Game on: Private Equity Investment in Africa
A discussion with US private equity executives on some of the newest opportunities in emerging markets

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On September 23, 2013, PwC and the Foreign Policy Association co-hosted an evening panel of US private equity executives in New York City to explore the acceleration of investment in Africa. In a lively, interactive conversation about the pioneering efforts of private equity investment in Africa, the panelists sought to demystify several aspects of a continent that, despite a two-decade record of growth and economic resiliency, remains an enigma to many investors. The event attracted an audience of approximately 200 in PwC’s Madison Avenue Auditorium. The discussion was moderated by Harry G. Broadman, PwC’s Chief Economist and Leader of PwC’s Emerging Markets Management Consulting Practice.

**Panelists:**
- Sean Klimczak, Blackstone, Senior Managing Director
- David Marchick, The Carlyle Group, Managing Director
- Kola Olofinboba, Fairview Capital Partners, Partner
- Hurley Doddy, Emerging Capital Partners, Co-Chief Executive Officer

**Moderator:**
- Harry G. Broadman, PwC, Chief Economist; Leader, Emerging Markets Management Consulting Practice
Over the past several years, interest in Africa as a destination for investment has been growing at a steady clip. Private equity was the first to make serious inroads into this heterogeneous continent of 54 countries. More recently, multinational corporations and a variety of other investors have entered the fray.

The excitement over Africa is based on fundamental economic factors that have been edging upwards for more than a decade and a half. It’s a trend that too few investors and business leaders either know about or acknowledge. The continent has enjoyed a relatively uninterrupted record of robust growth—more than a 5 percent average annual increase in gross domestic product (GDP) for the past 20 years. This rising prosperity is the result of smart choices by African policymakers, as well as some hard-won reforms, both economic and political.

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Furthermore, increased inflows of foreign direct investment (FDI) have helped stimulate the rapid rise of African entrepreneurs whose new products and services are warmly embraced by an African middle class with improved purchasing power.

Africa has also demonstrated a new resilience to business cycles. Although sudden and deep economic crises can still derail growth, it’s clear that the continent is no longer lurching from economic crisis to economic crisis as it did in the last century. In fact, during the recent downturn, Africa proved more resilient than many other parts of the world, thanks to intelligent decisions by policymakers. While leaders in Russia, Turkey, China, and even countries in the most advanced economies responded to the crisis with price controls and protectionist measures, there were few such actions in Africa.

It is true that too many African countries are still trapped in the commodities business, but an increasing number of them have industries that are climbing the value chain, producing value-added products and services, and engaging in new forms of international trade. And the pace of change is much more rapid too, taking two or three years to engender a change of tastes, instead of five.

In a trend that stands the traditional product life cycle (PLC) model of multinational corporate strategy on its head, fundamental inventions are now originating in Africa. The PLC model, put forth by the late Ray Vernon of Harvard Business School, proposes that inventions originate in the most advanced countries, then enter middle-income countries as diffused innovations, and finally come to emerging markets as standardized commodities.

Mobile money is a great example of a reversed PLC model of innovation diffusion. Combining telephony and banking in a hand-held device was born out of necessity in Kenya. Today, you’d be hard-pressed to take a taxi in Nairobi (or in other cities in Africa) and pay in cash or use a credit card. It is all done through your smartphone. But is mobile money in use in the United States and the European Union yet? It is these kinds of opportunities that are sparking the interest of private equity investors in the African continent.

In short, this is not your grandfather’s Africa or even your father’s Africa. So when it comes to investing, game on!
Private equity firms are approaching investment in Africa from a variety of perspectives, with different goals and objectives. Some have established histories in the region, while others are relative newcomers.

For example, Blackstone, which entered Africa about a decade ago, invests primarily in the energy and power sector. It does not maintain region-specific funds, instead making investments from its global private equity and energy funds, which combined hold some $19 billion in capital. Blackstone’s investments in Africa, most of which have been made through Greenfield Development Projects, range from developing the Bujagali Hydroelectric Dam, a $900 million project in Uganda, to investing in Kosmos Energy in Ghana.

The Carlyle Group, on the other hand, invests through funds that are dedicated to a particular region or sector. Based in both Johannesburg and Lagos, they are investing mostly in medium- to large-sized companies that are growing as a result of rising demand from middle-class consumers.

There are a few fundamental ways for institutional investors to invest in Africa. They can invest directly in companies. They can select one or two funds investing in the region and invest in those directly. They can assemble a team internally to build a diversified portfolio from the ground up. Or they can use an intermediary firm that partners with organizations with ties to the region.
Fairview Capital Partners is entering the African market through a partnership with FMO, the Dutch Development Finance Institution (DFI), which has been investing in Africa since 1970 and in African private equity funds since the mid-1990s. Fairview takes a fund of funds and co-investment approach to investing in Africa, acting in essence as an arbitrager for other investors. A typical private equity fund invests directly in companies, helping to grow them to the point that their interest can be sold at a profitable return to the fund’s investors. When there are a large number of these funds, investors don’t always have the resources to do the due diligence needed to build a strong portfolio. That’s where firms like Fairview Capital Partners come in. Fairview invests in the infrastructure and teams needed to do this and, acting as a general partner, raises capital from investors and then serves as a limited partner in the individual funds.

Emerging Capital Partners (ECP) has launched a series of Africa-focused private equity funds that each typically invest directly in eight to twelve African companies that it then helps develop to a point where they can be profitably sold. Since launching the business in 2000, ECP has invested about $1.3 billion in over fifty companies in more than forty African countries. Notes Hurley Doddy, co-chief executive officer of ECP, “We see opportunity in a lot of different sectors in many different countries in Africa. As a result, we have invested in a broad range of sectors including diapers, bottled water, restaurants, cell phones, rubber, power and water, airlines, cable television, and tuna fish processing.”

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Why Africa? Why now?

Despite their strategic differences, private equity investors agree on what makes the African market attractive: a growing population, a burgeoning middle class, and improved governance and economic policies.

Africa was not as obvious a play in 2000 as it is today, according to Doddy. Nevertheless, many of the structural adjustments that have made investing there attractive were already under way in the 1990s, including managing the debt and even more important, reducing the role of government in the economy.

The demographics are also favourable. There are a billion Africans. The workforce is growing, unlike much of the rest of the world, where both the workforce and the population are shrinking. In fact, Africa will eventually have a bigger workforce than China.

Demographics are one important reason for Blackstone’s power and energy investments in Africa. There is and will continue to be a tremendous need for electrification, according to Senior Managing Director Sean Klimczak, who points out that the entire continent has the installed energy base of Spain, with twenty times as many people.

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The economic picture is also increasingly bright. Compared with countries like the United States, where long-run annual GDP growth has been in the range of 2-3 percent, the sub-Saharan Africa countries, where long-run annual GDP growth has been above 5 percent, look relatively attractive in terms of their ability to invest in large-scale power projects. As a result, Blackstone is focusing on transformative projects with good developers. Says Klimczak, “In Uganda we were able to double the amount of available power. At the same time, the country cut the cost of power by two-thirds and expects to almost double GDP growth.”

David Marchick, managing director at The Carlyle Group, points to an intangible test his firm uses to gauge the attractiveness of an emerging market: Some 15 years ago, many Chinese citizens wanted to come to the United States, go to the best business schools, and then work here. About ten years ago, those same high achievers became interested in returning to China. Over the past four or five years, the same thing has been happening with citizens of sub-Saharan African countries. Says Marchick, “For us, it’s a sign of confidence that the most talented people want to go back to the countries where they grew up because they see greater opportunity there. It’s a signal that Africa is probably a good place to invest.”

Those signals have not gone unheeded by the investment community at large. Demand for well-vetted investment opportunities is on the rise. Institutional investors are clamoring for access to private equity funds with assets in Africa, but don’t have the resources to make informed decisions about which funds are the best fit. For intermediaries like Fairview, this is probably the strongest indication that this is the time to go into Africa. Notes Kola Olofinboba, who heads up Fairview’s African Practice, “There is something happening—there’s a significant structural shift and we think it’s there to stay. And yet when you look at the amount of private equity capital that has actually come into the continent annually over the last ten years, it has grown a little bit but hasn’t really spiked. So we think the opportunity is still very early. And for people who get in now, the view through the windscreen is a lot brighter than what you see in the rear view mirror.”

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Centralization versus decentralization

Private equity firms entering new markets must decide the extent to which they will operate out of headquarters versus stationing personnel in the countries where they are making investments. Operating from a central headquarters is advantageous both because it is a less expensive way to enter a market and because it places decision-making closer to the technical expertise and resources that the firm has built up over time. On the other hand, placing “troops on the ground” helps firms conduct more effective due diligence and intelligence gathering.

Private equity firms vary in how they deal with the centralization/decentralization issue. While about 10 percent of Blackstone’s investors are in Africa, the firm has no investment professionals based on the continent. The firm’s professionals, who are stationed in the United States, Europe, and India, as well as other parts of Asia, are responsible for investment decisions globally. These executives log hundreds of thousands of miles each year as they vet different companies in Africa and elsewhere.

In contrast, about 70 percent of ECP’s African investment professionals are stationed in Africa, operating out of seven offices across the continent. These individuals work hand-in-hand with the companies ECP has invested in, learning their needs and helping them develop. Migrating personnel to Africa was a gradual process, notes ECP Co-CEO Doddy. They started out with most people based in Washington D.C, building the team and strengthening relationships. But over time, they found it was important to move people closer to the investment destinations.

This approach has made it easier for ECP to perform due diligence and manage its investments. Furthermore, because many of the companies that the firm is investing in are growth businesses that are looking to expand to other parts of Africa, having personnel stationed in various regions across the continent signals that ECP is prepared to support their expansion.

Carlyle has also chosen to station its investment personnel in Africa. In fact, according to Marchick, 100 percent of the people investing in the region are from the region and live there, including team members from South Africa, Zimbabwe, and Liberia.
Despite Africa’s significant opportunities, there are also considerable risks. Private equity firms manage these risks using a variety of strategies.

Fairview’s fund of funds approach allows the firm to build a portfolio of investments, creating diversification for its limited partners. This helps mitigate the idiosyncratic risk of investing in any single fund. What investors pay for is Fairview’s ability to pick the best managers in a particular market with the help of its sizable research team.

ECP also spreads risk through diversification, even within a single fund. Each fund will typically invest in ten or so different companies in different sectors, operating in different countries.

As with Fairview, ECP’s comprehensive due diligence makes it possible to select the companies in each sector that have the best potential to perform well.

Carlyle manages risk by sticking with what it knows. Says Managing Director Marchick, “We tend to focus on transactions where we can actually add value, where there’s some niche or some capability that allows us to help that business grow faster, expand internationally, strengthen governance, or improve financial management. In Africa we concentrate on sectors where we can help companies globally.”

The firm uses this approach in every region where it invests. As one of the larger investors in China, Carlyle has managed or invested in about 55 transactions totalling more than $4.5 billion; most of these are minority investments in growth-oriented companies. The firm plans to take the same approach in sub-Saharan Africa. An example might be a family-owned business that has grown to the point where it needs the financial management, operational management, and branding capabilities of a larger company. Large firms like Carlyle or Blackstone can bring to these capabilities to the table and help that company reach the next level.

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Co-investing

Not all private equity firms choose to go it alone, especially when entering a new market. Many of them opt for co-investment, a strategy that allows them to place larger bets without having to allocate too much of the fund’s capital to a single transaction. Says Carlyle’s David Marchick, “Co-investment is becoming a much more important part of all of our businesses—Blackstone, Carlyle, every private equity firm.” He points to two main types of co-investment. The first is a private equity fund’s investors, who are limited partners in the fund. These investors are pension funds, high net-worth individuals, and foundations. According to Marchick, there is increasing demand from these investors to co-invest alongside their general partners, so it is important for private equity funds to provide these kinds of opportunities.

The other type of co-investment Marchick describes is done with a competitor firm. For example, Carlyle has partnered with Blackstone on a number of transactions in the United States and around the world. This is an important strategy when the other firm offers complementary capabilities that can benefit the transaction. Marchick notes that it is especially important to find a partner with a similar investing philosophy or one with similar objectives for a particular project.

Blackstone’s Klimczak points to two other types of co-investors. One is strategic partners. For example, when Blackstone invested in The Weather Channel, it partnered with NBC because of its valuable knowledge of the industry. For Blackstone’s energy investments in Africa, having a strategic energy partner is equally critical.

Finally, in a region like Africa, identifying a local partner can be critical. Blackstone tries to partner with local institutions and successful entrepreneurs in the countries where it is investing. For example, in Uganda, the firm partnered with The Aga Khan, who has a stellar track record and reputation. Establishing local partnerships, especially in the absence of significant resources on the ground, is the best way to ensure that the firm truly understands the lay of the land in a particular market.

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Figure 1: Structure of financial sponsor with equity co-investment in a portfolio company

- **Private Equity Firm** (General Partner)
- **Limited Partners (Investors)**
  (public pension funds, corporate pension funds, insurance companies, high net-worth individuals, family offices, endowments, foundations, fund-of-funds, sovereign wealth funds, etc.)
- **Private Equity Fund** (Limited Partnership)

Ownership of the Fund

Investment

The Fund’s ownership of the portfolio investments

Source: PwC analysis
Multilateral development banks (MDBs) are large financial institutions that provide funding for national development projects. They are staffed with financial professionals from a number of countries, both developed donor nations and developing borrowing nations. MDBs offer professional advice as well as financing in the form of long-term loans, credits (below-market-rate loans), and grants. The best-known MDB is the World Bank. Other MDBs include the European Investment Bank and the African Investment Bank.

Development Finance Institutions (DFIs) are alternative financial institutions that provide funding for private sector investments in developing countries. They receive backing from nations with developed economies. DFIs include both government development banks and non-governmental micro-finance organizations.

According to ECP’s Doddy, MDBs are big players in Africa, particularly because in some more evolved markets, such as Brazil and China, their role has decreased. Their investing and lending activities have proved critical in launching the industry and in supporting projects at earlier stages in order to pave the way for prospective corporate investors. But MDBs alone cannot address the needs of African economies. In the long run, private capital will be the linchpin to their development.

Blackstone’s Klimczak points to the critical role of both MDBs and DFIs in Africa, especially on the infrastructure side. The involvement of the World Bank’s International Finance Corporation, the African Development Bank, or DFIs like Germany’s KFW lends a perceived insurance value to western investors. MDBs also provide exclusive political risk insurance in the countries where they invest, which helps lower their cost of capital. For example, the World Bank’s Multilateral Investment Guarantee Agency, which has issued more than 500 insurance policies, has seen less than a 1 percent default ratio.

Fairview’s Olofinboba credits the DFIs with spotting opportunity in Africa early on. “They were there when commercial investors were wary of investing in the market. They certainly had motivations to invest, but they have now proven the case that investors, including private equity, can be successful in Africa. And now you see commercial investors coming back in greater strength.”

—Kola Olofinboba, Fairview Capital Partners
The role of non-traditional investors

Around the world, people are beginning to see Africa as a market with healthy prospects for growth. As a result, over the last decade and a half a number of non-traditional investors, including Chinese and Indian companies, have entered Africa. This trend has important implications for private equity.

One consequence is that private equity firms have a wider group of candidates to sell portfolio companies to, once they have built them up. At the beginning of the century almost all investment and development was being financed by Europeans. Now, Indian companies have become big players.

As ECP’s Doddy explains, Indian companies tend to be comfortable with the income level that exists in many African countries. Drawing on their own success, they are looking to expand in a number of industries. The same holds true of many capital-rich Middle Eastern-based companies, which are especially comfortable expanding in North Africa.

In China, by contrast, investment tends to be more government-to-government. The Chinese are not yet as likely as the Indians to buy and take control of an African company. But Doddy believes this will probably begin to change.

African companies themselves, as they become more successful, are pursuing expansion in other regions. Some South African businesses are seeking opportunities in the north, while Moroccan enterprises are casting their sights south. Doddy expects that in the next 10 years a broad range of African companies will begin expanding into other markets on the continent.
Whenever investment occurs in an emerging market, a whole host of public and social benefits can accrue. While providing social benefits is not generally the primary motivator for private equity investing, to the extent that this improves the overall economic climate, everybody wins. According to Blackstone’s Klimczak, the potential for social benefits is not really a factor in the firm’s investing decisions. Nevertheless, he adds, “The thing we do look at particularly closely when we’re investing in Africa is whether this is the lowest-cost, best option for the country. It’s one of the most effective forms of protection out there. If you’re a hydroelectric dam in Uganda, you definitely want that to be the lowest-cost option for the country.”

The story is somewhat different in the case of Fairview, which partners with a DFI. For DFIs, the environmental, social, and governance issues are huge, notes Olofinboba. DFIs have led the development of best practices in the African companies they have invested in. Fairview takes the same approach. Helping these companies in this way is not the same as offering aid. On the contrary, says Olofinboba, “If you are going to invest, and you want to generate returns for your investors, you want to do whatever you can to make those investments sustainable. We believe that in the process, we’ll also benefit the environment we’re investing in.”

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Carlyle addresses the issue by including a rigorous evaluation of economic, social, and governance factors in its due diligence process for investments in Africa. According to Managing Director Marchick, the firm’s investment criteria have so far been fairly consistent with many of the development goals of both the leaders in the region and those of multilateral institutions. For example, the firm’s first investment target was a distribution company in the agribusiness sector. Focused on regional integration in East Africa, the company brings products from small farmers to the market, creating greater efficiencies. This business model accords well with Carlyle’s emphasis on investments to promote the strength of the middle class, upward mobility, and regional integration.

ECP’s Doddy believes that private equity firms have a good reputation in Africa because they are fundamentally growth investors there. They are focusing on helping good companies that want to get bigger and better, provide services, and fill in some of the many gaps in Africa.
Conclusion

While the private equity community has not always been ahead of corporate investors, it is clearly playing a leading role in emerging markets, particularly in Africa. If private equity investors prove successful there, they may promote even greater investment and economic growth in a region where profits can accrue not just to investors but to local businesses and the people whose livelihoods depend on them.

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