funds have a key objective - to get access to transactions with satisfying risk and return ratios. And Africa certainly has all the makings of a compelling investment case. Should investors be put off by such low rankings in Africa? Absolutely not. It seems there is a perception gap of Africa’s attractiveness. For those already investing in the region, Africa presents exciting opportunities, whereas those with no business presence in Africa raise concerns.

It also seems that for those already investing in the region, the top-down approach doesn’t really work. The industry experts agree that in Africa one should choose companies and not countries. With a proper due diligence, one can find hidden gems anywhere in the world, be it in Africa or elsewhere.

And when it comes to choosing the right companies, it is all about partnerships. The recent case studies by private equity houses Phatisa and Ethos Private Equity, both point to the importance of partnerships. Jos van Zyl, Partner at Ethos Private Equity, says that “partnerships in African private equity often define the difference between success and failure”. Phatisa’s co-founder Stuart Bradley agrees, adding that “private equity teams in Africa are very much about close and trusted partnerships.”

That said, the index could be a useful tool for assessing risk/reward profiles around the globe. But it would be even a better tool for regulators to help them set or revise policies in order to better attract VC/PE money down the road.



Heat map showing regional trends of private equity attractiveness. Graphic from The 2015 Venture Capital & Private Equity Country Attractiveness Index

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