Private Equity & Venture Capital in Africa
Covid-19 Response Report

In collaboration with
African Private Equity and Venture Capital Association
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Foreword

Over the past decade some of the world’s fastest-growing economies have emerged from Africa. By 2030 the continent will be home to nearly 1.7bn people and, according to the Brookings Institute, have combined business and consumer spending of $6.7trn. This economic potential has made Africa an attractive option for investors seeking high-growth businesses with long-term impact. As such, private equity (PE) and venture capital (VC) have emerged as important vehicles for directing capital into these businesses, stimulating economic growth and capacity building across the continent.

African PE- and VC-backed companies have demonstrated their ability to provide catalytic solutions to the world’s most pressing development challenges. They are among the most innovative and pioneering firms in the world, and increasingly attract international and local investment, which further enables their growth. As a result of Covid-19, 2020 has been defined by seismic socio-economic shifts that have prompted companies to decisively act on how they will emerge from the crisis. Despite these headwinds, many African PE- and VC-backed companies, especially businesses in essential sectors, are likely to emerge from this pandemic more resilient and productive. This is because these businesses provide solutions to the pressing needs of African consumers and have models designed to survive crises, while also solving structural problems.

At a time of global uncertainty and concerns over public health and safety, institutional investors and fund managers have provided support and additional liquidity to investee companies to enable ongoing operations and trade, as a result, protecting jobs and livelihoods. For some, this is a time of difficulty. For others, this is a time of vast opportunity, but for all, it is a time of change and transformation. In this report OBG, in collaboration with the African Private Equity and Venture Capital Association (AVCA), will highlight the investment opportunities that have emerged in essential sectors and showcase how Africa’s PE and VC industry have risen to the challenge of supporting economies and companies through the pandemic.

'Tokunboh Ishmael, Chair, AVCA Board
Part 1: PE & VC in Africa

**Background**

Africa’s private equity (PE) industry was initiated by development finance institutions (DFIs) that had a mandate to invest in private sector businesses in developing countries with the aim of driving economic growth, creating jobs and promoting business-friendly ecosystems. While DFIs primarily granted loans for government-initiated projects, in the 1990s the institutions began to extend equity capital to private, unlisted companies with the aim of enabling such firms to access financing and grow. Soon after, the first Africa-focused PE firms emerged. By 1997, $1bn had been raised by 12 PE funds investing primarily in South Africa, but also in markets such as Botswana, Côte d’Ivoire, Ghana, Kenya, Mauritius, Zambia and Zimbabwe. The 2000s attracted further interest from investors to the continent due to a commodity boom and record economic expansion in some of its economies, as well as the promise of future returns from a rapidly expanding middle class. By comparison, as of mid-2020, there are more than 150 active fund managers with diverse strategies across sectors, geographies and ticket sizes.

DFIs – with extensive experience in the region and long-standing relationships – continue to play a key role in PE on the continent by raising awareness of the importance of private sector development and investment-facilitation frameworks. Key DFIs include the European Investment Bank, the African Development Bank, the UK’s CDC Group, France’s Proparco, Dutch development bank FMO and the World Bank’s International Finance Corporation (IFC), among others. These institutions are among the largest investors in Africa-focused PE funds. Between 2014 and 2019 the continent raised $18.7bn in PE, peaking in 2015 at $4.5bn due to first-time contributions from several US and European institutional investors such as insurers, public pension funds and endowments. The subsequent years saw falling commodity prices and currency volatility, which dampened prospects in some of Africa’s largest economies. As a result, PE fundraising fell to $2.4bn in 2017 and $2.7bn in 2018. However, this figure rose to $3.8bn in 2019 on the back of recovering oil prices and increased agricultural exports.

**Graph source:** AVCA 2019 Annual African PE Data Tracker & 2020 H1 African PE Data Tracker

$19.2bn in African PE fundraising took place between 2014 and H1 2020

$139m was the median size of final closed funds in Africa in 2014-19

**Total value of African PE fundraising*, 2014-20 ($ bn)**

![Graph showing total value of African PE fundraising](chart.png)

- Interim closes
- 0.6

*year of final close
Part 1: PE & VC in Africa

Pipeline of PE Deals

The African PE industry has become increasingly complex and diverse, with the arrival of global institutional investors in recent years paving the way for some of the world's largest firms to enter the market. Between 2014 and 2019 the total value of the 1053 PE deals reported in Africa reached $25.4bn. While deal volumes have maintained an upward trend, their value has gradually eased, suggesting growing investor interest but smaller deal sizes.

Moreover, in addition to consumer-driven industries, PE fund managers have diversified their strategies to invest across a variety of sectors such as IT, renewable energy, infrastructure and real estate.

The continent's growing consumer class played a crucial role in driving much of this change, as did government efforts to move beyond commodity-based growth. This encouraged greater private sector participation and fostered expansion in a wide range of industries.

Breakdown of African PE deals by sector, 2014-19

<table>
<thead>
<tr>
<th>Sector</th>
<th>% by volume</th>
<th>% by value</th>
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<tbody>
<tr>
<td>Consumer discretionary</td>
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<tr>
<td>Consumer staples</td>
<td>14</td>
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<tr>
<td>Industrials</td>
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<td>8</td>
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<tr>
<td>Financials</td>
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<tr>
<td>IT</td>
<td>10</td>
<td>3</td>
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<tr>
<td>Real estate</td>
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<tr>
<td>Health care</td>
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<td>Utilities</td>
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<td>Communication services</td>
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<td>Materials</td>
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<tr>
<td>Energy</td>
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<td>12</td>
</tr>
</tbody>
</table>
Part 1: PE & VC in Africa

Shifting Landscapes

There has also been a marked shift in PE destinations. While most early activity occurred in Southern Africa, West Africa has become an attractive destination for investment. Southern Africa attracted the largest share of deals by volume between 2014 and 2019, at 26%, whereas multi-region deals accounted for the greatest share in value terms, at 38%. Central Africa accounted for the lowest volume and value of activity, at 3% and 2%, respectively.

According to the “African Private Equity Industry Survey” published in March 2020 by the African Private Equity and Venture Capital Association (AVCA), 88% of limited partners (LPs) that participated in the survey pointed to West Africa as the most attractive region for investment over the next three years. Meanwhile, 89% of general partners (GPs) identified East Africa and Kenya in particular as holding the most potential for investment over the same period. The extent to which the Covid-19 pandemic will alter these outlooks remains to be seen.
Part 1: PE & VC in Africa

Activity by Region

WEST AFRICA: Home to Ghana and Côte d’Ivoire – two of the world’s fastest-growing economies – West Africa is one of the top regions for PE investment on the continent. Between 2014 and 2019, 274 deals with a combined value of $10.2bn were executed. Although powerhouse Nigeria has grappled with economic uncertainty and currency fluctuations, it attracted the highest number of deals both in terms of value (68%) and volume (55%). This is partly attributable to the fact that it is home to Africa’s largest population and consumer class, at 200.9m people in 2019, according to the World Bank.

Ghana came in second place, with 22% of deals by value and 20% by volume. The country owes this ranking to its attractiveness as a business-friendly destination and the key reforms carried out by the government to diversify and restructure its economy, such as the financial clean-up that has been under way since 2017.

Breakdown of PE deals in West Africa, 2014-19

<table>
<thead>
<tr>
<th>Country</th>
<th>% by volume</th>
<th>% by value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cape Verde</td>
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<td>Côte d’Ivoire</td>
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<td>Ivory Coast</td>
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Viewpoint

Edoh Kossi Aménounvé, CEO, Bourse Régionale des Valeurs Mobilières

African economies are typically debt economies seeking to transition to the US model, in which the private sector provides financing over the long term through capital markets. Africa cannot leapfrog to this point without undertaking a transition phase, and PE is the vehicle that will facilitate such an evolution. If PE is well structured, it can be a formidable instrument – not just for the African private sector, but especially for the transition from a debt economy to a stable economy.

Stock exchanges across the continent understand the importance of PE in catalysing this transformation and are looking to partner with PE to facilitate exits. For example, in Côte d’Ivoire ECP Private Equity partially exited its investment in the pan-African banking group Oragroup through a public offering on the BRVM in 2019.

The Covid-19 crisis has revealed the importance of certain sectors for PE, such as health care, education and IT. Historically, PE financed the industrial sector, logistics, telecoms and others, but now pharmaceuticals, pharmacies, high schools and tech start-ups are front of mind for PE investors in Africa. Mass-market retail has also benefitted from changing consumer habits. Some supermarkets have doubled their revenue while also improving profitability over the crisis period. Funds targeting these sectors have benefitted from their success.

However, on the whole, the PE environment was greatly challenges by the pandemic, which has had a measurable impact on investor sentiment. International investors are now more prudent and are closely following the economic evaluation of emerging markets. But in spite of the crisis, the ensuing turbulence and the challenges faced in 2020, Africa has a promising future in the medium to long term. The growth margins available are compelling, and the continent must continue to develop to meet its sizeable infrastructure deficit and expand upon its robust pool of human resources. Access to financing will be the deciding factor in how quickly this occurs. Ultimately, investors with patience will be most rewarded by their investments in Africa.
Activity by Region

NORTH AFRICA: North Africa attracted 183 PE deals between 2014 and 2019, collectively valued at $3.6bn, with Egypt accounting for the largest share by volume and share, followed by Morocco and Tunisia. Despite the political instability that has characterised some North African economies since 2011, Egypt has maintained its reputation as an attractive regional PE centre, signing 47% of deals by volume and 42% by value. The country, which has the largest consumer market in MENA, initiated a number of projects and reforms in recent years aimed at boosting its competitiveness, such as the 2017 New Investment Law and the directive granting the General Authority for Investment and Free Zones the power to act as the single issuer of all licences to investors.

Breakdown of PE deals in North Africa, 2014-19

<table>
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<tr>
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SOUTHERN AFRICA: Southern Africa saw 311 deals concluded between 2014 and 2019, for a total value of $3.8bn. Despite South Africa experiencing a contracting economy since 2013, the country has remained the most attractive in the region for PE investment, capturing 65% of deals by volume and 58% by value since that year. This was supported by a number of government initiatives to build investor confidence in 2019, such as the second South Africa Investment Conference, which attracted R365bn from a wide variety of companies.

Breakdown of PE deals in Southern Africa, 2014-19

<table>
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<tr>
<td>South Africa</td>
<td>65</td>
<td>58</td>
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</tbody>
</table>
Part 1: PE & VC in Africa

Activity by Region

Breakdown of PE deals in East Africa, 2014-19

- % by volume
- % by value

<table>
<thead>
<tr>
<th>Country</th>
<th>% by Volume</th>
<th>% by Value</th>
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<tbody>
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<td>Uganda</td>
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<td>Tanzania</td>
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<td>Ethiopia</td>
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<tr>
<td>Djibouti</td>
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</tr>
</tbody>
</table>

EAST AFRICA: Kenya was by far the most popular PE destination in East Africa between 2014 and 2019, comprising 56% of deals by volume and 54% by value. The country owes its competitiveness to a number of factors, including its macroeconomic stability, its openness to business, and the rollout of key projects and reforms under its Big Five agenda and Vision 2030. In total, East Africa attracted $2.4bn through 184 PE deals over the period.

Case Study

GenAfrica Asset Managers, established in 1996 in Nairobi, is an asset management company providing investment management services to Kenyan institutional investors. In 2013 Centum Capital Partners, a subsidiary of Centum Investment Company and a PE fund manager, invested $10m in the company, acquiring a 73.4% stake. After the acquisition, Centum worked with GenAfrica to implement a number of revenue-enhancement measures, efficiency improvements and risk-reduction strategies. These included developing higher-margin, long-term alternative assets including income draw-down funds, real estate funds and wealth management products. GenAfrica also expanded into Uganda and rebranded to reflect the new pan-African focus. These measures, along with the rollout of a new portfolio management platform, resulted in a 47% increase in revenue from $3.4m as of 2015 to $5m by 2017. Assets under management grew from $1bn in 2013 to $2bn by 2018. Centum exited the investment in 2018 after a holding period of 53 months through a $26.7m sale to US-based investment management firm Kuramo Capital. This resulted in a gross US-dollar internal rate of return (IRR) of 19.28%, the exit multiple representing 1.9x on initial cost. Fred Murimi, managing partner at Centum Capital Partners, told OBG, “Our investment strategy, which is built on our strong on-the-ground presence in East Africa, gives us early access to a large pipeline of deals, the ability to rapidly aid portfolio company management, and the ability to minimise risks associated with local regulatory, legal and tax challenges.” Such deals and our ability to access them, grow value and exit successfully has seen our Centum PE Fund 1 achieve a gross US-dollar IRR of 21% between 2009 and 2019.
Part 1: PE & VC in Africa

Investing in African PE

Since the turn of the century, Africa has boasted promising prospects for investors looking to capitalise on the continent’s attractive growth opportunities, expanding consumer class, thriving companies and improving business environment. The evolution in African PE activity has been reflective of these changes, notably with the arrival of global institutional investors and the development of Africa-focused funds, especially since 2010.

Even so, there remains room for growth. PE activity in Africa has to date been primarily focused on growth capital, meaning funds are channelled into activities linked to business expansion. According to the “African Private Equity Industry Survey” published in March 2020 by AVCA, growth capital was identified as the main strategy of interest for LPs (85%) investing in Africa over the next three years, followed by direct investing (52%) and venture capital (VC) (42%).

This can be explained by a number of factors. First, while many African countries made significant strides in overhauling business and investment frameworks, the risk factor associated with political uncertainty and currency volatility has traditionally diverted most PE investors’ attention towards safer deals with the view of maximising returns. Second, the limited number of large companies relative to other regions has meant that PE firms invest mostly in small and medium-sized enterprises (SMEs). As result, the value of most PE investments remains below $50m.

Taken together, these dynamics have served to increase competition and push up entry valuations. According to the GPs surveyed by AVCA, entry valuations increased in the three to five years leading to 2019 and are expected to continue rising through 2024.

Case Study

Continental Reinsurance (Continental-Re) is an African private reinsurer with operations focused on high-growth markets. In 2016 Africa Capital Alliance (ACA) acquired a significant stake in the company through the Capital Alliance Private Equity IV (CAPE IV) fund, a $567m fund focused on growth sectors in West Africa and the Gulf of Guinea. CAPE IV partnered with SAHAM Finances (now Sanlam) to procure a majority interest in Continental-Re. Post-acquisition, CAPE IV and Sanlam further capitalised the company, with CAPE IV investing a total of around $54m as of November 2020. CAPE IV and Sanlam jointly own approximately 95% of Continental-Re.

ACA and Sanlam, in collaboration with Continental-Re, implemented a strategy to diversify the company’s operations and reduce its reliance on anglophone West Africa. Expansions into francophone West and Central Africa, East Africa and Southern Africa have helped to mitigate the firm’s exposure to macro and currency risks. During this period, Continental-Re’s underwriting business profits saw a compound annual growth rate of approximately 75%. In 2020, when yields on fixed-income securities were low, its underwriting business in Africa saw positive results, thereby mitigating the pressures of a low-investment-yield environment. ACA and Sanlam also worked with Continental-Re to conduct stress tests and optimise costs in order to minimise the impact of Covid-19. The company is also leveraging the opportunities created by the pandemic to grow several segments of its business.

ACA has worked with Continental-Re to execute a multi-year strategy to raise the business’ credit rating from “B-” to “A” by delisting from the local stock exchange, upgrading its enterprise resource management system, and setting up and capitalising a new holding company in Mauritius. “The African reinsurance market, excluding South Africa, is valued at $4.5bn, and there are great opportunities for growth for a regional player like Continental-Re,” Steve Iwenjora, partner at ACA, told OBG.
Part 1: PE & VC in Africa

Investing in African PE

As the PE industry in Africa expands, and economies in the region pursue growth and diversification agendas, new opportunities and greater awareness are expected to arise. This will drive investor interest towards previously untapped sectors and industries that respond more directly to the needs and specificities of the market.

The on-the-ground presence of more PE funds and an expanding pool of skilled African executives have facilitated the identification of such deals. This evolution is reflected in the “African Private Equity Industry Survey” published in March 2020 by AVCA, in which 30% of respondent LPs identified the limited number of established GPs as a barrier to investment, compared to 42% in AVCA’s 2018 survey.

However, there is still work to be done to close the information and data gap on investment opportunities and deal track records, which remain determining factors for LP evaluation of African GPs. Industry growth in the years to come should help address this issue, as well as encourage investors to take up more majority stakes instead of limiting their participation to minority stakes in an effort to manage risk.

Expansion is also expected to diversify divestment options, which at present are mostly limited to sales to trade buyers and exits to PE firms and other financial investors. However, recent years have witnessed an intensifying trend of management buyouts or private sales. According to AVCA findings, GPs expect this to continue through 2022-24.

Evolution of exits & exit routes, 2014-19

Graph source: AVCA 2019 Annual African PE Data Tracker & 2020 H1 African PE Data Tracker
The promise seen in such start-ups has provided fertile ground for the development and expansion of VC. According to AVCA’s June 2020 “Venture Capital in Africa” report, 613 deals were executed between 2014 and 2019, with Southern Africa attracting 25% of the total, followed by East Africa (23%), West Africa (21%) and North Africa (14%). In terms of value, there were $3.9bn worth of VC deals over the same period, with West Africa accounting for 18%, followed by East Africa (15%), Southern Africa (10%) and North Africa (6%). Interestingly, 21% of deals went to companies based outside of Africa – but with operations on the continent – with a majority of those (53%) based in the US.

The largest share of VC deals (65%) were below $5m, while 25% were $5m-$20m, 8% were $21m-50m, and 3% were above $50m. PE and VC managers accounted for 39% of investors in VC deals, followed by PE and VC investment firms (19%), and corporate venture firms (11%).

In addition to its growing pool of SMEs, Africa has experienced significant expansion in the start-up ecosystem, with targeted programmes and funding directed at innovative and disruptive solutions being developed to address vital issues such as access to food, utilities and health care.
Part 1: PE & VC in Africa

Pipeline of VC Deals

The sectors driving VC activity between 2014 and 2019 included financials (19%), IT (19%), consumer discretionary (18%) and industrials (12%). In terms of value, consumer discretionary (28%) led the list, followed by financials (23%), industrials (18%) and utilities (17%).

North America accounted for the bulk of investors (42%) participating in VC deals over the period, followed by Europe (23%) and Africa (20%). The US ranked first on a country basis, accounting for 40% of investors in African VC deals. South Africa came next, with 9%, followed by the UK (8%) and Nigeria (4%).

“VC activity in Africa is booming, and the Covid-19 pandemic provided young Africans with an impetus to develop projects, many of which have already turned into success stories,” Ziad Oueslati, managing director and co-founding partner at investment and financial services firm AfricInvest, told OBG. “VC can help entrepreneurs access the funding they need to start and grow their innovative businesses, as well connect them with partners, suppliers and potential customers.”
What strategies have general partners (GPs) implemented to support their investments?

The negative impacts of the Covid-19 pandemic on African economies were two-fold: the health crisis not only put a strain on human capital, but the containment measures adopted by governments created further operational difficulties for African enterprises. GPs had to shift gears and adopt a portfolio-first approach to insulate their investments and support growth and recovery amid operational difficulties. In addition, some African GPs are raising recovery funds, such as the South Africa Recovery Fund launched by Ninety One and Ethos Private Equity with a targeted fund size of $600m. Such home-grown financing solutions further illustrate the strong commitment of African GPs to rehabilitate businesses adversely affected by the health and economic crisis.

In which sectors do you see the greatest recovery opportunities for private equity (PE) in Africa?

PE investment in health care has showed steady annual growth, and the sector is poised to remain a lucrative opportunity for PE in Africa. Given the challenges the pandemic imposed on Africa’s already overburdened health systems, this upward trend will likely accelerate over the next few years.

In the first half of 2020 the health care sector attracted the largest share of PE deals by value at 24%. Furthermore, finance and IT were also two of the most active sectors by both deal volume and value in the first half of the year, and IT has substantially impacted the growth of other industries such as finance, education and agri-business. The necessity of tech-centred innovation will only grow following the Covid-19 pandemic, and thus remains a high-interest sector for PE investment as Africa begins its economic recovery.

Which trends and developments will shape PE and venture capital (VC) through to 2040?

The African PE and VC industry has led the way in adopting environmental, social and governance principles into its investment processes and value-creation strategies.

Globally, investors are increasingly integrating sustainability and environmental considerations into their investment philosophies. We expect that as our industry grows and more funds are raised for investing on the continent, impact investing will feature more prominently in the years to come.

VC activity in Africa has seen significant growth recently, and as the entrepreneurial space on the continent matures, more national governments will likely implement supportive public policies and streamline business regulations to foster a better innovation environment.

Once fully implemented, the African Continental Free Trade Area will also significantly shape the trajectory of PE and VC. As the world’s largest free trade area, the agreement will make it easier for investors to access the 1.2bn-person market and improve scalability opportunities for African businesses.
Part 2

Trends Driving PE & VC in Africa

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Agriculture in Africa: Overview

Agriculture accounts for around 15% of Africa's GDP, though that figure is higher – at 23% – in sub-Saharan Africa. The sector is dominated by small-scale farms that produce around 90% of output, with roughly two-thirds of the population employed in the sector. At the same time, global food demand is continuing to rise, with the World Bank estimating that there will be a 102% increase in demand between 2017 and 2050, assuming income convergence. To meet this expansion, $80bn must be invested annually through to 2050. Demand growth for food in Africa is projected to outpace the global average, with the total size of the market expected to approach $1trn by 2030.

With urbanisation and middle-class consumer spending in emerging markets trending upwards, McKinsey estimated in February 2019 that this could precipitate $167bn of additional spending on food and beverages between 2015 and 2025, the majority of which is likely to originate in sub-Saharan Africa. According to the consultancy, nine countries on the continent account for 60% of total productivity potential, and Ethiopia, Nigeria and Tanzania comprise half of that figure.

Africa has some of the world's largest tracts of uncultivated arable land, making up 60% of the global total. However, a large portion of these areas is either completely inaccessible or difficult to convert to farmland. Unlocking the full potential of agri-businesses in Africa will require significant investment in infrastructure development, better access to inputs, more reliable data, higher crop yields and a more skilled workforce.

Case Study

Brightmore Capital is an impact investment fund established in 2017 and based in Dakar, Senegal, and Abidjan, Côte d'Ivoire. The firm targets investments in West African start-ups and small and medium-sized enterprises looking to expand into the region, with a particular interest in the high-potential and relatively untapped agri-business sector. Its expansion has historically been held back by established economic models that place local producers at a disadvantage relative to food products imported from outside the region. Difficulty also stems from the security situation in parts of the sub-region, such as Mali, Niger and Burkina Faso, hampering mobility and distribution networks.

To that end, Brightmore Capital's agri-business investments are focused primarily on Senegal, Côte d'Ivoire and Togo, with the goal of establishing strong domestic players and providing them incentives to expand beyond their domestic market to develop regional food trade.

The pandemic has had a modest impact on most of the fund's activities, thanks to the relatively young age of its portfolio companies. However, as first-time fund managers, the firm anticipates fundraising to dip as investors instead opt to bet on second- and third-time managers with well-defined track records. "There is a growing expectation that first-time fund managers raise funds locally, such as from family offices and high-net-worth individuals," Ndeye Thiaw, managing partner at Brightmore Capital, told OBG. "However, given that the West African industry is still in its infancy relative to the rest of the continent, data remains scarce and the notion of PE continues to be misunderstood."
Impact of the Pandemic on Agriculture

While the early stages of the pandemic – and the lockdown periods in particular – initially had negative effects on agriculture, the fallout was less severe for the sector than other areas. The immediate concerns of agri-businesses across the continent included constrained cash flow and reduced revenue. This was especially the case for export commodities such as cocoa, coffee and horticulture products, as well as for agri-businesses with significant exposure to the hospitality industry.

The lasting effects of the pandemic on the sector could prove to be more positive. The strong oil price decline shifted attention back to agriculture in oil-dependent countries such as Nigeria, where agricultural products are seen as a tool for diversification and an important provider of foreign currency.

With a heightened interest in food security – already a major concern since the continent imports around $35bn worth of food products a year, according to the African Development Bank (ADB) – governments have redoubled efforts to strengthen the sector.

In the first half of 2020 the Nigerian government reduced fertiliser prices, increased intervention funding, and lowered interest rates on existing intervention funding from 9% to 5%. Meanwhile, as part of the Covid-19 economic recovery plan, the government of Ghana executed an expansion of food security programmes such as Planting for Food and Jobs, as well as a number of initiatives that will provide better access to inputs such as seeds, fertilisers and machinery.

These additional public sector initiatives, the relative resilience of the sector and the significant non-correlation with other asset classes demonstrate that agri-business investments can be formidable sources of diversification in investors’ portfolios.
Agriculture Financing

Difficulty accessing capital is one of the major challenges agri-businesses in Africa face. Commercial loans are expensive and most businesses in the sector are small and medium-sized enterprises (SMEs) with little collateral. Commercial bank loans to the sector are also much lower than would be necessary to sustain expansion. As of 2018 loans to agriculture players accounted for 3% of total loan disbursements in Sierra Leone; 4% in Ghana, Kenya and Nigeria; 6% in Uganda; 8% in Mozambique; and 12% in Tanzania.

These challenges have driven a shift towards alternative forms of financing, including private equity (PE). Between 2010 and July 2020 information platform Crunchbase reported 242 agriculture-related deals in Africa, raising $616m from entities such as NGOs, foundations, banks, angel investor networks and private investment funds. PE funded 19.4% of the total.

There are a number of private investment entities focused on agriculture in Africa, with varying deal sizes. In addition, large African PE firms have raised generalist funds including agriculture. Players with the largest funds tend to execute deals with ticket sizes of $10m and up. Firms in this category include Helios Investments Partners, Development Partners International, AfricInvest, African Capital Alliance, Phatisa, Emerging Capital Partners, Amethis and LeapFrog Investments.

The sector remains largely dominated by DFI capital, even more so than in sector agnostic Africa-focused PE funds. General partners (GPs) and limited partners (LPs) generally expect the involvement of DFIs to intensify in the short term as a result of both Covid-19-associated risk driving away commercial capital, as well as DFIs looking to make countercyclical investments in impact investment segments.

Venture capital (VC) is becoming an increasingly important – but still relatively minor – part of the funding ecosystem, as angel investors move to fund agricultural start-ups across the continent. As of 2018 there were 82 African agri-tech start-ups, around half of which were launched between 2016 and 2018. In 2017 agriculture ventures raised $59m in capital. Agri-tech start-ups comprised $13.2m of the total, per Crunchbase data – an increase of 203% from the previous year.

Part 2: Trends Driving PE & VC in Africa
Opportunities and Challenges for PE Investors

Africa’s production of grains remains significantly below its potential, which provides an opportunity to add value through improved seed technology, reduce post-harvest losses and expand the amount of cultivated land. A McKinsey analysis concluded that on the whole, Africa could double or even triple the volume of cereals and grains produced; were this potential met, it would add 20% to global output as of 2020, or 2.76bn tonnes.

Emerging technologies including drones, blockchain and artificial intelligence (AI) have the potential to significantly enhance productivity and diminish post-harvest losses. For investors with significant available capital, there are major opportunities to boost value chains in prominent segments such as cocoa in Ghana and Côte d’Ivoire.

There is also a deficit in robust cold-chain systems and storage facilities. Taken together, the Alliance for a Green Revolution in Africa estimated that $300bn of investment in the value chain is needed between 2017 and 2027.

Challenges remain for PE fund managers and other investors. A common difficulty for GPs seeking different-sized transactions is finding well-run companies that meet all the requirements for PE, as smallholder farming continues to dominate.

Some GPs point to a persistent lack of funds that meet the requirements of operations in Africa. “The 10-year fund life is suboptimal in emerging markets generally, and particularly in the agricultural space in Africa. Instead, a fund life of close to 15 years or the use of permanent capital vehicles would be more appropriate,” Jerry Parkes, managing principal of Injaro Investments, told OBG. However, a longer fund life is often unattractive to LPs, particularly when entering a new market or a sector with a perceived high risk.

With comparatively lower ticket sizes for most funds in the segment, the cost of due diligence tends to be higher and the need to be on the ground is more important – a challenge that was exacerbated by the pandemic. A widely shared expectation is that there will be more local-global partnerships with established GPs on the continent.
Part 2: Trends Driving PE & VC in Africa

ICT and Digitalisation in Africa

Unique mobile subscribers

- Unique mobile subscribers: 2019-25 CAGR: 4.3%
  - 2019: 477m, 45% penetration rate
  - 2025F: 614m, 50% penetration rate

Mobile internet users

- Mobile internet users: 2019-25 CAGR: 9.7%
  - 2019: 272m, 26% penetration rate
  - 2025F: 475m, 39% penetration rate

ICT was one of the driving forces behind the accelerated development of many African economies prior to the pandemic. As a result, tech companies already presented some of the most attractive investment opportunities on the continent, contributing to much of the increase in PE and particularly VC activity between 2015 and 2020.

One of the stand-out segments leading up to 2020 was mobile technology. Research from mobile network operator association GSMA in early 2020 showed that sub-Saharan Africa is on track to remain the world’s fastest-growing market for mobile phones, with a compound annual growth rate of 4.6% between 2019 and 2025, above the global average of 3%.

Increasing revenue, employment and ICT activity will have an effect beyond the telecoms sector. Indeed, widespread digital transformation fuelled by smartphone use, growing digital literacy and technological adoption will impact a wide range of sectors. The disruption of financial services, particularly in East and West Africa, is one of the most prominent tech-fuelled developments that demonstrates this potential. Mobile money has enabled non-banking financial institutions to offer millions of previously excluded people the ability to conduct fast and safe transactions. Meanwhile, in Nigeria, where mobile phone penetration exceeds 100% even with inconsistent power supply, both banks and non-bank financial institutions are expanding their offerings, contributing to the formalisation of the economy.

Mobile services and technologies already comprise a large proportion of the region’s GDP, with an added value of $155bn, or 9% of the total. This figure is expected to rise to $184bn by 2025. In 2019 mobile technology directly and indirectly contributed to the creation of 3.8m jobs, and generated $17bn in tax revenue for sub-Saharan African governments.

Unique new mobile subscribers, 2019-25F (m)

- 2019: 477
- 2025F: 614
- Nigeria: 25
- Ethiopia: 16
- DRC: 11
- Tanzania: 7
- Kenya: 7
- Others: 66

Graph source: GSMA
ICT and Digitalisation in Africa

Global tech giants have increasingly their attention to Africa due the opportunities it offers. In May 2019 Microsoft opened Africa Development Centres for software engineering in Nairobi and Lagos, which aims to have 500 engineers in the fields of AI, machine learning and mixed reality innovation by 2023. Google followed suit in early 2020, with the opening of a Developers Space in Lagos. The facility is intended to provide support to tech entrepreneurs, developers and investors. Facebook has also expanded its footprint, announcing plans in September 2020 to open a second Africa office in Lagos in late 2021.

Rapid ICT growth and future expectations for digital technology have fuelled an influx of investment in African tech start-ups, with much of the funding provided in the form of PE and VC. According to VC data from AVCA, 2019 saw a record $1.42bn in equity funding, up from $736m in 2018. The number of VC tech deals also rose, from 111 to 136. In 2014-19, 63% of deals were valued lower $5m, while 3% were valued at $50m or higher. While deal volumes and values have grown dramatically – particularly in 2017-19 – much of this continues to be directed at the most attractive markets: South Africa, Kenya, Nigeria and Egypt. Together, they accounted for 64% of funding on the continent in 2014-19. Southern Africa (25%), East Africa (21%) and West Africa (21%) led VC tech deals by volume, while multi-region deals attracted the most value (52%). A significant share of investors in VC tech deals in Africa are based in the US (41%), followed by South Africa (9%), the UK (8%) and Nigeria (4%). Although there are many types of start-ups involved in equity deals, financial services leads (23% of deals by volume in 2014-19), with consumer discretionary accounting for the most by value (28%). Other key segments are IT, which saw 19% by volume and 5% by value; industrials, with 12% by volume and 18% by value; and utilities, at 11% and 16%, respectively.

VC funding for African tech start-ups, 2014-19 ($ m)

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Case Study

Sango Capital, established in 2011, is an investment management firm focused on generating risk-adjusted returns from funds and direct investments in Africa. The firm invests capital in mid-market opportunities for global investors, including sovereign wealth funds, pensions, endowments, foundations and family office clients.

While the pandemic has had a significant impact on African economies, Sango Capital’s portfolio of funds and direct investments has been relatively resilient. “We anticipated resilience because our portfolios are designed with a strong risk-mitigation focus. Prior to the pandemic, we advised our GPs to plan for a global downturn and encouraged teams to strengthen their risk navigation, which has contributed to better-than-expected returns thus far in terms of portfolio company performance,” Richard Okello, co-founder and partner at Sango Capital, told OBG.

The composition of Sango Capital’s portfolio, which was designed to defend against left tail risks and principal losses that occur during rare, unexpected events like a pandemic, provided an additional buffer. By maintaining a balance between assets that benefit from general economic growth and those that are countercyclical, Sango was able to maintain a buffer against economic shocks. In addition, like many other middle-market-focused PE companies, the firm has invested heavily in businesses that provide essential services, such as grocery store chain Market Square in Nigeria.
Part 2: Trends Driving PE & VC in Africa

Impact of Covid-19 on Digital Transformation

For obvious reasons, ICT has been among the most resilient sectors worldwide since the emergence of Covid-19, with many tech companies able to adapt or pivot to new, lucrative business models to provide solutions in the pandemic era. Nonetheless, as a result of the severe general macroeconomic impact, there was a sharp decline in foreign direct investment in the sector, with the number of software and IT projects in the first half of 2020 dropping to 1198 globally, the lowest level since 2012, according to the Financial Times’ greenfield investment monitor fDi Markets.

By contrast, the number of African software and IT FDI projects had a less precipitous fall, from 48 to 39 over the first six months of the year. Total capital expenditure on those projects during the same period was valued at $831m, exceeding the $555m recorded in 2019 and $336m in 2018. The bulk of the investments made through to July 2020 were in South Africa (15 projects), Nigeria (7), and Egypt (4) and Kenya (4).

Many digitalisation policies that were already under way before the pandemic were redoubled after the outbreak of Covid-19. “Over the last few years the financial regulators have pushed for financial inclusion and digital transformation,” Mohamed Okasha, managing partner of Egypt-focused financial technology (fintech) fund Disruptech, told OBG. “Since the pandemic they have accelerated these efforts. Online services are being embraced at the corporate level, as well as by SMEs, the government and consumers. Meanwhile, digital payments have replaced cash transactions so rapidly that we witnessed a two-year jump in activity in just three months. The pandemic has forced service providers to take this seriously.” Similar developments were seen across the continent, with regulators in countries such as Rwanda and Ghana mandating that providers scrap fees on mobile money and other digital transactions to promote cashless exchange. The pandemic also heightened the urgency to achieve greater levels of financial inclusion. “The digital transformation not only facilitates more contactless interactions, but it will also allow governments to transfer funds directly to the most vulnerable citizens,” Moses Baiden, CEO of Ghanaian technology company Margins Group, told OBG. In Nigeria, this was demonstrated when the government used digital platforms to disburse cash to 3.6m poor households during the lockdown.

Capex on African IT & software FDI projects

2018 $336m
2019 $555m
2020 H1 $831m

Graph source: fDi Markets
While fintech and fintech-enabled segments such as e-commerce offer many use cases and are expected to attract a significant proportion of new investments, there are a number of other verticals poised for growth. Business services such as enterprise software and cloud computing, as well as health, food, agriculture, education and renewable energy technologies, are all slated for expansion. While many of these segments are in the nascent stages in Africa, prior to the pandemic many were already involved in a number of deals. In 2019, $247m was invested in the continent’s off-grid tech platforms, $189m in health technology and $124m in education technology (edtech), according to investment platform Partech.

One company that received funding was Nigerian genetics testing platform 54Gene. Founded and funded with seed capital in 2019, the biotech start-up raised $15m in Series A equity in April 2020 as it became involved in scaling up Covid-19 testing infrastructure. Other disruptive tech start-ups funded with VC and PE have helped provide solutions to problems caused by the pandemic. Among them are edtech firms such as Etudesk, a training management company from Côte d’Ivoire that provides free access to students there and in Senegal; regional talent and training platforms like Andela and Gebeya; technology-enabled logistics start-ups such as Nigerian TradeDepot and Kobo360; and software-as-a-service start-ups like Africa’s Talking, which has used its technology to enable the spread of information about Covid-19 to remote communities.

To understand the impact of Covid-19 on PE, it is necessary to first understand the implications of the pandemic on individual portfolio companies and their ability to adjust. The role of a PE firm is to build on the quality of management and transfer knowledge, particularly in challenging circumstances like those witnessed in early 2020.

Through the Ezdehar Egypt Mid-Cap Fund, we invest in mid-sized companies with high growth potential, operating in defensive sectors that benefit from the country’s underlying macroeconomic and demographic growth drivers. The fund’s portfolio has been relatively shielded from the impact of the Covid-19 outbreak, partially driven by the resilience of those sectors. Additionally, the companies in our portfolio have limited debt, which has been an asset in terms of cash flow management during the pandemic.

In response to the developing economic situation, the firm engaged closely with its portfolio companies and worked with the management teams to implement weekly updates to their response action plans focused on the areas of staff safety, continuity of service and sustaining future growth. While there have been some cancelled contracts, the bigger challenges at the moment are global in nature. As face-to-face interaction remains a key feature of PE transactions and due diligence, international investors have met some hurdles – although this has also provided opportunities for local investors.

For portfolio companies, reduced client demand and supply chain disruptions are key factors, while on the investment side, global uncertainty and risk of limited exit routes are major concerns. However, as PE investments are long term in nature, we ultimately expect the fallout to be limited.

A positive emerging trend is the move towards digitalisation and new technologies in Egypt, and this has been accelerated by the pandemic. Historically, mid-sized companies in Egypt have somewhat lagged behind their global peers in terms of technology adoption, perhaps due to the perceived high initial capital expenditure and the desire to direct investments towards the expansion of products and services.

Egypt remains poised for growth following recovery. Since 2016 an unprecedented number of overdue decisions have been made and key reforms implemented that have benefitted the business environment. One example is the reduction of subsidies, which placed a burden on state finances. At the same time, there has been increased investment in infrastructure, which will be an asset for small and medium-sized enterprises in the country. Prior to the pandemic, projections were very optimistic on the back of these reforms and because of the population growth and improving consumption rates. These underlying factors will continue to make Egypt an attractive destination for PE investors.
Challenges and Opportunities in ICT

Digital transformation will provide notable opportunities for PE and VC investors in Africa in the near future, as evidenced by the presence of tech firms with flexible business models capable of meeting emerging needs, strong impact outcomes that use technology to benefit society and rapidly rising pre-pandemic investment in tech infrastructure.

However, challenges remain. While digital connectivity is growing across the continent, more investment in digital skills is needed. A digital divide also persists, with regions like North Africa and countries such as Kenya, Nigeria, South Africa and Ghana seeing an outsized proportion of overall tech-related investments. The International Finance Corporation (IFC) highlights that the macroeconomic impact of Covid-19 is likely to increase the gap between those who can afford fast and reliable internet, and those who do not have access to digital solutions.

A final challenge for the long-term growth of the sector is posed by the comparative lack of support for businesses in the very early stages of their start-up life. However, this could also provide an opportunity for VC investors. A 2017 study conducted by the French Development Agency demonstrated that the African start-up landscape was underdeveloped, with 0.3 start-ups per 1m people in sub-Saharan Africa, below the developed-country average of 43. This is mainly due to insufficient seed investment and early-stage business support for entrepreneurs. Capital and resources in the form of accelerators, co-working spaces and tech clusters have helped to narrow the divide, but it is clear that VC still has a key role to play in the development of the ecosystem.

Key findings: PE deals

81 Africa PE deals were reported in H1 2020

$700m worth of African PE deals were reported in H1 2020

There was a notable increase in IT deals in terms of volume and value, rising from 8% and 7%, respectively, in H1 2019 to 17% and 16% in H1 2020
Digital transformation is a priority across the continent to enable it to leapfrog into modernity and reach its full potential. Acknowledging this, investors have sought out businesses with the capability and tools to transform traditional industries, especially essential services such as health, education, finance and energy. The importance of their impact is underscored by the pandemic, which has laid bare the need for technological solutions in a world where most activities have gone virtual and social distancing is a public health necessity. In addition to companies that address food security challenges, essential service providers will remain critical as the world emerges from this public health crisis.

Businesses that deliver social impact are tragically underfunded. Africa faces significant funding gaps, particularly in essential services, and especially where technological infrastructure can accelerate access and affordability. The good news is that PE and VC funding in Africa has seen significant growth in recent years: AVCA reports that Africa attracted 613 VC deals valued at $3.9bn in 2014-19. Despite the pandemic, investment in impactful businesses is on track to play a key role in alleviating health care challenges in emerging economies, bridging the gap in the provision of personal protective equipment and other medical necessities. The trend of investing to address developmental challenges is becoming mainstream, as shown by the recent launch of a $100m Impact Fund by Salesforce, a company known more for software than social impact. This growth is expected to continue into 2021 as more investors acknowledge the importance of impactful and sustainable businesses that balance the needs of people and the planet alongside profit.

Although impact investment professionals have long highlighted the underinvestment in essential services on the continent, funds addressing the gap have overwhelmingly come from western development finance institutions (DFIs), and increasingly from foreign private capital. Domestic capital, both public and private, has failed to match the focus of DFI capital on resolving market failures in social sectors and creating jobs. In April 2020 the World Bank predicted that this pandemic would push sub-Saharan Africa towards its first recession in 25 years, as growth falls sharply across the region. Meanwhile, McKinsey estimates that 150m Africans could lose their jobs, which would be particularly devastating for the informal sector, where women make up 75% of the workforce. In addition to security consequences, this downturn is an existential threat to the development achieved over the last decades. It demands global action and the urgent mobilisation of funds, both locally and internationally. It is time for domestic sources to play a prominent role in developmental impact and economic progress. Now is not the time to hide. We must unlock domestic capital to work assiduously alongside foreign capital to make the investments in impactful businesses that will enable Africa to reach its full potential.

By the second quarter of 2020 the pandemic had caused economic downturns around the world. In April, amid the unprecedented global public health crisis, Alitheia Capital announced it had raised $75m for its $100m gender inclusion pioneer PE fund, Alitheia IDF, which identifies, invests in and supports high-growth small and medium-sized enterprises (SMEs) led by women and gender-diverse management teams in sub-Saharan Africa. The fund is set to announce its first set of investments, with plans to invest in 12 SMEs across six countries.

Motivated by the belief that technology has a central role to play in financial inclusion, in 2010 Alitheia Capital led an investment in Paga, a savings and payments financial technology (fintech) firm, and subsequently invested in a second generation of fintech firms, providing access to affordable finance and other essential services. Two such notable companies are Lidya, a digital SME lender, and MAX, a logistics and transport provider.

In a similar vein, Alitheia Capital’s energy inclusion strategy has enabled the provision of clean energy to over 1m Nigerian households, shifting them away from the use of firewood. In the process, this has established a value chain that created tens of thousands of jobs, provided working capital to thousands of retail businesses, curbed infant mortality from indoor air pollution, and reduced the felling of trees and deforestation.
Renewable energy has become one of the fastest-growing segments in many countries in Africa in terms of consumer and industrial demand, as well as the volume of public and private investment. This trend has been largely driven by solar, given the abundance of sunlight on the continent. Indeed, in 2019 the International Energy Agency (IEA) estimated that 75% of all newly installed energy generation in Africa was renewable.

A number of factors have contributed to the rapid uptake of renewables, including persistently high demand for energy solutions, as around half of the continent’s inhabitants, or 600m people, lack access to electricity. Meanwhile, some 80% of sub-Saharan businesses are hampered by unreliable and costly electricity supply. While Africa is home to 17% of the world’s population, it receives just 4% of global power supply investment. The IEA estimates that closing this gap and ensuring universal access by 2040 would require tripling the number of people connected to the grid per year from 20m to 60m, as well as increasing investment four-fold, to $120bn annually.

The rapidly declining cost of renewables, and solar in particular, is driving further investment, including a growing proportion from PE and VC. The International Renewable Energy Agency estimated there were significant reductions in the cost of all commercially available renewable power-generating technologies in recent years. Figures from 2018 show a 26% decrease in the cost of concentrated solar power, with solar photovoltaic (PV) declining by 13%. Non-solar renewables such as bioenergy (-14%), hydropower (-12%) and onshore wind (-13%) also saw large cost reductions, with the trend expected to continue. Solar remains particularly attractive in large parts of Africa, as the continent has the richest solar resources in the world – and, according to the IEA, less than 1% of global installed capacity, at just 5 GW of solar PV as of 2019.
The growing focus on environmental, social and governance (ESG) standards and climate change within the PE industry is also contributing to renewable energy’s growing share of investee companies. The important role of DFIs as LPs in the PE ecosystem and their interest in providing impact investments are contributing factors, although other investors have reasons to adhere to such standards. According to a 2018 report from the African Private Equity and Venture Capital Association (AVCA) on responsible investing in Africa, ESG standards are increasingly being seen as a key aspect of financial analysis and decision-making in the investment community due to their ability to mitigate risk and ensure higher commercial returns.

According to AVCA’s sustainability study focused on climate change, published in April 2020, 75% of respondents had a responsible investment policy in place that covered climate action. Investors also recognised climate change both as a risk to their portfolio and a market opportunity. Around 95% of investors identified energy as an attractive sector from a climate perspective. For example, in West Africa, changing the current energy mix would result in large immediate returns for carbon footprints, especially as 40% of the electricity in the region is currently generated by back-up generators with very high emissions.

Viewpoint

Olusola Lawson, Managing Director and Co-Head, African Infrastructure Investment Managers (AIIM)

Over the last decade, given rapidly falling component costs, there has been significant growth in the number of opportunities in both the utility-scale renewable energy space and the distributed energy sector. With more than $700m of equity invested in renewable energy projects in South Africa as well as distributed-energy business across Africa, AIIM has emerged as one of the largest equity investors on the continent within these emerging sectors.

The energy transition theme is one where we continue to see major opportunities, in the context of a fast-changing value chain, which is morphing from a system of centralised plants to an increasingly distributed system. Due to ongoing structural power-supply deficits, which have led to the existence of up to 20 GW of diesel-fired generation in the country, Nigeria has become a major potential market for distributed solar. One such company is Starsight Energy, the largest energy-efficiency and distributed solar company in West Africa, providing services for commercial and industrial customers. AIIM first invested in Starsight Energy in 2018 through the African Infrastructure Investment Fund 3. At that point, the business had less than 30 pilot sites across the country. This has grown to more than 500 sites operating and in construction, equivalent to more than 40 MW of capacity.

What we saw during the pandemic is that construction activities were disrupted by logistical challenges in relation to supply chains, as well as the difficulty in moving key specialists across construction sites and reduced access to customer locations. This lasted for a short period, and operations are now almost fully restored. The impact of Covid-19 on the PE space in Africa will generally differ according to the type of underlying asset class exposure the particular fund or manager has. For example, within the infrastructure space, we have seen remarkable resilience in performance across our energy and digital-infrastructure assets, where demand for these essential services has held up through the pandemic. Overall, we are pleased to see how the asset class has held up during the pandemic, and we see opportunities for funds that are willing and able to continue investing in Africa. We believe that significant opportunities across the African infrastructure landscape exist within our core investment themes – energy transition, mobility and logistics, and digital infrastructure. The dislocation between the demand for capital across these essential assets and the supply of capital in the uncertain post-Covid-19 world provides an opportunity for experienced, local managers to invest at attractive risk-adjusted returns. We expect the increasing competition for capital to drive business reforms that will make investing in many African countries more attractive. As governments struggle under the weight of widening pandemic-induced fiscal deficits, private capital will be increasingly required to plug funding gaps, and the friendliest investment climates will be the recipient of such capital.
Part 2: Trends Driving PE & VC in Africa

Impact of the Pandemic on Renewables

Investors see climate-related opportunities for Africa in energy, agriculture & water

Where do you see the most opportunities for climate investments in Africa?

While renewables such as solar are important to the long-term development of Africa, the Covid-19 pandemic impacted the energy sector, both worldwide and on the continent. The initial disruption of the renewable energy supply chain affected companies in Africa, as did the lockdowns.

Yet there are some indications that the pandemic could provide opportunities in renewables in the longer term. Two key trends that would benefit the sector are a liquidity boost due to investors moving away from oil to perceptively less-risky renewables, and Covid-19 stimulus packages and funding vehicles driving an accelerated transition towards clean energy, according to a study published in *Energy Research and Social Science* in October 2020 by Mark Akrofi and Sarpong Antwi. Funding vehicles in Africa include the Covid-19 Energy Access Release Fund issued by Social Investment Managers and Advisors, GET.invest’s Covid-19 window for energy projects, the Africa Enterprise Challenge Fund’s REACT Kenya Relief Fund for off-grid companies and the Covid-19 Solar Relief Fund issued by All On in Nigeria. At the national level, the government of Nigeria, through its Rural Electrification Agency, partnered with the ADB and the World Bank to provide solar-related pandemic response measures. The government also released funds to households to install solar home systems (SHS), as well as to health and medical centres to build solar mini-grids.

In which sectors are you likely to invest?

- **Solar**: 90%
- **Smart & off-grid energy solutions**: 66%
- **Micro-grid solutions**: 48%
- **Oil & gas**: 35%
- **LNG**: 22%

Graph source: AVCA; Survey of 176 energy professionals conducted by African Business magazine, published August 2020
Part 2: Trends Driving PE & VC in Africa

Viewpoint
Samaila Zubairu, President and CEO, Africa Finance Corporation

There remains a significant gap between Africa’s sizeable investment requirements and the number of bankable projects available. To that end, the AFC seeks to de-risk the available opportunities, and works with key players such as sponsors and governments to transform initial ideas into bankable projects. The organisation does so by being the first investor in a project and subsequently distributing opportunities to other partners, including PE investors.

Our mandate is to reduce Africa’s $170bn annual infrastructure deficit and improve the continent’s challenging operating environment. We aim to do so by developing and financing infrastructure projects, promoting natural resource development, and creating and upgrading industrial assets that enhance productivity and economic growth.

The need for private capital has been intensified in the wake of the Covid-19 pandemic, which is one of the most transformative and significant events of this century. The pandemic has affected economies in Africa immensely, particularly because commodity price volatility has resulted in the depreciation of some of the continent’s currencies.

The AFC and international partners are working to address this destabilisation through the construction of integrated industrial zones thereby giving African countries the means to add value to goods. Africa currently trades predominantly in primary commodities, ensuring that countries on the continent remain price-takers.

By making improvements in the value chain, we will be able to insulate economies from the worst and most unpredictable economic changes. Indeed, the Covid-19 crisis has demonstrated how volatility in the price of cotton does not significantly affect clothing prices, just like volatility in the price of cocoa has only a slight impact on chocolate prices. The challenges presented by this price instability also provide an opportunity for Africa to reset how the continent trades with its partners around the world. The establishment of value-added production centres will not only position Africa as a new engine for worldwide growth, but also provide local employment opportunities and reduce the global carbon footprint by shifting industrial production facilities closer to the source of raw materials.

Considering the size of the capital investment required for African infrastructure projects, PE clearly has a role to play. While PE returns have been suboptimal, primarily because of persistent currency depreciations, extending investment time horizons would offset many of the associated risks. It is expected that more PE investors will become active in the market as we de-risk opportunities and demonstrate that it is possible to make a profit by investing in infrastructure on the continent.

Case Study
In 2016 the Africa Finance Corporation (AFC) invested $188m in a 26% stake in Gabon Special Economic Zone (GSEZ). In early 2020 GSEZ was rebranded as ARISE and reorganised into three verticals: ARISE Port & Logistics, ARISE Integrated Industrial Platforms and ARISE Infrastructure Services. ARISE was created to accelerate Gabon’s economic diversification and development. Gabon is now a significant exporter of veneer, sawn wood and furniture. It went from generating approximately $350m in timber product exports in 2010 to more than $1bn in 2019 while creating more than 34,000 jobs in the sector. “ARISE serves as a framework for investors to establish themselves in Africa,” Samaila Zubairu, president and CEO of the AFC, told OBG. “We aim to expand as investors need access to not only land and raw materials, but also working capital and a way to navigate permits, quotas and other bureaucratic hurdles. ARISE also demonstrated that trade sales are a viable and attractive alternative to listings as a way to recover capital in the transport and industry sectors.”

Investors were attracted to the equity opportunities offered by ARISE. More specifically, one of the container ports was acquired by French transport firm Bolloré Group; UK-based Meridian Equity invested in a mineral port; and French investment vehicle STOA partnered in a cargo port. Moreover, in 2019 the AFC announced it would partner with fund manager A P Moller Capital.
Opportunities and Challenges in Renewables

Corporate-level investment in off-grid energy access companies, 2010-18 ($m)

Within the solar segment, off-grid solutions such as SHS and mini-grids are the most attractive to investors. Off-grid technology was the second-highest funded technology vertical in 2019, receiving $247m in VC funding and accounting for 12.2% of all VC tech funding in Africa that year, according to Partech.

Some notable off-grid start-up deals from 2019 include $50m in Series D funding for pay-as-you-go (PAYG) off-grid solar utility BBOX, which operates in 12 countries on the continent; $25m in Series C funding for West African-based PAYG solar company PEG Africa; and $20m in Series A funding for Nigerian start-up Rensource Energy.

Large international energy companies such as the French multinational Engie, which acquired East African home solar provider Mobisol; Shell, which has provided capital to a number of renewable energy funds and invested in off-grid start-ups such as D.light and PowerGen; and Total, with investments in PEG, among others, are recognising the strategic importance of the off-grid market in Africa. The level of foreign government investment is also high, with the Netherlands-based Entrepeneurial Development Banking ranking as the top investor by value in the energy access space, alongside other DFIs such as the UK’s CDC Group and the Norwegian Investment Fund.

The PAYG model, whereby remote residential customers receive a leased solar unit, is proving particularly attractive in East and West Africa. There were around 2m PAYG systems sold in 2018, and PAYG accounted for 91% of the $500m invested in off-grid energy that year, according to GSMA. The rise of mobile money technology fuelled the segment, which is in turn boosting the usage of mobile money, according to the association. The importance of mobile money to the PAYG model is emphasised in a 2019 report from research and consultancy group Wood Mackenzie, which found that nearly 80% of global annual investment in off-grid energy takes place in Africa, in large part because of the ubiquity of the mobile money payment systems.

Graph source: Wood Mackenzie and Energy 4 Impact
Part 2: Trends Driving PE & VC in Africa

Opportunities and Challenges in Renewables

As a result, East Africa – the region with the most mature mobile money market – has thus far received the bulk of this financing in the continent, attracting 58% of investments. It is, however, increasingly seen as saturated. East Africa, for its part, is seeing rising levels of mobile money penetration and received just 17% of capital. The region is considered an attractive market due to the large proportion of the Nigerian population that is without electricity.

Another factor that has made PAYG off-grid companies appealing to patient investors is the potential for upselling to newly acquired customers. Goods and services that could be looped into the PAYG value chain include utilities such as water, telecoms and internet; goods like smartphones, batteries and stoves; and services including insurance and lending products.

While the solar home segment receives the bulk of investment in such projects, mini-grids that provide up to 5 MW of generation capacity are also an important growth opportunity in the off-grid space. Indeed, mini-grid solutions would be the most cost-effective option for 30% of the continent’s population that is currently without access to electricity, according to the IEA.

Mini-grids are already catching on. Wood Mackenzie estimates that 292m households will be connected to electricity through mini-grids by 2030, more than the 194m projected to use SHS within the same timeframe. With high capital expenditure, this is an underfunded space that requires significant investment from both the public and private sector.

Solar home systems (SHS)

SHS are only connected to the household to which they provide electricity. The simplest forms consist of a solar panel, a charge controller and a battery.

Green mini-grids

Green mini-grids supply energy directly or via batteries to a group of households connected to the system. The units are disconnected from the main energy grid and produce solar energy via renewable sources such as solar. They are often supplemented with diesel generators.
Part 2: Trends Driving PE & VC in Africa

Health Care in Africa: Overview

The health care sector in Africa was already witnessing significant growth and attracting rising PE investment in the years leading up to 2020. With Covid-19, public and private sector actors across the continent are realising the urgent need for investment in health, particularly to boost access to affordable care.

This shift is reflected in the analysis provided by AVCA’s “2020 H1 African Private Equity Data Tracker” report where the health care sector accounted for the largest share of PE deals by value (24%), led by Mediterrania Capital’s investment in MetaMed, the largest platform of Diagnostic Imaging centres in Egypt, Jordan and Saudi Arabia. Other prominent deals announced during the first half of 2020 include investments in MET Health by Oasis Capital in West Africa and Pioneer Diagnostics Centre by Zoscales Partners in East Africa.

These investments saw the value share of health investments double compared to H1 2019, when deals in the sector accounted for 12% of African PE deal value, which was already a significant improvement on H1 2018, when just 4% of total deal value went to the sector, per AVCA data. According to the organisation, North Africa saw 11% of deal volume directed to health care in 2014-19, making it the fourth-most prominent sector in the region.

With medical technology becoming more widespread, VC investment in health care companies is also on the rise. According to figures from AVCA, between 2014 and 2019 the sector accounted for 7% of total deal volume and 3% of deal value. Meanwhile, Partech data on tech VC funding in 2019 shows that health tech received $189m in investment across 13 deals - accounting for 9.3% of total VC tech funding for the year and an increase of 969% on 2018. Some examples include the $45m investment in Kenyan mobile health services start-up CarePay in 2019 and the $9.7m investment in Ghanaian pharmaceutical solutions provider mPharma that same year.
Part 2: Trends Driving PE & VC in Africa

Opportunities and Challenges in Health Care

Historically, the health care sector has been attractive to PE investors, likely in part due to the comparatively high internal rate of return (IRR). The IFC estimates that health care investments deliver a 17.5% investment-level gross IRR in emerging markets outside Africa, and 9.6% in Africa – representing the second-highest IRR by sector in emerging markets generally, and the fourth-highest returns behind telecoms, IT and consumer staples in Africa.

The sector also accounted for the largest proceeds raised through initial public offerings (IPOs) by value between 2010 and 2017, according to an AVCA/PWC report on exits of African PE portfolio companies via global capital markets. In total, $1.1bn was raised in IPOs during this period, including the largest African PE exit – a $681m IPO of Life Healthcare Group on the Johannesburg Stock Exchange by Old Mutual Private Equity and Brimstone Investment Corporation.

Comparatively high IRRs and favourable exit opportunities are expected to persist in the years to come. “Higher PE activity also means that there is a greater degree of liquidity for sales to financial buyers. This is particularly important when considering that exits are key on the highly illiquid African continent,” Albert Alsina, Founder and CEO of Mediterrania Capital, told OBG.

Alsina estimates that health care assets could reach 20%+ IRRs in three- to five-year holding periods, due to the substantial potential in terms of both organic and acquisition-based growth.

PE-backed IPO proceeds by industry, 2010-17 (%)
Part 2: Trends Driving PE & VC in Africa

The pandemic has resulted in increased public investment in health infrastructure across Africa. In Nigeria, a Covid-19 Basket Fund was created by the government and the UN to disburse funding to health care companies to procure medical goods and serve as a financing and investment platform. With constrained public budgets, the private sector is expected to play a more significant role going forwards. The already significant momentum behind online and tech-enabled health care start-ups is expected to accelerate. Verticals with particularly high surges in demand, according to the IFC, include blockchain-based epidemic monitoring platforms, telehealth and online diagnostics. Health insurance platforms with a focus on affordable micro-insurance and mobile payments like BIMA are also expected to continue seeing rapid growth. Verticals such as pharmaceuticals, health logistics, electronic medical records and health infrastructure that were attractive prior to the pandemic should similarly see more activity.

Case Study

Founded in 2011, Akdital began operations with Jerrada Clinic in Casablanca, and since 2018 it has been making major investments in the construction of four new multidisciplinary and specialist health establishments: Ain Borja Clinic, Casablanca International Oncology Centre, Longchamps Clinic and Casablanca Ain Sbaâ Private Hospital. Today, it has a total capacity of 550 beds and provides services such as cardiology, cardiac surgery, neurosurgery, oncology, radiotherapy, intensive care and neonatal care.

With oncology centres concentrated in central Casablanca and demand increasing elsewhere, Akdital opened a new oncology department in October 2020 at the Casablanca Ain Sbaâ Private Hospital on the edge of the city. This new centre, which offers diagnostic and treatment services, provides a medically underserved community with critical care. Furthermore, in June 2020 Akdital signed a letter of intent to acquire a leading 30-bed paediatric clinic in Casablanca, which will enable it to expand the range of specialties it offers patients. The group is planning to continue its expansion with new developments in El Jadida, Agadir and Tangier.

“The Mediterrania Capital team provided Akdital with strategic, operational and financial support, helping us deploy the strategy we established. This enabled us to continue our expansion, making high-quality health services accessible to a wider portion of the Moroccan population,” Dr Rochdi Talib, founder and CEO of Akdital, told OBG.

Viewpoint

Albert Alsina, Founder and CEO, Mediterrania Capital Partners

As the pandemic has unfolded, the deeper challenges facing Africa’s health care systems are becoming widely apparent, and a broader spectrum of stakeholders is feeling the consequences of chronic underinvestment. This has renewed the urgency for reform and reimagining across the continent, and created new momentum for PE to play an important role in deploying capital sustainably and efficiently.

There is no conflict between financial returns and sustainable development. When we invest, we do so to make companies champions in their field and able to survive long after we exit. Only with this approach can we ensure that companies generate value for shareholders and patients in the long run.

Now is also the time to consider investment and portfolio actions in the context of the unfolding humanitarian crisis. At a time when public expectations of the role of business in society are shifting rapidly, firms should consider doubling down on commitments to environmental, social and governance-related investing, and evaluate their actions from a social citizenship standpoint.

Investing in African health systems is an opportunity to accelerate economic development and growth, contribute to saving millions of lives, prevent life-long disabilities and, overall, help communities reach a higher quality of life. Today, the private sector has emerged as a key driver of health care development and innovation on the continent.
Part 3

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Global Trends and the Impact on PE and VC

The global economic downturn following the outbreak of Covid-19 has slowed private equity (PE) and venture capital (VC) activity across emerging economies. According to an analysis by the International Finance Corporation (IFC) published in September 2020, growth equity funds, which invest in comparatively more mature businesses compared to VC funds, have been particularly affected by the initial economic shocks.

Disruptions in supply chains and reduced income disproportionately impacted light manufacturing and urban consumer businesses, which together comprise a large share of PE investments in emerging markets.

The nature of the contraction, with both supply shocks and a decline in demand, resulted in weaker valuations of portfolio companies, an increase in the volatility of exchange rates and delayed exits across emerging markets.

Case Study

As with many countries around the world, Tunisia was affected by the sudden and rapid spread of Covid-19, and opted for a country-wide lockdown.

To mitigate the economic and social impact, the government created a $260m emergency fund, the biggest public fund in the country’s history, with $185m dedicated to supporting small and medium-sized enterprises (SMEs) affected by the crisis. Its launch was led by Tunisia’s public long-term investment fund, Caisse des Dépôts et Consignations (CDC), which will anchor the fund with a 40% commitment.

With the support of the USAID Tunisia JOBS programme, the assistance included the Empower Fund for medium to large SMEs (in the amount of $110m), the Impact Fund for investment in interior regions ($37m) and the Aspire Fund for restructuring affected SMEs ($37m). The objective of these funds is to maximise the impact of the CDC’s investments, particularly those supporting SMEs affected by the pandemic, and businesses in underserved regions that employ women and young people. SMEs can be matched to investors through the digital SME marketplace JoussourInvest.tn.

The CDC initiated discussions with development finance institutions (DFIs) and local investors to present the emergency fund and accelerate its launch. Interested DFIs and impact investors will be joining the CDC in its endeavour to support the recovery of the Tunisian economy.

The African Context: Resilience and Opportunity

Many of the trends that affected PE and VC around the world were mirrored in Africa. However, notable differences were seen between the continent and other emerging markets, as well as within the continent itself. With the notable exception of South Africa and parts of North Africa, the region was relatively less affected by the virus than other parts of the world. This, along with several other key factors, has to an extent shielded the VC and PE ecosystem from more intense fallout.

First, PE investment in Africa has historically involved comparatively smaller deal sizes, and VC in particular has seen significant growth in recent years. While growth equity and buyout PE deals have felt the greatest impact of the pandemic, 2020 saw a series of VC deals benefitting the financial, health and education technologies deemed essential during the pandemic.
A second important factor that helped to insulate the PE and VC landscape from the pandemic is the composition of the LP base, which tends to involve a significant role for development finance institutions (DFIs). These institutional investors are more likely to have strong environmental, social and governance measures – factors that should provide greater preparation for disruptive events like the pandemic. Additionally, many DFIs have adopted strategies to support GPs and investee companies in light of Covid-19-related challenges.

SDG Impact Standards for PE Funds

- Standard 1 (Strategy): Embedding foundational elements into purpose and strategy
- Standard 2 (Management Approach): Integrating foundational elements into operations and management approach
- Standard 3 (Transparency): Disclosing how foundational elements are integrated into purpose, strategy, management approach and governance, and reporting on performance
- Standard 4 (Governance): Reinforcing commitment to foundational elements through commitment to foundational elements through governance practices

In October 2020 the UN Development Programme (UNDP) released a set of impact standards for PE’s contribution to the UN Sustainable Development Goals. The standards – which cover strategy, management approach, transparency and governance – aim to establish a system that allows PE and VC to make greater social and environmental impacts through their investments. The standards are also designed as guidance on how to translate intent into action for the private sector more broadly, given its important role as a source of technology, innovation, skills, services and employment.

Africa’s PE industry has made good progress over the past two decades. This is reflected in the value of fundraising, as well as deals and exits and the resulting success stories that have helped drive further investor interest towards the continent. Despite the Covid-19 pandemic, we have continued to invest in Africa thanks to existing funds and available dry powder, as well as the successful first close of AfricInvest IV, our pan-African fund. We have also maintained support for portfolio companies that have been impacted to varying degrees, with businesses in tourism and construction faring less well than those in agri-business, pharmaceuticals and health care, for example. Our broader recommendations to counter the effects of the pandemic have consisted of cutting operational costs, postponing capital investments and ensuring a maximum amount of cash on hand, among others.

Looking ahead, we can expect to see a wave of consolidations take place across the continent, especially among larger companies which previously boasted sufficient cash flow and relied on debt financing. This will present the PE industry with new opportunities. New acquisitions will also be realised in order to establish strong regional players in high-potential sectors. The cost of acquisitions, however, is likely to fall due to the reduced number of active funds and increasing amount of available offers on the market.

In terms of fundraising, the ongoing pandemic means Africa’s PE industry will continue to depend on DFIs for the majority of funding in the short to medium term. Nonetheless, there is growing interest from local African players and pension funds in particular. Moreover, before Covid-19 we noted significantly greater interest from US pension funds specifically looking for Africa exposure. This is good news for Africa’s PE industry, and both are areas in which AfricInvest – alongside AVCA – has played an instrumental role in raising awareness about the potential of this asset class in terms of financial returns, job creation and gender equality.

Lastly, African fund managers see themselves as taking a more hands-on approach than GPs in many other regions, with firms ensuring business continuity in order to be able to raise capital for funds during the pandemic. As a result, many GPs in Africa were in a better position to provide additional support to their portfolio companies.

Furthermore, given that many African businesses have weathered significant challenges and crises in recent years, many felt they were better prepared to contend with pandemic-induced structural problems relative to other emerging markets where portfolio companies often face shorter supply chains, more debt and less inventory. “Crisis is not new to Nigeria,” Iyinoluwa Aboyeji, co-founder and general partner of Future Africa, told OBG. “We have already lived through a number of them, and they provide both challenges and opportunities. Indeed, two of our top portfolio companies were founded in the middle of previous crises. Software engineer training firm Andela was established during the Ebola crisis, and payment solutions provider Flutterwave successfully raised money in Nigeria in the middle of a major financial and economic crisis.”

This built-in preparedness ensured that many portfolio companies were able to absorb some of the initial shocks to global supply chains and local demand.

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<td>Lucas Kranck, Founding Partner, Ascent Africa</td>
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“Unlocking local capital is also very important to the future of PE in East Africa, as well as the continent at large. We have seen encouraging developments, particularly in Kenya, where regulators have been pushing for pension funds to diversify their asset classes, but this shift is still in the early stages. Trustees in pension funds remain conservative with their investments, and across East Africa it is clear that the case for PE as a viable and safe investment still needs to be made to most local institutional investors. We have seen some success in raising funds from local pensions funds thanks to our strong local partners – making Ascent the first PE fund to raise funds from local Kenyan pension funds – but the asset class remains underinvested.”

LPs’ views on GPs’ investment policies regarding ESG factors

<table>
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<tr>
<th>ESG Factor</th>
<th>Very important</th>
<th>Important</th>
<th>Not important</th>
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<tbody>
<tr>
<td>Environmental</td>
<td>79%</td>
<td>18%</td>
<td>3%</td>
</tr>
<tr>
<td>Societal</td>
<td>79%</td>
<td>21%</td>
<td>12%</td>
</tr>
<tr>
<td>Governance</td>
<td>88%</td>
<td>0%</td>
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Graph source: AVCA African Private Equity Industry Survey, March 2020
A number of structural factors also contributed to more significant challenges to LPs, GPs and portfolio companies in Africa relative to other regions. According to the industry stakeholders, the factors that are most likely to deter LPs from investing in Africa include weak exit environments, political risk, currency fluctuations, a limited number of established fund managers and poor historical performance. Some of these issues have been exacerbated or exposed by the pandemic. This is particularly the case with foreign exchange volatility, as well as the fact that portfolio companies and fund managers in Africa are less likely to receive government support and more likely to operate amid unclear or unfavourable regulatory climates.

**Top-3 concerns of African GPs regarding Covid-19**

As a result, fund managers in sub-Saharan Africa are closing their funds at smaller sizes due to the pandemic than expected, and this trend seems likely to continue, according to the IFC. It also anticipates a delay in fundraising cycles – a trend confirmed by a survey published in April 2020 by AVCA. According to the survey, 49% of respondents indicated a six- to 12-month delay in capital deployment, and 67% highlighted a deteriorating fundraising environment in 2020.
Exit Opportunities: A Mixed Picture

The exit environment in Africa remains one of the most challenging aspects for GPs and LPs considering PE and VC opportunities on the continent. 57% of GPs surveyed by AVCA indicated that exit opportunities were among the greatest challenges in Africa in the near to medium term. One of the structural factors that has limited exit strategies is the underdeveloped nature of domestic capital markets, with initial public offerings accounting for 2% of exits in 2019, according to AVCA. This was the lowest level in recent years, falling below the 7% achieved in 2015. According to AVCA’s “2020 H1 African Private Equity Data Tracker” report, the number of exits dropped to 13 from 25 in the corresponding period the year before. The same report indicates that exits through PE and other financial buyers were the most common exit route, representing 54% of the total exit volume on the continent, followed by sales to trade buyers, at 31% of the total.

Adenia Partners, an African PE firm specialised in control buyouts and growth capital investment, acquired a 95% stake in Mauritian paint, coatings and chemical products manufacturer and marketer Mauvilac in 2014. Antoine Delaporte, managing partner of Adenia Partners, told OBG, “Our controlling stake investment in Mauvilac is typical of our investment strategy – it is an asset with a good profitability track record in a non-cyclical industry with high barriers to entry, where we can provide additional value through our entrepreneurial expertise and source strategic buyers down the line.”

Following the acquisition, Adenia initiated and implemented several value-creation initiatives. It recruited a new management team to steer the implementation of a modernisation plan. Significant investments were made to upgrade the factory and bring standards in line with ISO 9001, ISO 14001 and ISO 45001, respectively, for quality, environmental, and occupational health and safety management. Through targeted investments in research and development, Mauvilac launched multiple new products with an increased focus on eco-friendly and water-based products.

Another key focus was improving the job quality of Mauvilac’s 250 employees. By strengthening the company’s human resources function and improving safety measures and training, a 44% decrease in work accidents has been recorded since 2017. Notable productivity improvements and a wider direct distribution network resulted in a 65% increase in the earnings before interest, tax, depreciation and amortisation margin since acquisition, while maintaining strong leadership in the Mauritius market.

As part of its standard investment process, Adenia considers various exit scenarios at the beginning of each acquisition. In the case of Mauvilac, it concluded that the optimal outcome would be to sell its stake to a major global paint company: in March 2020 the business was sold to Dutch paint manufacturer AkzoNobel. The exit of Mauvilac generated a 3x cash-on-cash return for Adenia’s investors.
Exit Opportunities: A Mixed Picture

LPs’ expectations about African PE exit routes that will increase over the next three to five years (% of respondents)

Immediate challenges that resulted in delayed time horizons for exits include the logistical troubles brought by travel restrictions, which complicated the ability to conduct the necessary due diligence.

While the exit environment remains challenging, recent developments indicate that the pandemic has not necessarily made things more difficult across the board. Indeed, a number of notable exits have taken place in Africa in 2020.

Examples include the $288m acquisition of payments start-up DPO Group by Dubai-based Network International in July 2020; Adenia Partners’ exit from Mauritian paint manufacturer, Mauvilac, to Dutch paint manufacturer, AkzoNobel, in April 2020; and Actis’ exit from GHL Bank, a full-scale commercial bank in Ghana, to First National Bank Ghana in May 2020.

"Covid-19’s impact on Africa cannot be summed up into a single message. Although overall there has been a deterioration in asset values across Africa, we see variations in the way certain sectors, countries and investment classes have performed," Mark Napier, CEO of FSD Africa, told OBG. "Because the investment picture is so varied, it is crucial to conduct in-depth analysis of specific areas, rather than assume that all sectors are in trouble," he added.

FSD Africa views Covid-19 as a short-term, albeit serious, hurdle in Africa’s long-term development, and expects new kinds of investment vehicles and greater interest in private debt to emerge as a result. However, it also notes the importance of a robust regulatory landscape for the industry – not only to guarantee improved capacity-building, but also to enable regulatory support and innovation in the funding process.

Africa Remains an Attractive Destination

On balance, early indications based on survey results seem to suggest that Covid-19 has not made Africa a less attractive PE or VC investment destination relative to other emerging markets.

Although the IFC estimated that between 2008 and 2018 just 4% of PE investment and fundraising in emerging markets took place in sub-Saharan Africa, a March 2020 AVCA survey of LPs active on the continent shows that a significant proportion (59%) view Africa as the most attractive emerging or frontier market.

According to AVCA’s “2020 H1 African Private Equity Data Tracker” report, Africa’s PE industry has demonstrated its resilience with $1.1bn of funds raised in the first half of 2020 – including both final and interim closes – and 81 PE deals reported during the period, totalling $700m. Financials, IT and consumer discretionary were the most active sectors, attracting 49% of deals by volume, with technology-enabled companies representing 51% of the investments. The health care sector accounted for the largest share of PE deals by value (24%).

What do LPs have planned for PE allocation in 2020-23?

Graph source: AVCA African Private Equity Industry Survey, March 2020
Some GPs in Africa are anticipating a temporary reduction in capital inflows, particularly from commercial investors in Europe and institutional investors from Asia. This could leave the remaining investors with attractive propositions.

The pandemic could also prompt many previously hesitant companies to reconsider PE. “The crisis is leading companies to be more realistic about what they have to give up in equity, opening up opportunities for PE,” Tokunboh Ishmael, managing partner of Alitheia Capital, told OBG. “Many businesses have recognised that their debt-dominant capital structures are insufficient and that they need more patient capital.”

Prior to the pandemic, the long-term trend for PE in Africa was positive. The continent offered a higher growth rate than other emerging markets as well as an unsaturated market. New players have shown a keen interest in the African investment space, and existing players have made more lasting commitments. During crises and external shocks, capital will inevitably seek out a safe haven. This trend played out during the Covid-19 crisis. According to the International Institute of Finance, the first quarter of 2020 saw the greatest capital flight from emerging markets ever recorded, and although official figures have yet to be published, Africa’s PE market was negatively impacted. However, the continent has shown resilience during the pandemic; there were more than 80 deals executed and a significant number of exits conducted despite the constraints. Moreover, in contrast to developed markets, where PE investors gravitate towards technology and energy sectors, African PE is also attracted to infrastructure investment, which has a positive knock-on effect on other sectors of the economy. PE catalyses private investment in Africa, and once the crisis fades, investors will return to seek out opportunities. The continent must therefore be ready to attract new capital and leverage existing capital. Raising funds from local and regional institutional investors will be pivotal for long-term development, and to achieve that, Africa must leverage existing and innovative financing mechanisms. Asset recycling is one solution we have been advocating for at Africa50: it enables governments to unlock the capital they invested in profitable infrastructure assets, such as toll roads, power plants, airports and fibre-optic networks, by offering them to private sector investors under a concession model. The freed-up capital could then fund stimulus plans and build new infrastructure for the recovery phase, especially in the health sector. This is the kind of fresh thinking that could help meet Africa’s investment needs.

Beyond leveraging existing brownfield infrastructure, investing in new greenfield projects in strategic sectors from logistics to mid-stream gas and power-generation infrastructure would stimulate job creation and business formation, and this requires increased government support. However, governments need fiscal breathing room to concentrate on the pandemic. The required amount put forward by African finance ministers to support post-Covid-19 stimulus measures and the development of new projects is a minimum of $100bn per year. PE could be the investment vehicle to help plug that gap. Compared to other developing regions, Africa is still very undercapitalised, particularly in terms of infrastructure. To address this, the continent needs to do a better job of promoting its success stories while continuing to improve its enabling environment for investors. While new financing models, asset-recycling solutions and greenfield projects could stimulate growth on the continent, without a strong marketing campaign to highlight the wealth of opportunities and the market’s growing maturity, we may struggle to pique the interest of international investors.

Africa Remains an Attractive Destination

There are some signs that the need for additional investment to support economic recovery could result in government action to foster a legal and regulatory environment that is more conducive to PE. In Ghana, the government’s Covid-19 recovery programme includes a commitment to overhaul the institutional framework for investment promotion and strengthen the capacity of the Ghana Investment Promotion Centre. There is optimism that this approach will be adopted more widely throughout the continent.

“The current lack of PE-friendly regulatory changes is a function of governments not meeting as regularly as they usually do, and because leaders have focused more on solving the immediate health crisis than attracting foreign direct investment,” Maxine Barnett, founder and CEO of Hong Kong-based PE firm Acorus Capital, told OBG. “That may change, as it becomes clear that pandemic-related challenges will persist for at least another year, so a look is needed at the economic fallout and how to find a means to bridge funding gaps.”

Graph source: AVCA African Private Equity Industry Survey, March 2020

LPs’ expectations about PE returns in Africa relative to other markets (% of respondents)

- African returns will outperform
- African returns will be similar
- African returns will underperform

Relative to emerging and frontier markets
- Over the next 3 years
- Over the next 5 years
- Over the next 10 years

Relative to developed markets
- Over the next 3 years
- Over the next 5 years
- Over the next 10 years

Strategies and Adaptation

In some countries, PE and VC investment by pension funds expanded significantly following the passage of legislation allowing for alternative investments. In Kenya, where the Retirement Benefits Act of 2016 allowed pension funds to invest up to 10% in the asset class, PE and VC became the fastest-growing asset class for pension funds, with KSh1.17bn in investments as of June 2020, up 20% from KSh969m in December 2019. However, this increase comes from a low base – highlighting both the potential that lies ahead, and the challenges GPs have faced unlocking local institutional capital.

While the size of Africa’s PE industry remains modest, PE firms play a key role in fostering good governance in companies across the continent. There is a strong correlation between good governance and growth, and it is very challenging for companies that do not adopt good governance to grow over the long run. In light of the ongoing pandemic, PE will prove to be a very powerful tool for providing capital for companies that have been adversely affected by the crisis, as well as fundamentally improving underlying corporate governance.

Opportunities for investors can be anticipated across most sectors, and Africa’s demographic growth remains a key indicator that the region’s consumers and expanding middle class are where the focus should be.

To that end, we are a strong advocate for investing in the industrial sector. It is hard to imagine that a country like Côte d’Ivoire, which has a high rate of electrification and a relatively skilled workforce compared to the rest of the region, only locally processes 4000 tonnes of the 160,000 tonnes of mangoes it produces each year. PE can help to drive the necessary shift in African industry, encompassing segments other than traditionally exported goods such as cocoa.

The challenge that lies ahead will be to raise awareness among African institutional investors of the role that PE can play in Côte d’Ivoire and French-speaking West Africa more broadly. Presently, PE investments in the region are low due in large part to a lack of understanding of the PE asset class, hence there is a lack of trust in equity investors as opposed to debt investors. This situation has held back industries which, for the most part, rely solely on banks for funding.

In order to offer quality food and services to African populations and foster a stronger industrial ecosystem, PE funds and banks must cooperate to a much larger extent. Together, they have the financial means and knowledge to back the industrial champions of tomorrow.

Strategies and Adaptation

Nonetheless, the latest AVCA survey showed that a majority of LPs (69%) believe that local capital will catalyse the PE industry in Africa. Of those, 91% plan to increase or maintain their African PE allocation through to 2022, with 59% planning to increase the number of GP relationships in Africa during that period. While pension funds have some of the largest assets under management, other domestic funding could provide the necessary impetus. “We expect an increase in domestic funding, primarily from public funds like the Nigerian sovereign wealth investment fund,” Ishmael told OBG. “VC and PE initiatives from the public sector will lead awareness and drive some activity, but in the immediate future, pension funds are unlikely to rapidly shift their risk profile.”

Which developments do LPs expect to catalyse PE in Africa? (% of respondents)

<table>
<thead>
<tr>
<th>Development</th>
<th>% Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local capital</td>
<td>72</td>
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<tr>
<td>Co-investments</td>
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<tr>
<td>Permanent capital vehicles</td>
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<td>Secondary funds</td>
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<tr>
<td>Credit funds</td>
<td>24</td>
</tr>
<tr>
<td>Other</td>
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</table>

Total assets of pension funds per country* (US bn)

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>309.8</td>
</tr>
<tr>
<td>Morocco</td>
<td>25.7</td>
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<tr>
<td>Nigeria</td>
<td>18.9</td>
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<td>Algeria</td>
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<tr>
<td>Angola</td>
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*Latest data available