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AFRICAN INSIGHTS

MINIMISING RISK WHEN INVESTING IN AFRICAN-FOCUSED PRIVATE EQUITY FUNDS

Investing in African private equity funds is not a new phenomenon: development finance institutions (DFIs), such as UK based CDC Group, have been doing it for decades. However, institutional investors are finally recognising the opportunities that the continent affords. As a result, some managers (for example, Helios Investment Partners and The Abraaj Group) are now raising significant African-focused funds in the region of $1bn. Below, we consider a few issues likely to concern managers and investors when making an investment in an African-focused private equity fund:

- **Environment, social and governance (ESG) considerations and business integrity:** in contrast to many European or US managers, African managers have grown up with robust, well-documented ESG policies that are central to the way in which the fund and portfolio companies are operated. Therefore, concerns about ESG and integrity issues in African funds may be misplaced by investors. However, managers must ensure that their ESG and business integrity procedures can be implemented in practice. For example, some European and US standards are not recognised in African jurisdictions which will hamper the investment strategy if deals are all supposed to conform to such standards.
- **Political risk:** inevitably, investors will be concerned about the perceived political fragility of some of the target regions. Managers can address this in a number of ways. They may ignore deals in any companies that are heavily regulated or otherwise linked to the government; and investment policies tend to be broad and cover a range of sectors and geographies to avoid over-concentration.
- **Investment policy:** in order to manage over-exposure to a risky jurisdiction and over-concentration, investors may want to invest in an African fund with a broad investment policy. However, a broad investment policy often leads to investors requesting additional investment restrictions and excuse rights to deal with investments prohibited by their own investment mandate. It is not uncommon to have lengthy discussions with managers about how to balance these restrictions with making profitable investments and the need for flexibility.
- **DFIs versus institutional investors:** as demand for African funds increases amongst institutional investors, the role of the DFIs, especially in the larger funds, is arguably diminishing. In the future we might expect to see DFIs focusing on investing in smaller or first-time managers, with the institutional investors concentrating on managers with a proven track record.
- **Establishing a new manager relationship:** "due diligence and more due diligence" seems to be the message from investors, especially those that are not used to making African investments. Investors spend more time on pre-investment due diligence than they might do with a European / US / Asian fund proposition, perhaps because of the lack of familiarity with the geography, the deals and the team executives, as well as needing to "sell" the investment to their own investment committee.
- **Structure:** Jersey, Guernsey, Cayman and Mauritian limited partnerships are frequently used for African funds. These structures are familiar to most institutional and DFI investors, which means that the legal due diligence, negotiation and closing process is usually no more complex than making an investment in a standard European / US / Asian fund.
- **Deal flow:** concern has been expressed about the volume of recent fundraising in contrast to the number, size and quality of African deals available. Competition from global funds is also a potential threat to locally based managers. African funds are swift to downplay this concern and highlight the breadth and depth of local opportunities for funds which have proper local teams and deep seated local knowledge.
- **Currency risk:** many African funds will be denominated in US Dollars, Euros or Pounds Sterling with the deals being done in the same currency to limit currency risk. Fund documentation will also usually permit the manager to invest in currency, currency futures, currency options or other instruments with a view to hedging investments if required.

- **Exit routes:** with African capital markets, including stock exchanges, in their infancy in many African countries, the exit routes available are more limited than in Europe or the US. This is gradually changing, with more stock exchanges opening which will facilitate private equity exits and dual listings. In addition, with some of the larger, global houses focusing on African opportunities (for example, KKR and Carlyle), the potential for secondary sales is heightened.

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