# The economics of fundraising for Africa

*Private equity fund managers have their work cut in negotiating fund structures and terms that meet their investors' mandates – and that also make for viable and sustainable business models.*


J-P Fourie


Herc van Wyk


Lelo Rantloane

Established and new managers operating in a range of regions on the African continent, and who are galvanised by the growth and returns opportunity in their markets of expertise, have in recent years been promoting the private equity asset class to institutional investors – many of whom have declared their interest in initiating or expending their African allocations.

Though the region is still relatively new terrain for the private equity asset class, certainly compared with the long history of private equity in developed markets and even in some other emerging market regions, investors have a wide range of fund managers from whom to choose in order to fulfil their allocations.

"There are a number of institutional-quality private equity fund managers operating across the continent," says J-P Fourie, head of investor relations at Metier. "This is testament to the amount of capital that the industry has raised over many years, and to the returns track record of the asset class."

Even new fund managers, who have pulled together experienced team members to work towards raising a first fund, are attracting the attention of limited partners (LPs) who recognise that insisting on "institutional quality" does not necessarily rule out newcomers.

Herc van Wyk, CEO of Pembani Remgro Infrastructure Managers, says raising a first-time fund for Africa is particularly difficult, though, and that "there is often a higher level of natural initial scepticism from investors to overcome".

"It was especially difficult when one dealt with individuals [at LPs] who have never been to Africa before, and it introduced another level of information to be shared regarding perceived increased political, governance and currency risks. To us it helped significantly to involve shareholders such as Remgro and Phuthuma Nhleko, both with established track records in the region."

The Pembani Remgro Infrastructure Fund had its first close in May 2015.

Lelo Rantloane, CEO of Ata Capital, observes that it continues to be a challenging environment for first-time managers, who find it difficult to motivate how the individual track-records of the team members will make them a great team.

"We have found that, in the current environment, LPs are less likely to be swayed by a great idea and are more likely to be won over by a team that they trust based on track-record and skill."

Rantloane's advice is for new managers to consider focusing their energies on one or two anchor or seed investors – who often tend to be more entrepreneurial – and who would be comfortable with the approach of allowing the team to build a track-record ahead of raising third-party funds.

## Push-back on terms

Nicole Paige, a partner at Webber Wentzel, notes that LPs' requirements for first-time managers tends to be much more onerous than they are for more established managers – and has seen that there is a great deal of push-back on legal agreements and commercial terms from LPs. "In a context where it's all about being competitive relative to other fund managers, the new manager can't push back too hard and risk losing the investor, and it becomes a fine line of pleading one's case on what is feasible commercially, and of ensuring that funds are raised."

Van Wyk sees this as an opportunity, having, as he says, "come across a few large and active investors who actually state a preference for first-time managers, as they regard them as being more 'hungry for success', which creates scope for the LP to negotiate more preferable fund terms".

## Paying the bills

Paige's point about the commercial feasibility of a fund is one that managers weigh up carefully. The fund sizes targeted by the investor relations team are a factor of the fund focus and of the resources required to fulfil that mandate.

The fundamental economics are that the fund size should cater to a sufficient number of portfolio assets – around eight to twelve, typically – to ensure diversification," says John Bellew, head of private equity at Bowman Gilfillan. "The average deal size, in turn, depends on the segment in which the manager operates.

He elaborates on the criteria for optimum fund size: "Funds targeting large transactions obviously need more capital to achieve the required diversification, whilst funds focused on smaller transactions must raise enough capital to achieve diversification, but not so much as will result in there potentially being too many deals in the portfolio to manage properly."

Too big a fund may also result in the manager becoming less selective in the deals it chooses in order to invest the capital in the fund, he says.

Furthermore, management fees, typically 2% of the fund value, have to be sufficient to cover operational expenses – including salaries of investment professionals, administration staff and premises. "A manager running multiple offices in various countries may need a bigger fund to cover overheads," Bellew says.

## Competing interests

Paige says that, with the increasing numbers of managers raising capital for Africa-focused funds, there is a growing element of competition for managers – including those focused purely on Southern Africa. "Development finance institutions (DFIs), for instance, have a certain amount of capital to allocate per year. With some big names in the international industry moving their sights to Africa, and with new managers emerging, there is more competition."

Also, there are nuances in LPs' interest in African funds. Bellew says "international LP appetite and trends are driven partly by perceptions of yield: while some like the South African story, others are looking to take on broader African risk with the view that this will provide better results".

Van Wyk says his team found that "most investors would not make a distinction between Southern African funds and sub-Saharan African funds", treating them all as falling in the 'African' investment bucket.

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# Know your investor

*Development finance institutions (DFIs) traditionally have been firm supporters of private equity in Africa Commercial investors have in recent years started taking on exposure to the asset class in the region. How do these two classes of investor differ in their approach to fund managers?*

**Herc van Wyk,** Pembani Remgro Infrastructure Managers:

"In our experience it was very important to involve at least one anchor DFI at the outset. It firstly ensured that the fund terms are market-related – DFIs have much more experience and exposure in setting up funds in Africa, and hence a greater awareness of prevailing best practice – and it also provided a level of comfort to commercial investors that the Fund has been through a certain level of due diligence."

"We found the requirements of the DFI investors to be far more onerous and very detail orientated, not only with regards to ESG requirements, but also other commercial terms. It was, however, beneficial to the fund as several commercial investors took comfort that those areas would have been adequately addressed by the DFI investors."

**Lelo Rantloane,** Ata Capital:

"Different DFI's will have different mandates depending on their particular international and regional agendas and priorities at a particular point in time. In most cases DFI's will be required to strictly adhere to these priorities, which at times may be contrary to a GP's business case. Whilst commercial investors will be more flexible in terms of following certain investment themes at different times, DFIs will not have that luxury and may therefore seem inflexible. GPs should therefore understand the mandate of a DFI before pursuing them as an LP."

"Because DFIs generally have a greater agenda than just financial performance, they have historically been perceived to be more onerous in terms of reporting and compliance. However, this is increasingly true for commercial investors as well. Therefore, GPs should aim to hold themselves to the highest standards of reporting and compliance."