September 2015

Working paper 424

Sub-Saharan Africa and international equity

Policy approaches to enhancing its role in economic development

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Abstract

International private equity has been the fast growing capital flow to the sub-Saharan Africa with a five-fold growth and a total of more than $50 billion of inflows since 2008. It now comprises approximately $12 billion annually and 20% of cross-border capital flows.

It offers an unprecedented opportunity to accelerate economic development.

However, new policy is needed from development finance institutions, national governments and bi-lateral agencies to capture their benefits. Policy priorities include;

- Being more proactive at an earlier and smaller level of enterprise development
- More holistic policy that develops “eco-systems” for sectors and industries
- More sophisticated and well-priced risk mitigation that is more closely aligned with investors needs
- Capital flow management to manage risks to financial stability especially from mutual funds and ETFs
- Universal, but pragmatic, standards for responsible investment tailored to the sub-Saharan African context especially for energy, healthcare and education.

Acknowledgements

The ODI gratefully acknowledges the support of DFID in the production of this Working Paper.

We are grateful for the very helpful comments provided by peer reviewers, Dr Annalisa Prizzon and Dr Dirk Willem te Velde of the ODI.

We would like to thanks interviewees in the private equity industry for generously giving their time to be interviewed for this paper.

The views presented are those of the authors and do not necessarily represent the views of ODI, DFID or the interviewees.

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Abbreviations

AIM	Alternative Investment Market
BPM	Balance of Payments Manual
CDC	CDC Group
CFM	Capital flow management
DFID	Department for International Development
EMPEA	Emerging Market Private Equity Association
ESADE	Escuela Superior de Administración y Dirección de Empresas
ETF	Exchange traded funds
FDI	Foreign direct investment
GDP	Gross domestic product
IFC	International Finance Corporation
IFI	International Financial Institutions
IMF	International Monetary Fund
IPO	Initial public offering
LSE	London Stock Exchange
MIGA	Multilateral Investment Guarantee Agency
NYSE	New York Stock Exchange
ODI	Overseas Development Institute
OECD	Organization for Economic Cooperation and Development
PWC	Price Waterhouse Coopers
SME	Small and medium sized enterprises
SSA	Sub-Saharan Africa

UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNGA	United Nations General Assembly
UNECA	United Nations Economic Commission for Africa
USD	United States dollar

Executive summary

Private capital is needed for sub-Saharan Africa’s economic development. This paper focuses on one element of private capital – international private equity.

It has been the fastest growing flow to the region with a five-fold growth rate and more than $50 billion of inflows since 2008. It now comprises approximately $12 billion annually and 20% of cross-border capital flows.

This has been driven by bullish investor sentiment about the growth prospects in the region – colloquially known as “Africa rising” - as well as a search for alternative investments because of weak economic in advanced economies.

It offers an unprecedented opportunity to accelerate economic development, particularly in the private sector, through direct and induced effects. The latter include employment and technology and knowledge transfer.

Such gains will benefit the poor directly through low-skill job creation and indirectly through enabling broader economic deepening.

However, there are barriers to seizing this opportunity.

The region is suffering from an “overhang” of unused capital because of the lack of suitable companies for investment. Firms are too small, lack human capital and are often within underdeveloped sectors that lack the economic “eco-system” that supports growth of individual firms.

Private equity investors have responded through “build, not buy” strategies but they are costly and need longer timeframes for execution, reducing their commercial attractiveness.

Other investors, such as mutual funds, are responding by investing in the regions limited stock markets – creating moderate but growing risks of assets bubbles and financial instability.

Current policy is already acting in some key areas. Development finance institutions are active in building infrastructure, enabling improved business environments and by providing co-investment and risk mitigation. [1]

[1] Major IFI financiers include the World Bank, the African Development Bank (AfDB), the Asian Development Bank, the European Commission (EC) and European Investment Bank (EIB). These are likely to be joined by other development organisations, which are also becoming important; the New Development Bank (NDB), representing the BRIC countries and China’s Asian Infrastructure Investment Bank are new entrants to financing infrastructure projects.

These approaches are achieving successes in infrastructure – a critical area for economic development and for public-private partnerships.

However, in the small and medium sized enterprise sector, they are insufficient. Seed capital for private equity funds, provided by development agencies such as the IFC and CDC, do not tackle the fundamental problems – a lack of investable firms and a lack of private sector “eco-systems”. Such approaches may even be adding to the capital overhang.

In addition, risk mitigation instruments from development agencies are seen as costly and inadequate in their sophistication and flexibility.

We suggest that policy needs to be refreshed with priorities including the following;

- Being more proactive at the “pre- private equity” level of firm development to support the growth of small enterprises into a greater supply of investable medium-sized businesses for on-sale to private equity funds.
- There is a need for policy to be less piecemeal and more holistic, aiming to develop “eco-systems” for sectors and industries in partnership with the private sector. We suggest this is of particular relevance to manufacturing and agriculture because of their role in low–skill employment creation and the importance of value-chains and logistics in their development.
- There needs to be closer partnership with private equity investors to provide more sophisticated and well-priced risk mitigation that is more closely aligned with investors risk management and financing structures.
- This is particularly because country risk is the highest constraint to equity finance. Political risk insurance is a key area where policy can act to extend risk-taking by private equity investors. However, its effectiveness is being undermined by high cost and burdensome execution.
- Finally there are also needs for risks to financial stability to be managed through capital flow management and to establish universal, but pragmatic, standards for responsible investment, including for energy, healthcare and education services.

Much is to be gained from the current equity flows into sub-Saharan Africa. They offer a unique opportunity to finance development in a period when the outlook for other options – including overseas development assistance and domestic public and private resources – are limited.

However, policy needs to be developed to capture and encourage these benefits. Further research is needed to develop such policy.

1 Introduction

Sub-Saharan Africa overall has seen a decade of strong economic growth and poverty reduction. However, the outlook has become more challenging - growth in 2014 was a relatively weak 4.5%. There is an urgency for policy to regain momentum, including creating the additional 18 million jobs needed annually until 2035. [2]

In examining this agenda, the 2015 UN 'Financing for Development' conference outcome document emphasised that there are significant challenges to be overcome to raise the capital needed for development and that the private sector will be an essential part in doing so.[3]

Private capital can be sourced from domestic and international markets and through three types of capital – foreign direct investment (FDI), bank lending and portfolio flows. Portfolio flows include debt and equity.

It is against this background that this paper focuses on one element of private capital in sub-Saharan Africa – international private equity. [4,5]

International private equity has significant advantages over the alternative sources of finance for private sector development – international and domestic debt and domestic equity.

Compared to domestic equity, international equity has much greater scale and liquidity. This is especially true in the short-term because of the continued underdevelopment of domestic equity markets in sub-Saharan Africa.

It is risk capital. Risks are borne by private international investors. They are not borne by the public sector nor are they borne by domestic economies.

Compared to debt, risks have little potential to create damaging losses in the banking sector or volatility in debt capital markets.

Section 2 provides a detailed oversight of recent trends in international private equity. Unlike other research, it does this by examining flows classified by three investor categories – private

[2] IMF, 2015a.

[3] UNECA, 2015; UNGA, 2015.

[4] A detailed discussion of international capital markets activity in relation to bonds can be found in the previous Shockwatch (Tyson, 2015).

[5] The paper also excludes sovereign wealth funds. A recent report by ESADE suggests that between 2006-2013, SWFs allocated insignificant amounts to sub-Saharan African infrastructure. The report shows that among the largest SWF infrastructure deals, none have been in Africa. The largest SWFs have remained almost absent from investing in sub-Saharan Africa. The main reason for this lies in their specific mandates. For example, Norway's Government Pension Fund Global is prohibited from investing in infrastructure projects or in unlisted equities. This makes it difficult for Norway to make investments in a region with under-developed equity markets. Interestingly, in December last year, the Norwegian Ministry of Finance called for a re-assessment of whether its SWF should be allowed to invest in infrastructure.

equity funds, international listed equity (i.e. stock markets) and mutual funds and exchange-traded funds (ETF).

As will be discussed, although international private equity remains a smaller source of capital than foreign direct investment or international bank lending, it has been most the rapidly increasing flow to the region with a five-fold growth rate and inflows of more than $50 billion since 2008. It now comprises approximately $12 billion annually and 20% of cross-border capital flows. Further, this growth in its importance is likely to continue.

However, there are barriers to further growth. The region is suffering from an ‘overhang’ of unused capital. This is because of the lack of suitable companies for investment.

Instead, the regions firms are dominated by family firms with small-scale and weak human capital.

Such firms are also often within underdeveloped sectors that lack the economic ‘eco-system’ that supports individual firms. This includes infrastructure – such as energy and transport – as well as sector clusters, developed value-chains and supportive business services.

Private equity investors have responded by investing in a smaller scale of companies than in other regions. They use a ‘build, not buy’ strategy with a hands-on approach that adds value through management and human capital development.

However, such strategies have low economies of scale because of the need for intensive on-the-ground teams and longer time frames – such as 10 years or more compared to a preferred investment horizon of 3 to 5 years - to execute. This is making investment less attractive.

Other investors, such as mutual funds, are responding by investing in the regions limited stock markets – creating risks of assets bubbles and financial instability.

In Section 3 the effects of international private equity on economic development are discussed. Positively, it is associated with economic growth and particularly the growth of the private sector.[6]

It has important secondary benefits for productivity, employment and technology and knowledge transfer.

However, these flows can be associated with negative effects. This is especially where there are short-term and volatile cross-border capital flows and where they flow into asset markets. This means they can be causative factors in macroeconomic and financial instability. This is especially the case where there is also financial underdevelopment - which is the case in some sub-Saharan African countries.

From a policy perspective, this raises the question of how to interact with international private equity to realise the benefits and mitigate the risk. Section 4 examines possible policy responses.

Some of these are common to other capital flows and already a focus of policy. This includes the need to build supportive business environments and build infrastructure – especially transport and power – to enable business. Risks to financial stability need to be managed through capital flow management.

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[6] For example see Reisen and Soto, 2001.

There is also a need for establishing universal standards for responsible investment, including for in energy, health and education services because of their environmental and social welfare importance.

However, other policy needs are unique to international equity. Current policy has two basic approaches – co-investment and risk mitigation. It has been active in infrastructure and in providing seed capital for private equity funds.

We suggest further policy action is needed if the opportunity offered by it is to be fully captured – especially for small and medium sized enterprises - and that the priorities are to be more proactive at the 'pre- private equity' level of firm development and be less piecemeal and more holistic and aim to develop 'eco-systems' for sectors and industries in partnership with the private sector.

In addition there is a need to build closer partnerships between development financial institutions and private equity investors to provide a more sophisticated and well-priced approach to risk mitigation that is more closely aligned with their risk management and financing structure approaches.

In Section 5, we conclude that the increasing flow of international private equity into sub-Saharan Africa offers an opportunity to accelerate private sector development. Current policy approaches are positive. However, additional new policy is needed if the full opportunity for private sector development is to be realised. Further research into developing policy approaches relating to these issues is needed.

2 Trends in international private equity

2.1 Introduction

In this section we examine in more detail international private equity flows to the region using an analysis based on investor type.

We focus on the post-2008 period because, prior to the 2008 these flows were negligible. However, since 2008, they have grown five-fold to average more than $12 billion annually and total $50 billion up to June 2015. Section 2.2 provides more detail of these trends.

We identify three major categories of international private equity that have been important in these growing equity flows to the region based on investor type;

- Unlisted private equity funds
- Mutual and exchange traded funds; and
- International listed equity

These were chosen because all three types of investor raise equity through international capital markets but are differentiated by their risk-reward appetite, the vehicles used for investments and – consequently - their effect on economic development. These characteristics are discussed further in Sections 2.3 to 2.5.

In addition, Section 2.2 gives details of the methodology and data analysis used, including comparing it to that of the IMF and World Bank, for readers for whom methodology is of interest.

In Section 3 we will then consider the effects of these flows on economic development and the comparative advantages and disadvantages of each investment class.

2.2 Methodology

Private capital flows are composed of FDI, bank lending[7] and portfolio flows. Portfolio flows are comprised of equity and bond flows.

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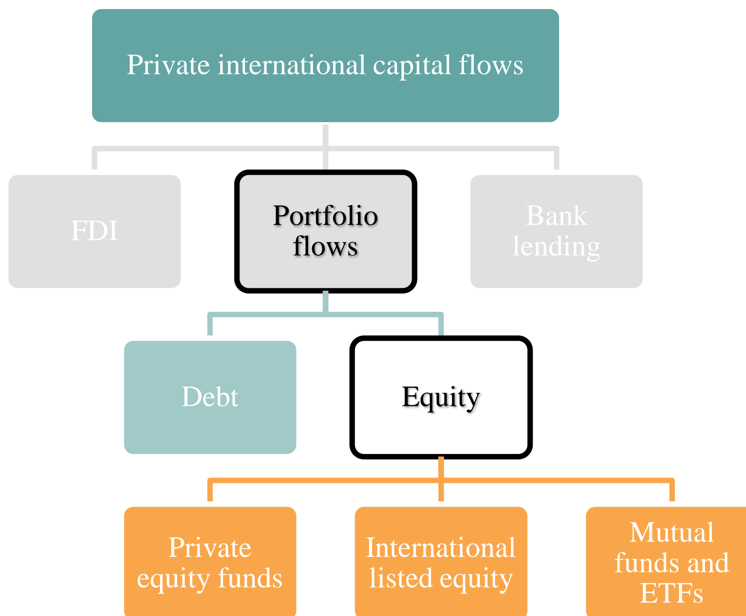
[7] Also known as financial flows.

Equity flows – the subject of this paper – can then be sub-classified in a number of ways. For this paper, we classify them by investor type. (Figure 1).

Figure 1: Components of private cross-border capital flows



Source: Author

However, this analysis differs from the classification of the IMF – which are used as data sources for some of the analysis in this section – because they define flows using the criteria of 'control'. FDI is defined by there being 'control' or 'a significant degree of influence' over an enterprise and portfolio investments have 'less of a role' defined as less than 10% of the equity of a company and includes, but is not limited to, securities traded on organized or other financial markets.

For two of the investor types - mutual and exchange traded funds and international listed equity– this does not present a difficulty because they are aligned with the IMFs definitions of equity and included in portfolio flows. This is because it unusual (although not impossible) for an individual investor in these categories to hold more than 10% of the equity in an individual company.

However, for private equity funds, there is a difficulty because the IMF treatment of private equity funds is less clear. It can be defined as either FDI or portfolio investment on a case-by-case basis and country-by-country basis.

This is discussed in the IMF's Balance of Payments Manual (BPM6) which states that 'private equity funds… are examples of portfolio investment that occurs in less public and more lightly regulated markets… shares in these funds are included in direct investment when the holdings reach the 10 percent threshold'. (IMF, 2009, p100).

However, this definition of 10% of equity as 'control' is not consistently used by different countries submitting data to the IMF. (IMF, 2009) Some countries use the OECD definition, which differs from the IMF data one, as the OECD defines FDI as involving a 'lasting interest' and 'a strategic long-term relationship'. Consequently the OECD, and submitting countries using their definitions, include private equity investments as portfolio investment even where the control threshold is met. [8]

Lastly, gathering data on the percentage of share holdings in a company or subjective measurements of 'control' is difficult. For reporting countries in sub-Saharan Africa, it is not clear how accurate data maybe because of this issue.

For the purposes of this paper, we have assumed the IMF definition has been adopted and that the majority of private equity investments – which usually involve a controlling stake in the company – are included in FDI.

In order to adjust to the definition used in this paper, in the data analysis that follows figures showing 'FDI' show the IMFs FDI values less private equity investment. The latter has then been reclassified and added to 'Portfolio' flows. This is the treatment used in Figure 2 and 3 below.

In addition to these issues, it is also necessary to discuss the methodology and data used to detail the activities and investments of the three investor groups.

For private equity funds there is no public disclosures or official reporting. This makes sourcing data on their activities difficult.

For this report a database was compiled from media searches in all financial press of reported capital raising and investments made in the region. Care was taken to source all available information. However, it needs to be recognised that there may be errors or incomplete data from these sources. This is particularly the case for smaller funds. This data is used for the analysis in Sections 2.4, 3.3 and 3.6.

Some data has also been sourced from the private equity industry body, the Emerging Markets Private Equity Association (EMPEA). However, the majority of the analysis was completed using an original database complied for the paper which provides more granular data than the EMPEA's publicly available information offers.

Data on international listed equity, mutual funds and ETFs was sourced from public disclosures made by stock exchanges and from public disclosures by the various funds. Again, a database of deals was compiled. This data has a higher degree of reliability because such disclosures are regulatory requirements including data that is relied upon by investors and so a high level of due diligence is completed on its accuracy and completeness. However, for mutual funds and ETFs full sector disclosures were not always available for individual funds. Consequently some assumptions were made based on disclosures of their top 10 holdings (A regulatory requirement) to complete a sector analysis presented later in this paper. This data is used for the analysis in Sections 2.5, 2.6, 3.4, 3.5 and 3.6.

[8] OECD, 2008.

2.3 Post-2008 Sub-Saharan Africa's capital flows

Between 2008 and 2010, during the financial crisis in advanced economies, cross-border capital flows to sub-Saharan Africa declined. Post 2010 they have resumed but have been volatile including a decline in 2013. 2014 and 2015 figures are not yet available but are expected to be similar to 2013.

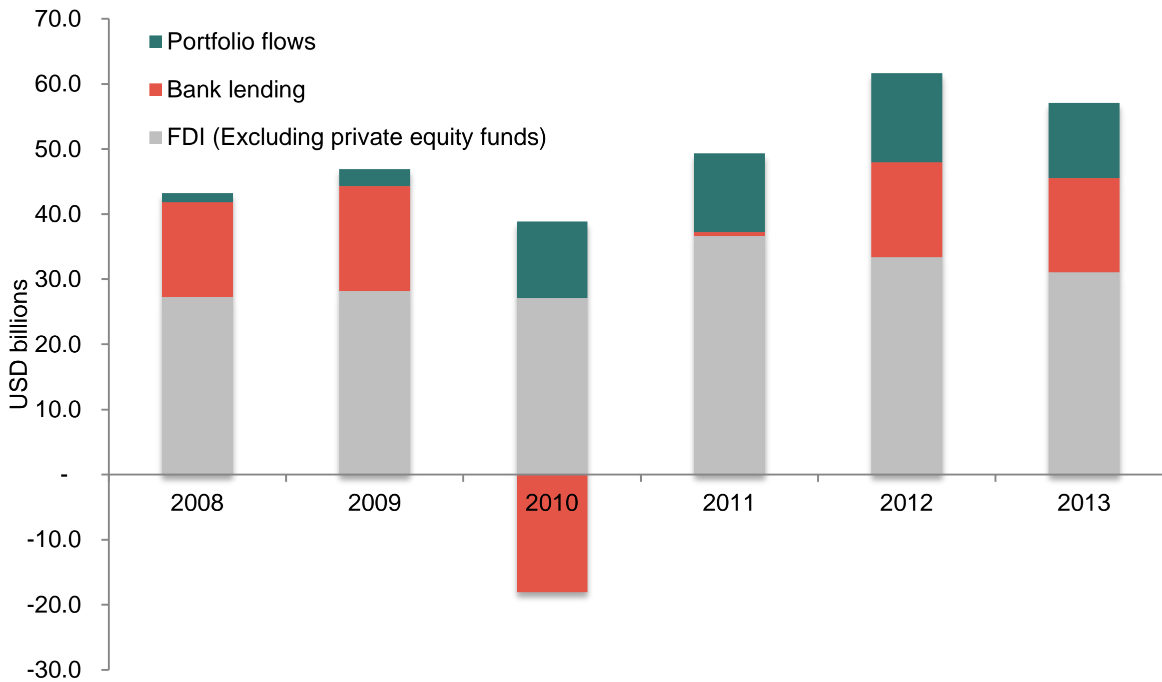
FDI (excluding private equity[9]) has been relatively stable and remains the majority capital flow to the region with $183.6 billion or 66% of post-2008 flows being FDI.

Bank lending collapsed in 2010, with net outflows, but has since returned to pre-crisis levels. However, it is now the least important flow to the region, with it making up $42.2 billion or 15% of post-2008 capital flows.

Portfolio flows – which for this paper is defined as bonds, listed equity and private equity - have boomed. Since 2008, they have shifted from $1.5 billion in 2008 to range between $11.6 billion and $13.7 billion annually, making up 19% of the post-crisis flows to the region and totalling $53.3 billion between 2008 and 2013. (Figure 2).

[9] Characteristics which differentiate private equity investments from FDI include (i) the investment is not made by individual companies but by investment funds; (ii) the motivation is not to establish long-term operations or subsidiaries, but to make relatively shorter-term investment for on-sale at a profit; and (iii) expected gains are primarily from capital gains not from income.

Figure 2: Net capital flows to sub-Saharan Africa (2008-2013)



Source: International Monetary Fund, World Economic Outlook Database, April 2014. EMPEA.
Of this total for portfolio flows, the majority was made through international listed equity – also termed listed private equity and being primarily listed stocks, mutual funds and exchange traded funds - which accounted for $34.2 billion or 64% of portfolio flows.

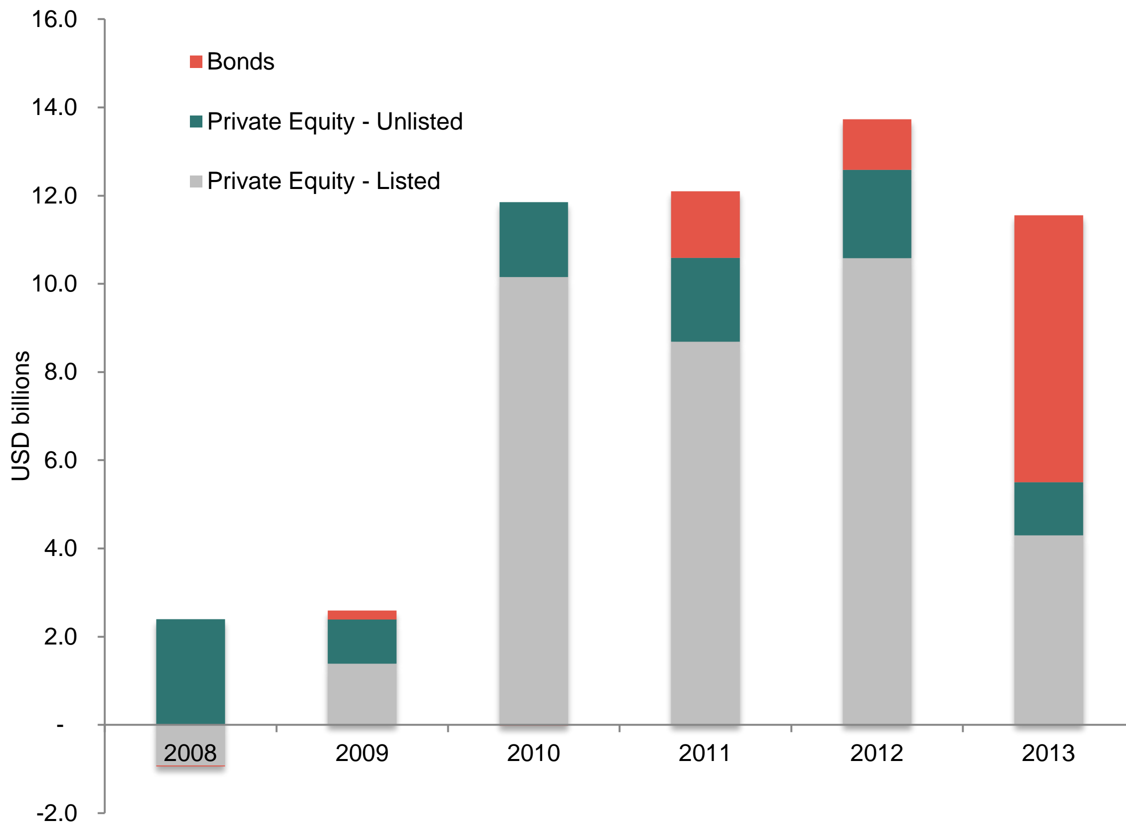
Private equity funds – also termed unlisted private equity - accounted for $10.2 billion or 19% of the total.

Bond flows accounted for $8.9 billion or 17% of the total.

Private equity flows were the most stable. Bond and equity flows were significantly more volatile.[10] (Figure 3)

[10] This is assessed as the standard deviation of flows. For private equity this is 7%, for bonds 26% and for equity 17%.

Figure 3: Net portfolio flows to sub-Saharan Africa (2008-2013)



Source: International Monetary Fund, World Economic Outlook Database, April 2014.

These equity inflows have been attracted by 'pull' factors summarised by the 'Africa rising' narrative that sees the recent economic growth and the rise of the middle classes in sub-Saharan Africa as a key investment opportunity. There is a perception of improved macroeconomic management and political stability in the region and of commercial opportunities offered by demographics including a growing workforce and consumer population.

Although moderated by economic headwinds in 2014 and 2015 – including commodity price declines, currency depreciation and concerns about sovereign debt levels in some countries – confidence amongst international investors in the regions long-term prospects remains firm. [11]

The inflows have also been driven by 'push' factors – most importantly the 'search for yield' because of poor alternative opportunities in advanced economies and emerging markets in Asia and Latin America where growth has slowed and interest rates are at historical lows. (Tyson, 2015)

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[11] For example, The Financial Times, "From Africa Rising to Africa Watching". May 30, 2014.

2.4 Private Equity Funds

Private equity funds are unlisted investment funds that pool and invest private investor funds.[12] They are unregulated and they are private in the sense that they are not required to make public disclosures and can invest in an unlimited range of investments (Subject to any self-imposed constraints by individual funds). They are leverage their equity capital in order to increase returns on capital.

They make 'high-risk, high-return' investments. Target rates of returns are 25-50%, reflecting the uncertainty and volatility of the returns on the investments they are making.[13]

Risk is managed by having large, diversified portfolios of investments as well as active risk management.

In sub-Saharan Africa, between 2008 and June 2015, $16.4 billion has been raised by private equity funds for investment. In the half-year of June 2015, US$2.7 billion was raised - an annualised $5.4 billion, well above 2014 full year levels of $4.1 billion. [14] (Figure 4)

The funds have a range of investment strategies, including regional and country focused funds and sector specific funds.

Investors in funds are wide ranging (although figures are not available). Private individuals and funds, sovereign wealth funds and pension or other investment funds are important. Development agencies, such as the IFC and CDC, have also been investors including providing seed capital for new funds in the region.

Investment of funds has also been steady between 2011 and 2014 with $12.7 billion invested. (2015 figures are not yet available). As will be discussed, this shows there is un-invested, committed capital seeking suitable opportunities. Investor views are that there is a barrier – not in raising capital – but in finding suitable investment opportunities. This is discussed further in Section 4. [15] (Figure 4)

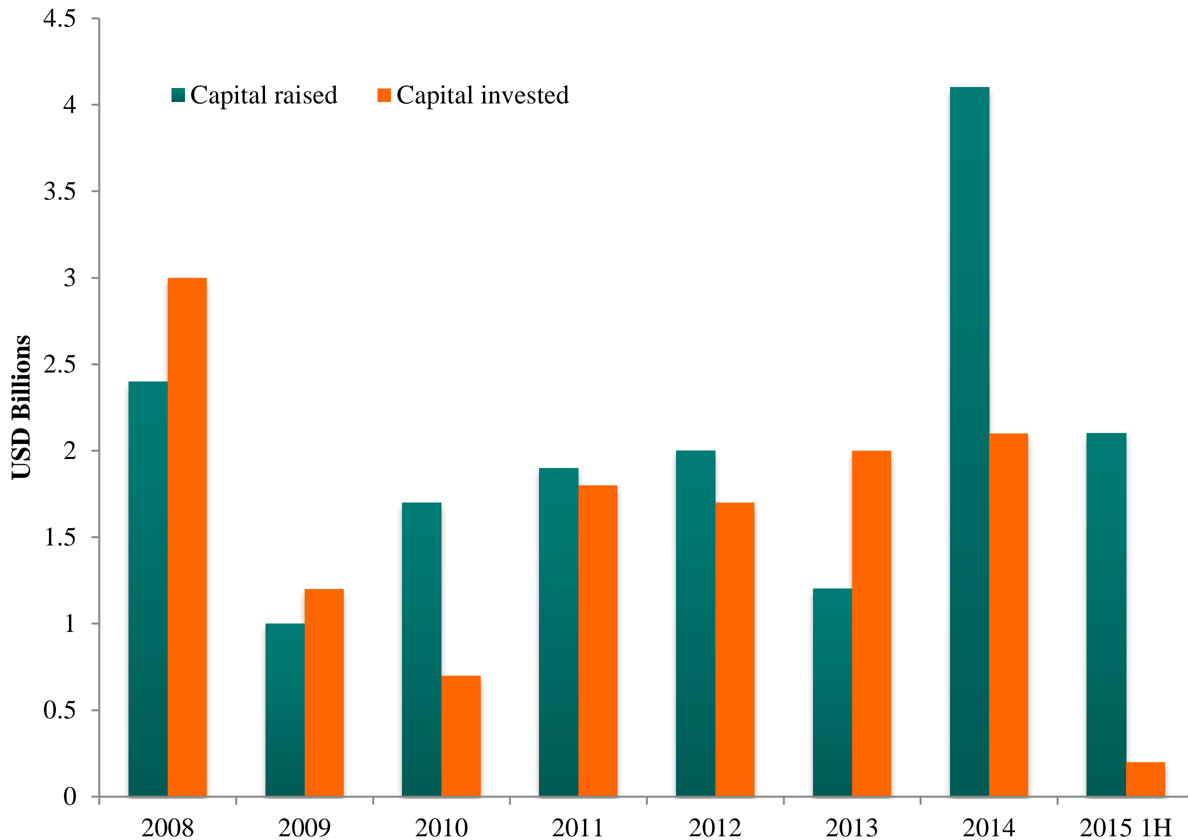
[12] They represent a wide range of investors including sovereign wealth funds, pension funds, corporates, development finance institutions, family offices, financial institutions, high-net-worth individuals, hedge funds and fund of funds.

[13] The IFC reported actual internal rates of returns were 22% with a range of between 46% gain to 38% loss (IFC, 2012).

[14] This figure includes 2014 and 2015. The $10.7 billion figure in Section 2.1 includes only data through to 2013.

[15] Interview material and EMPEA 2015

Figure 4: Private equity capital raised and invested in sub-Saharan Africa (2008- June 2015)



Source: EMPEA. Notes: (i) capital raised is committed capital that may not have been fully drawdown. (ii) capital raised includes private equity, private credit and infrastructure and real assets.

The capital was raised by over 165 private equity funds.[16] However, the capital is concentrated in a few, larger funds with the top 6 fund managers raising 67 per cent of the capital between 2008 and June 2015.

This has included $8 billion raised by Blackstone Energy and Denham Capital for investment in the energy sector and $1.9 billion by Helios Partners for diversified sectors including energy, financial and consumer sectors. (Figure 5).

[16] EMPEA

Figure 5: Top[17] private equity funds in sub-Saharan Africa (2008- June 2015).

Name	Capital Raised USD millions (i)	Fund details	Main Region/ Country	Major sectors
Blackstone	5,000	Energy and infrastructure.	Sub-Saharan Africa inc. Djibouti, Ethiopia, Mozambique, Nigeria, South Africa and Togo	Various power projects plus $1.35 bn Djibouti – Addis Ababa oil pipeline
Denham Capital	3,000	Energy & mining inc. renewables.	Sub-Saharan Africa inc. Botswana, Cameroon, Ghana, Malawi, Mozambique, Nigeria, Sierra Leone, South Africa & Tanzania	Various energy projects inc. biothermal and hydro power generation.
Helios	1,900	Energy, consumer, telecommunication, financials.	Sub-Saharan Africa inc. Kenya, Nigeria and South Africa	Telecommunications and financial services companies
Actis	1,500 Est	Global emerging market firm. Formerly part of CDC Group.	Sub-Saharan Africa inc. Cote D-Ivoire, Kenya, Ghana, Mauritius, Tanzania, Rwanda and Uganda	Real estate, financial, energy, consumer, industrials and mining.
TPG Growth	1,000	Started in 2015	Not yet invested	Healthcare, retail & education.
Abraaj Group	1,000	Established emerging market PE fund with 4 offices in SSA.	Sub-Saharan Africa inc. Cote D'Ivoire, Ethiopia, Ghana, Kenya, Nigeria, South Africa, Togo and Uganda.	Industrials, real estate, healthcare, consumer goods, energy, steel, finance and mining.

Source: Financial Times, fund websites. For global private equity funds, capital raised is only that dedicated to sub-Saharan Africa.

[17] Top funds are defined as funds with $1 billion or more in capital.

The sector focus of these top three funds is reflected in the sector composition of investments made. (Figure 6)

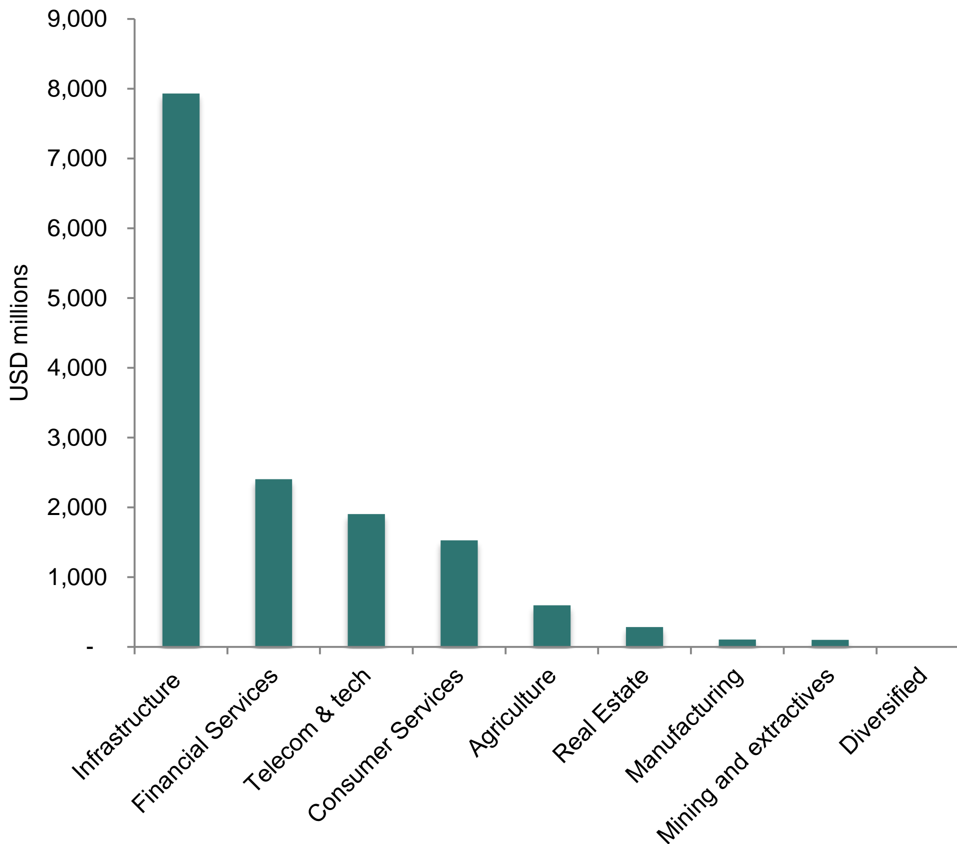
The top sector, with $7.9 billion or 53% of funds invested between 2008 and June 2015 is energy. The investments cover a wide spectrum of projects including traditional gas and oil exploration to renewable energy projects in thermo and hydro power generation.

This concentration of invested funds in the energy has been driven by a few large transactions. This has included $5 billion of investments by Blackstone in a number of projects including the Bujagali hydropower station in Uganda, the Ruhudji hydro plant in Tanzania, and the Ruzizi hydropower project (which will supply current to Burundi and the Democratic Republic of Congo) and a $1.35 billion oil pipeline connecting Djibouti and Addis Ababa.

Denham Capital, a specialist energy private equity fund based in Texas, have raised $3 billion to invest in thermo and hydro power companies and oil exploration companies.

Warburg Pincus invested in Delonex Energy, an oil and gas explorer in Kenya. Actis have acquired a majority stake in Cameroon's national grid.

Figure 6: Private equity investments in sub-Saharan Africa by sector (2008- June 2015)



Source: Author

The financial sector has also been important sector for private equity funds to invest in – although it received only a third of the funds of the energy sector. It received $2.4 billion or 16% of funds invested between 2008 and June 2015.

Investments have largely been made in established banks in the region including those seeking funds for regional expansion. For example, Union Bank of Nigeria has received $1.4 billion from Atlas Mara in 2015 and African Capital Alliance in 2011. Equity Bank of Kenya, Banque Populaire du Rwanda and Zenith Bank of Nigeria have also received investments. Actis acquired Paycorp, a South African payments business. Emerging Capital Partners acquired Finadev, a microfinance holding company with assets in Benin, Chad and Guinea, and also has a stake in a regional insurance company with operations in 11 countries in West and Central Africa. Abraaj, a global Dubai-based fund, acquired a majority stake in Ghana Home Loans, the leading mortgage lender in Ghana.

The telecommunications and consumer sector are the other important areas of investment, receiving 13% or $1.9 billion and 10% or $1.5 billion respectively between 2008 and June 2015. This was driven by the potential commercial opportunities from increasing consumer demand in the region.

Telecommunications has included infrastructure such as communication towers and consumer service businesses. Helios have been particularly active in establishing a holding of regional towers. Other deals have include the Emerging Capital Partners acquisition of a regional tower provider and Wanachi, a pay television and high-speed internet providers in Kenya and Tanzania.

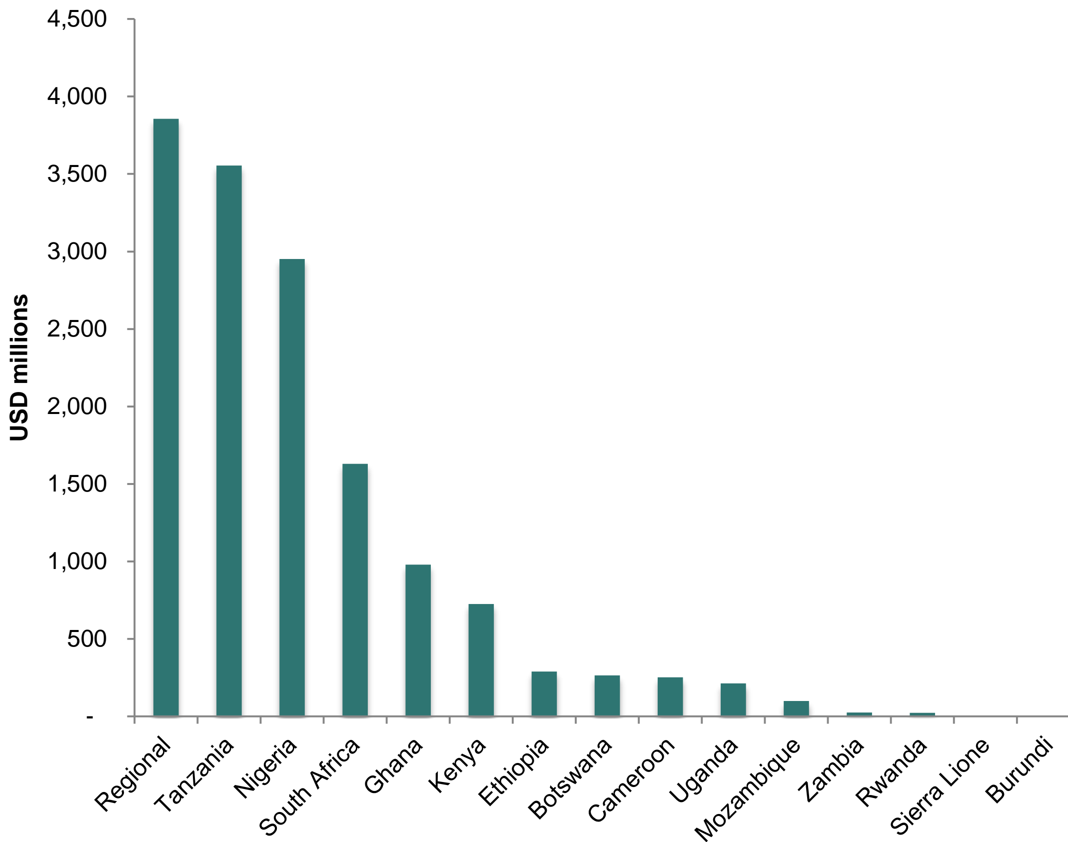
In agriculture, deals include Abraaj, who partnered with Danone to buy Fan Milk, a dairy processor, in West Africa. South Africa's Agri Vie is an agriculture-specific PE manager who have made smaller investments in the Tanzanian Food Corporation and Kariki Group, a Kenyan flower farming and exporting company. Phatisa is another South African asset manager with a similar focus, and its portfolio includes Goldtree, a palm oil business in Sierra Leone, Goldenlay, a poultry farming business in Zambia, and Feronia, a palm oil company in the Democratic Republic of Congo (DRC).

Other sectors that have smaller investments being made include retail, tourism, real estate, construction materials logistics, technology, healthcare and education. These sectors are dominated by smaller but more numerous funds with average deal size being $50 million. They are typically investments in small and medium sized enterprises with co-management by the original owners and the fund managers.[18]

In relation to countries, investments have been concentrated in pan-regional companies and in a few countries including Nigeria and South Africa. Tanzanian investments were dominated by the single Blackstone investment discussed earlier. Ghana and Kenya have also been moderately important recipient countries for investment. (Figure 7)

Figure 7: Private equity investments in sub-Saharan Africa by country (2008- June 2015).

[18] AVCA



Source: Author.

Note: Investments are defined as announced investments. Funds may not have been fully drawdown or utilised but are committed.

Regional investments have been motivated by the potential value of building pan-regional companies which provide both an opportunity for economies of scale and access to more markets. This is especially where there is economic integration such as in the East African Community. Such investments also assist in risk management because their regional scope diversifies risk across the region compared to investments in single countries.

In South Africa and Nigeria, the large economy and population have attracted investments due to perceived growth potential and size of the markets.

However, smaller and higher risk countries are recipients of private equity – highlighting one of the key advantages of private equity, their willingness to make high-risk investments in 'frontier markets'.

In relation to financial structure in private equity, there has been a wide variety of approaches.

Energy investments are typically made through wholly or majority-owned equity stakes. Debt is then used to leverage the investment. In the energy sector debt financing and guarantees have been provided by development banks. These have also provided assessments relating to environmental and social impacts in accordance with their standards. Often projects are subject to the public-private partnership with the fund responsible for building and operating the plants and it then reverting to public ownership after a set period, typically 30 years.

Investment made outside of the energy sector are typically made through acquisition of non-listed companies which are seen as having significant growth potential. This is known as "value investing'. Private equity funds seek to actively partner with that company to realise that growth by providing financing and management or sector expertise. The latter might include growth through developing new or expanded markets or through cost efficiencies.

The investment strategy is to then sell the company at a profit, typically within 5 years. It can be sold to another private investor or through an IPO. To date, the majority of deals have been exited through private sales because of the scale of companies being too small for an IPO. [19]

In other regions, value-investing has been completed by buying medium-sized companies. However, in sub-Saharan African there is a shortage of companies suitable for such a strategy. Instead, funds have adopted a 'build, not buy' strategy. This has involved investing in companies at an earlier stage of development and having a more intensive 'hands-on' approach to their growth. This has included active involvement in management, in-country teams to partner with them and creating value through consolidating firms within industries. It has also led to lower levels of leverage than global averages in the industry. [20]

As will be discussed in Section 3 and 4, this has led to a greater contribution to economic growth – especially knowledge and technology transfer – from investments by private equity funds. Adding such value is at the heart of their business strategies in the region.

However, it makes investing in the region costly and intensive. This acts as a barrier to the number of funds active in the region and creates a 'floor' to the level of investments they make because of the cost implications of executing this model.

2.5 International Listed Equity

New equity can be sought by private companies through listings on stock exchanges. An initial public offering (IPO) is the initial listing. It can raise new equity for a company or proceeds can go to the owners of the previously unlisted stock. It is a common method for exiting private equity investments.

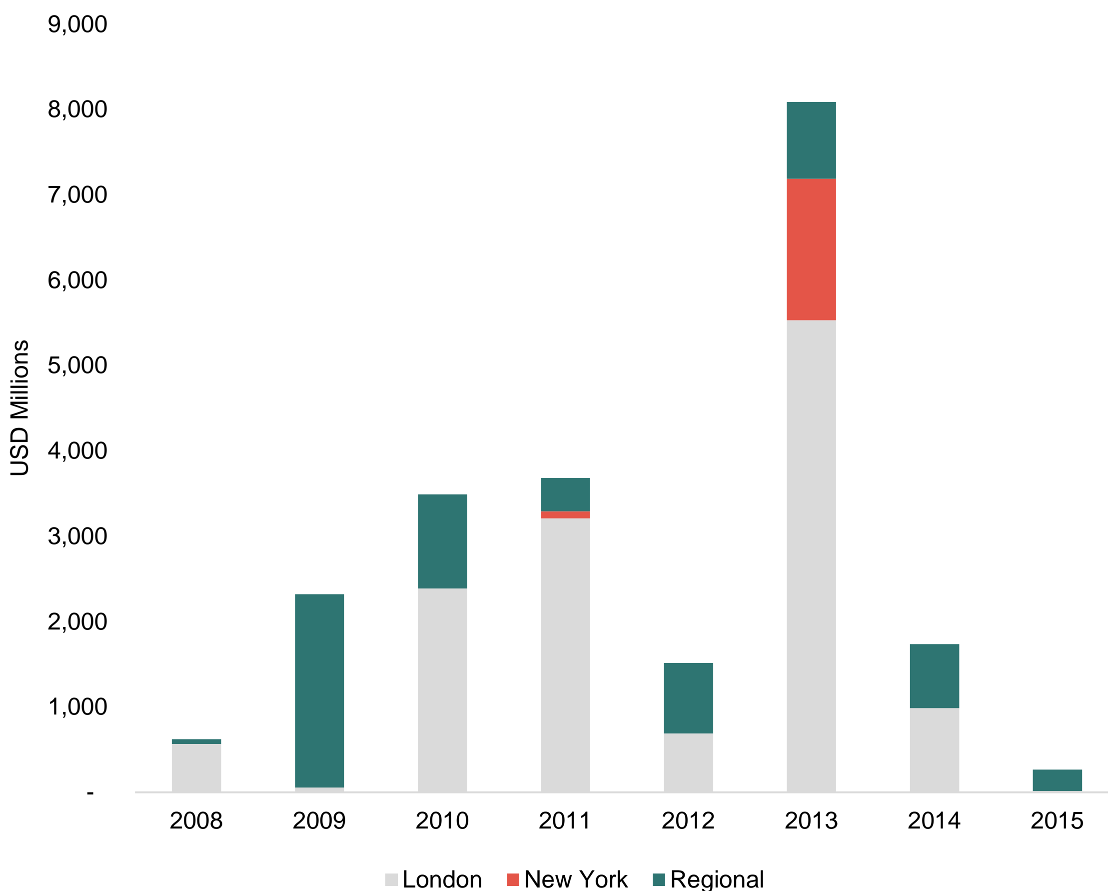
Despite growth in the post-2008 period, domestic stock markets in sub-Saharan Africa remain small and underdeveloped. IPOs remain limited and concentrated in the Johannesburg stock

[19] Interview material
[20] AVCA

exchange with about 35% of IPO value being through it. As such they currently offer limited opportunities for raising capital for private sector development. [21]

This has led to companies in the region seeking listings in international exchanges where greater liquidity and market infrastructure provide better opportunities for successful and large-scale IPOs. Between 2008 and June 2015, $21.74 billion has been raised through IPOs on international stock exchanges. (Figure 8)

Figure 8: Initial public offerings for sub-Saharan Africa companies (2008-June 2015)



Source: Stock Exchanges, Price Waterhouse Coopers, 2014a. 2014 and 2015 are estimated for New York and regional stock exchanges.

[21] Price Waterhouse Coopers, 2014a.

Prior to 2008, IPOs were limited to large corporations, mainly in the extractive industries. Since 2008, this has continued on the New York Stock exchange where 99% IPOs by value were in South African extractive companies.

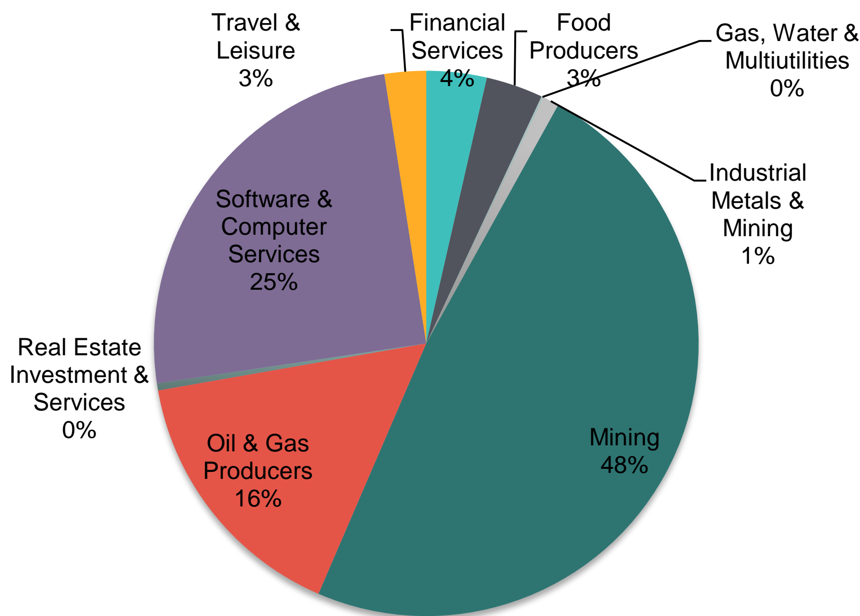
However, post-2008, there has been greater diversity in relation both scale and sector in companies completing international IPOs.

This has been especially true of the London Stock Exchange. Since 2008, the IPOs on the London Stock exchange raised $13.4 billion or 62% of the value of IPOs for the region for over 80 companies. New funds have been raised including, for example, for Nigeria banks recapitalisation and for general investment purposes. The LSE has also signed partnership agreements with sub-Saharan Africa exchanges for cross-listings including with the Nigeria Stock Exchange.

Most interestingly from a development perspective, the London Stock Exchange Alternative Investment Market (AIM) - a market for smaller, growing companies - has become a forum for listing of a sub-Saharan Africa companies with more than $4.6 billion for 67 companies being raised through IPOs on the AIM between 2008 and 2015. The average IPO value was $69.6 million, compared to $6.2 billion for the main market.

In addition, although the majority of capital remains in the extractive industries, the AIM listings have shown much greater diversity of sectors - including in technology (Software and computer services), food processing, travel and leisure and financial services. (Figure 9)

Figure 9: Initial Public Offerings of sub-Saharan African countries on AIM by sector (2008- June 2015)



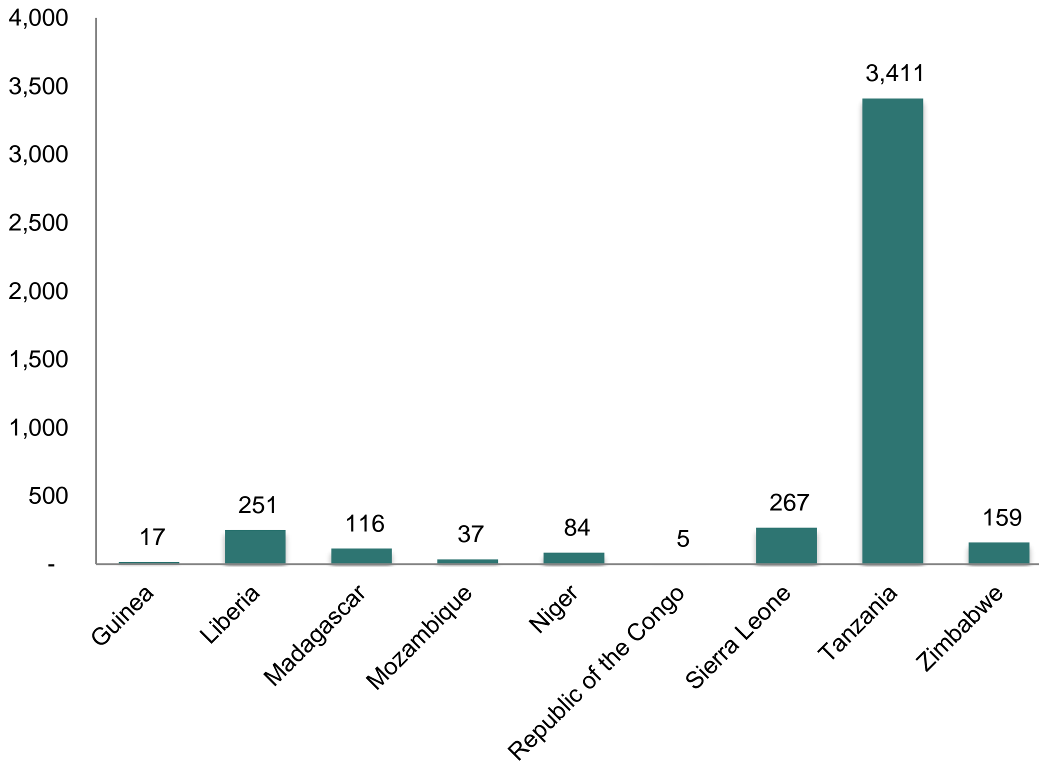
Source: The London Stock Exchange.

Although South Africa and Nigeria companies have continued to dominate the main market since 2008, there has increasing diversity in countries seeking IPOs.

This is again especially the case for AIM listings. AIM listings have included issuances for the DR Congo, Guinea, Liberia, Niger, Tanzania and Sierra Leone. The large Tanzanian figure included two large deals in mining and extractive industries. (Figure 10)

These trends illustrate that the AIM has the potential for becoming a new source of capital raising for medium sized enterprises from sub-Saharan Africa.

Figure 10: Initial Public Offerings of sub-Saharan African countries on AIM by country (2008- June 2015)



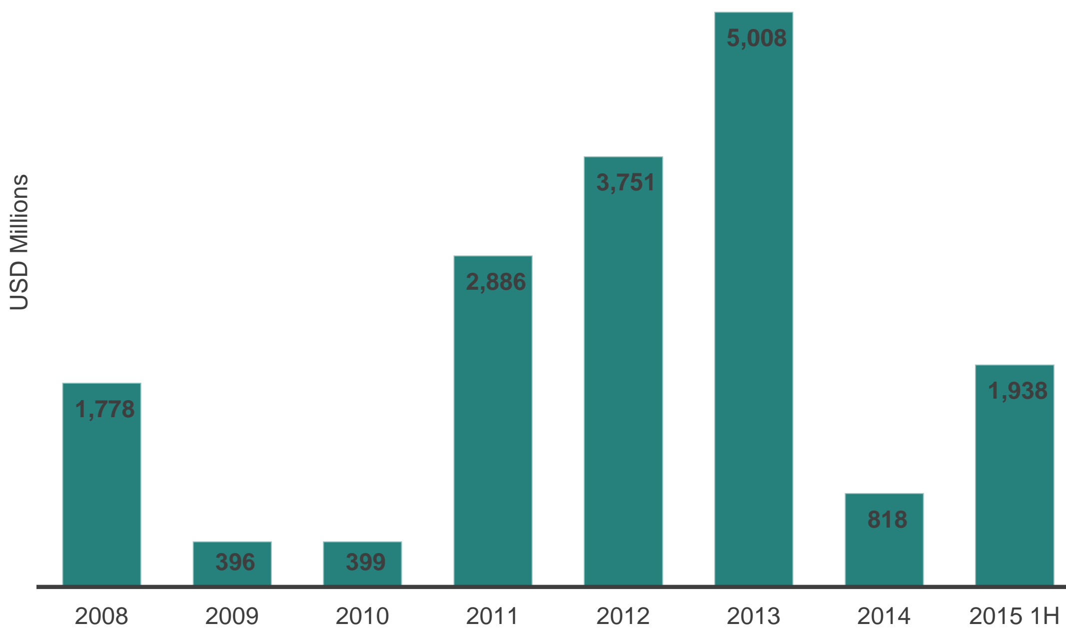
Source: The London Stock Exchange.

2.6 Mutual and Exchange Traded Funds

A mutual fund is a company that pools money from many investors for investment. They are not listed on any exchange but are traded by investors directly with the company. Exchange traded funds are similar but are traded on secondary markets, typically stock exchanges. Both are subject to financial regulation.

Between 2008 and June 2015, $16.1 billion has been raised for investment in sub-Saharan Africa through mutual funds and exchange-traded funds. A number of fund managers have been involved but are mainly established fund managers from Europe and the United States and investors have been largely private individual or institutional investors in these regions. (Figure 11)

Figure 11: Mutual and exchange traded funds issuances of sub-Saharan African funds (2008- June 2015).



Source: Morningstar

The funds are varied. They include pan-regional funds and those dedicated to specific countries. The majority are investing exclusively in listed equity on regional exchanges or companies on other exchanges (including those in developed countries) with substantial business in sub-Saharan Africa.

However, their investments are the more concentrated by country compared other types of equity with investments predominantly in South Africa (Where non-resident hold 34% of all listed equity[22]) and Nigeria. (Figure 12)

[22] IMF, 2013.

Figure 12: Top 10 Mutual and ETF issuances in sub-Saharan African (2008-June 2015)

Fund manager	Capital Raised USD billions	Fund structure	Main Region/ Country	Main sector	Major Holdings
Renaissance Capital	7.0	South Africa - dedicated equity fund issued in 2011-2015 of $2.7 billion each.	Sub-Sahara Africa	Financial (45%), resource (27%) and communications (15%)	Zenith Bank, EcoBank, Tullow Oil, Guaranty Trust, MTN (Telecom).
Vanguard	6.0	Tracker fund for emerging markets with 8.9% in SA.	South Africa	n/a	n/a
T.Row Price	3.5	SSA-dedicated equity fund issued in 2007.	Sub-Sahara Africa	Financials (41%) and technology (12%)	Naspers (SA media), Aspen Pharmacare (SA health).
Nedgroup	2.3	5 funds with 65-80% invested in SA.	South Africa	Concentrated in financials and consumer products and services.	Naspers, MTN, Sasol (SA energy & chemicals)
Global X MSCI Nigeria	2.1	Nigeria-dedicated equity fund for companies traded in Nigeria or with most of their revenues from it.	Nigeria	Financials (46%) and consumer (32%).	Nigerian Breweries, Guaranty Trust Bank, Zenith Bank, Nestle, Lafarge (Building materials)
SIM General	1.7	South Africa - dedicated equity fund	South Africa	Financials (21%) and consumer (19%).	Naspers, MTN, Steinhoff
Old Mutual	1.4	7 SSA-dedicated equity fund inc. frontier fund	Sub-Sahara Africa inc. Senegal, Botswana & Kenya	Various	Sechaba Breweries, Sonatel, Zenith Bank, Kenya Commercial Bank, Guaranty Trust Bank, Lafarge.
Ashburton	0.8	South Africa and Namibia dedicated equity fund inc. 'fund	South Africa and Namibia	Financials (29%), consumer (17%).	Foord Equity, Aylett Equity, Coronation fund,

		of fund' investments			Nedgroup, Naspers
Foord Equity	0.8	South Africa - dedicated equity fund	South Africa	Financials (18%), consumer (28%).	Steinhoff, Aspen
Templeton	0.7	2 SSA-dedicated equity fund inc. frontier fund	Sub-Sahara Africa	Financials (25%), consumer (39%).	Nigeria Breweries, Zenith Bank, Guaranty Trust Bank.

Source: Morningstar, Individual funds public disclosures.

This reflects that the funds are restricted to listed equity investments. [23] [24] This is because their investors are predominantly non-professional individuals and regulatory restrictions are imposed on investments for them. Although 'frontier market' investments are considered high risk for this investor class, these concerns limit their risk appetite relative to, for example, the private equity investors discussed earlier.

These regulatory restrictions on investments mean that funds have been invested in a concentrated pool of individual companies. This is because of the low levels of market capitalization and number of listed companies on regional exchanges. Popular holdings include Zenith Bank, EcoBank, Guaranty Trust Nigeria, Lafarge, MTN and Naspers.

The country concentrations also reflect this, investing in the more liquid and larger exchanges in South Africa and Nigeria. [25]

[23] Defined by each fund in its issuing prospectus.

[24] Some also have equity with a material proportion of their business in the region but listed elsewhere including in London and New York

[25] World Development Indicators, July 2015 (2012 data - Latest available).

3 Issues for development

3.1 Introduction

In this section, we will discuss the developmental effects of the different flows discussed in Section 2.

However, first, we briefly review the literature on the topic and find that, although accumulation of equity capital is robustly associated with economic growth, the literature is limited in relation to sub-Saharan Africa and in differentiating between the effects of different types of equity.

Given this limited empirical research, we build the discussion by asking what are the key questions that the literature suggests are of relevance. These have been identified as follows and are discussed in the following sections;

- **Is incremental capital being raised for investment?** For the new flows to be useful for economic development they need to provide incremental risk capital. [26] This varies according to the type of equity.

- **Is capital relieving financing constraints on economic development?** This can be at the level of the region, specific countries or specific sectors. For example, known financing constraints exist in selected countries, SMEs and infrastructure. [27]

- **What are the economic growth effects including direct, indirect and induced effects?** As well as GDP growth, this includes employment creation and knowledge and technology transfer. It is dependent upon the sector and the country being invested in. It is also dependent upon backward and forward linkages.[28]

- **Are there increased risks of financial instability?** Capital flows vary in relation to their liquidity and ability to exit host economies rapidly. This is important because volatile and

[26] DEPRG

[27] CDC, 2012. Countries defined (in order of increasing difficulty) as “hard” to finance include Nigeria, Namibia, Botswana, Ghana and Cape Verde; “harder” include Kenya, Angola, Sudan, Ethiopia, Rwanda, Tanzania, Senegal, Uganda and Zambia; “hardest” includes Zimbabwe, Sao Tome and Principe, DR Congo, Djibouti, Benin, Burkina Faso, Lesotho, Togo, The Gambia, Burundi, Sierra Leone, Liberia, Chad, Niger, Eritrea, Guinea, Central African Republic, Guinea-Bissau and South Sudan.

[28] CDC, 2012.

short-term capital flows create vulnerability to financial instability. [29] They also vary in relation to their interaction with domestic financial systems.

3.2 Methodology

Two key questions posed above 'Is capital relieving financing constraints on economic development?' and 'What are the economic growth effects including direct, indirect and induced effects?' are also the questions used in the UK's Development Finance Institution, CDC Group, to assess the development impact of investments. (CDC Group, 2012)

In the CDC approach, sectors are ranked as to their positive impact on economic development from 'low' – that is sectors which have limited impact on economic growth – to 'high' – that is sectors with high impact on economic growth. Impact includes direct, indirect and induced effects.

Countries are ranked as to the severity of the financing constraints from 'low' – that is countries facing little or no constraints – to 'highest' – that is countries facing severe constraints.

Further details of the CDC approach are provided in the appendix. (CDC Group, 2012)

In this Section, the paper has applied this approach to assess the impact of the types of equity and present them in the 'development impact grids' below.

3.3 A brief literature review

In assessing the desirability of the equity flows into for the region, it is necessary to consider the role of equity in economic development.

As for financial development in general, growth in equity capital is robustly and positively correlated – although not necessarily causative - with economic growth.[30]

It is also associated with productivity growth [31] and positive secondary effects, the most important of which are growth in employment and technology and knowledge transfer.

Further induced effects occur through backward and forward linkages. [32]

These effects vary by sector. Some sectors have strong productivity effects on the economy. These include infrastructure, finance and transport.

[29] Financial risks highlighted as a key risks by the IMF in April 2015 included reversal of cross-border capital flows, currency losses on dollar-denominated debt and weak fiscal positions (IMF, 2015).

[30] For example see Reisen and Soto, 2001.

[31] LeblebicioğLu, A. And Madariaga, J. 2015

[32] Gries, T., and Naudé, W. 2010

Some sectors generate greater levels of employment. For example, for low-skill workers, this includes retail, tourism, health and education. For high skilled workers, this includes finance, insurance and professional services. Other sectors can be important for growth in exports. [33]

However, these positive effects on economic development have two complicating issues.

Firstly, international equity flows make economies more vulnerable to macroeconomic problems. These include asset bubbles, currency volatility and inflation and – in the worst case - financial crisis.

Secondly, both the positive and negative effects of capital flows, including equity, are larger for less developed countries with maturing – but not yet mature - financial systems.[34] [35] This is of particular relevance because this is the state of many financial systems in sub-Saharan Africa.

Also important is that the academic literature is limited. It is particularly limited in relation to the comparative macroeconomic effects of different forms of equity – the subject of this paper.

This is partially because of the difficulties of methodology. For example, it is difficult to separate out causal relations at the macroeconomic level.

There have been some microeconomic studies of firms where private equity investments are made. These have found that private equity is associated with higher growth rates and improved management practises. Others have found it to be associated with reduced employment levels. [36] However, these studies suffer from methodological problems of establishing appropriate control groups because investors select the more promising companies in which to invest. [37]

These studies have also been conducted in advanced economies where the activities of private equity funds differ from those in sub-Saharan Africa. For example, there is a greater emphasis on mergers and acquisitions and restructuring in advanced economies compared to a focus on organic growth including ‘build, not buy’ approaches in sub-Saharan Africa.

Research specific to sub-Saharan Africa is very limited. There are a few microeconomic studies of private equity investments. For example, one study examined companies acquired by private equity funds in South Africa, Morocco and Tunisia and found greater growth in employment and sales growth than in control group companies. They were also associated with greater innovation in products and services. [38]

However, overall, the body of empirical research is thin. This is partially because equity flows to sub-Saharan Africa are recent. As a consequence, their effects are not yet known, especially as the most important effects of equity take years, not months, to become apparent.

[33] te Velde et al. 2015 forthcoming.
[34] LeblebicioğLu, A. And Madariaga, J. 2015
[35] World Bank, 2006.
[36] Beck et al, 2011.
[37] Beck et al, 2011.
[38] SAVCA and DBSA, 2009.

Further empirical research is needed to guide definitive policy and caution needs to be taken in relying on the existing limited body of research. Further suggestions for research are discussed in Section 5.

3.4 Private Equity Funds

3.4.1 Incremental capital and relief of financing constraints

Whether incremental capital is raised is dependent upon the financial structure used by private equity funds. If the fund invests simply by buying from an existing owner, no incremental capital is raised. However this is unusual in sub-Saharan Africa.

More usual in the region is to inject new capital into the company through both equity and debt. This is because financial resources are needed in order to grow the company – the goal of private equity funds.

Thus private equity can be an important source of incremental capital for the companies in which they are investing.

Importantly, this is risk capital. This means that, if the business fails, the loss is incurred by the private equity fund. This is important because the possibility of losses can be high on individual investments with losses of up to 40% of the invested amount on individual poorly-performing projects. [39]

Moreover, the key advantage for development of private equity funding is their willingness to finance 'high risk' countries, sectors and projects which, by definition, are also those facing financing constraints. Because of this private equity funds can be an important source of relieving financing constraints.

However, this view needs to be differentiated by sector because investments in some sectors create greater effects on economic growth than others. In order to relieve constraints on growth the sectors into which investments are made need to be both finance constrained and have positive impacts on economic development.

For example, the energy sector is constrained by finance and its development impact is strong because of its induced effects on economic growth. Positively, it has attracted significant private equity investments – more than $7.9 billion or 53% of private equity investments since 2008. Further these include clean energy projects, such as thermo and hydro electricity generation, which are also important for the environment.

Private equity is also investing minority amounts in the agricultural sector – again a sector where productivity increases are critical to poverty alleviation but where finance constraints are present. [40] $0.6 billion or 4% of funds have been invested in agricultural projects between 2008 and June 2015. They have included value-chain and export development. This includes

[39] IFC, 2013
[40] Beck et al, 2011

investments in the dairy industry to develop production, processing and distribution networks including regional trade in the processed products. Similarly, there have been investments in agricultural processing of cut flowers for export markets.

However, larger investments are also being made in sectors where there are lower constraints on financial or lower indirect and induced effects. This is being driven by their commercial attractiveness.

For example, although telecommunications – which received 13% of private equity funds - can have important enabling effects on other sectors but it is not a sector that is constrained by finance. This is because it is commercially attractive due to investments yielding rapid and relatively secure returns. This is driven by stand-alone masts with relatively quick construction times and security of payments through the use of pre-paid or regular (e.g. monthly) payment schedules.

Similarly, there are little constraints on financing in consumer services. Again, this is because it is relatively low risk and has high and quickly made returns. It also has lower induced economic effects than other sectors, although it can be a source of low-skill employment.

Private equity funds have also invested in a range of countries. This include countries facing financing constraints which otherwise have very limited access to private finance. This is because funds are more concerned with risk associated with a project, rather than the country-specific, and because taking such risk is an inherent part of their business model.

These effects can be summarised by using the development impact grid for private equity investments as discussed earlier in Section 3.2.As shown, private equity funds are investing in 70% of their funds in high priority sectors (which includes telecommunications and financial services under CDC methodology) and 34% in countries facing high financing constraints. (Figure 13)

Figure 13: Development impact grid – private equity funds

Figures are given as percentage of investments made from 2008 to 2014.

Country financing constraints	Low	Medium	High	Highest
Sector development importance				
High	15%	23%	30%	2%
Medium	5%	12%	0%	0%
Low	11%	0%	2%	0%

Source: Author

3.4.2 Employment creation

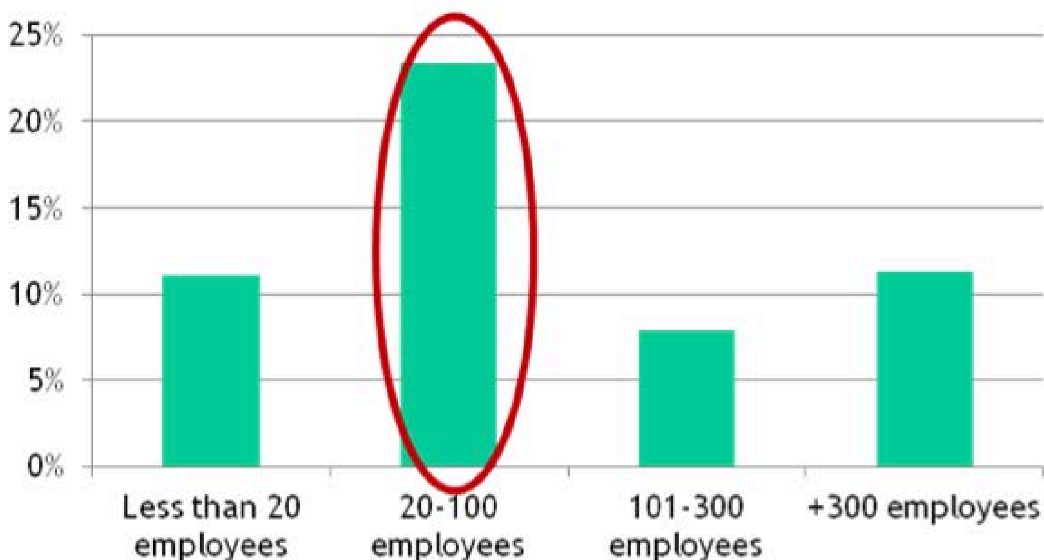
One of the key policy goals in sub-Saharan Africa is employment creation. Of importance is mass, low-skill employment because of its role in poverty alleviation.

Private equity is investing in some sectors that are not labour-intensive such as energy.

However, it is also investing in labour intensive sectors such as agriculture and small and medium –sized enterprises and it is likely it is creating significant employment in these sectors.

Empirical research is limited. However, IFC data supports this assertion. They report that the average annual job creation following a private equity investment is an increase of 14.7% in employee numbers at the company. Moreover, employment creation is most intensive in small and medium –sized enterprises where employment grew by 22% per annum. (Figure 14)

Figure 14: Employment creation from private equity fund investments by company size



Source; IFC, 2012. (Sample was 64 global funds, 466 individual companies and for the period from 2000 to 2010).

3.4.3 Knowledge and technology transfer

'Value investing' involves active management of the company, often in partnership with domestic co-owners.

Knowledge and technology transfer is also likely to be occurring in larger investments. For example, in the energy sector, investments are being made by specialist global emerging market funds. This means that, as they develop their portfolios in sub-Saharan Africa, they can apply and transfer their technical and emerging market expertise.

These activities are likely to be significant in enabling knowledge and technology transfer and building human skills in host countries.

3.4.4 Risks to financial stability and development

As discussed, liquidity and stability of investments and interaction with domestic financial systems are important factors in the potential risks to financial stability from equity investors.

In this regard, private equity firms present relatively low risk.

Private equity funds have limited interaction with domestic financial markets. Equity and leverage are both typically sourced internationally, not within domestic systems. They do not invest in local liquidity asset markets such as stock markets.

This is because they typically invest in illiquid assets. Such assets are not easily exited.

They are also typically committed to longer timeframes for investment – an approach sometimes termed 'patient capital'. This makes their investment strategies less susceptible to short-term economic or financial events.

This has been highlighted by the IMF who comment that private equity funds 'may contribute to financial stability because … private equity funds may be able to lend at very long maturities without facing the risk of a run'. (IMF, 2015c, p68)

This means that private equity funds present low risk to financial stability.

3.4.5 Other issues - Returns and exit policies.

Despite the positives highlighted in the above discussion in relation to private equity firms, they have a significant negative aspect – the high expected returns. Typically funds in the region expect to make a total return of 20-25%. [41] Given the international ownership of these funds, this is a net cost to the host economy.

However, such high returns can be considered to be a reasonable balance between risk and reward given the funds willingness to make high-risk investments.

For a host economy perspective, it can be viewed as the cost of receiving capital at an earlier stage of development that would otherwise have been the case with other sources of private international capital.

However, careful due diligence is needed to ensure that deals are fairly priced and that contracts are balanced between the funds and their local co-investors.

As part of this assessment, host governments should include the externalities for economic development – such as indirect and induced effects on growth - of the private equity fund investments. These issues are discussed further in Section 4.

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[41] Source: Interview material. (According to EMPEA,, net returns on pre-2014 deals are lower at 16%) (EMPEA, 2015).

3.5 International Listed Equity

3.5.1 Incremental capital and relief of financing constraints

International equity takes the form of initial public offerings with subsequent secondary trading. This can take the form of new equity issuances with funds raised being received by the company. Alternatively it can involve the public listing of previously unlisted, but privately held, stock with the IPO proceedings being received by the owners of the stock rather than the company.

Current approaches to raising equity capital in developing countries have focused on development of domestic stock markets. However, currently in sub-Saharan Africa domestic stock markets remain underdeveloped. In the longer term, development of local capital markets may become an important source of such capital. However, this is dependent upon other factors especially savings mobilization which is closely correlated to per capita GDP growth. This means that, in the short term, domestic stock markets are likely to remain a limited source of equity finance.

An alternative for companies seeking equity capital is to see IPOs on international exchanges. They offer significant immediate advantages. These include a strong regulatory, legal and market environment and a deep and liquid pool of primary investors and secondary trading.

International exchanges have the potential for becoming a new source of capital-raising for sub-Saharan Africa. This includes countries and sectors that currently face financing constraints – especially medium-sized enterprises - and some LICs.

International listed equity have raised capital that has been investing mainly in low priority sectors with only 29% of their funds in medium and 1% in high priority sectors. However, they do invest modestly in countries facing high financing constraints with 26% in 'medium' and 1% in 'high' ranked countries respectively. (Figure 15).

Figure 15: Development impact grid – international listed equity

Figures are given as percentage of investments made from 2008 to 2014.

Country financing constraints	Low	Medium	High	Highest
Sector development importance				
High	0%	0%	1%	0%
Medium	2%	26%	1%	0%
Low	25%	10%	31%	4%

Source: Author

3.5.2 Externalities: Employment creation and knowledge and technology transfer

Growth in medium-sized companies is an important source of employment creation. As noted, and as for private equity, this is encouraged by equity capital from international exchanges into labour-intensive sectors.

However, unlike private equity, such capital is not typically accompanied by active management or other involvement in the company. This means that these investments are not likely to be accompanied by significant levels of knowledge or technology transfer.

3.5.3 Risks to financial stability and development

International equity flows are not intermediated by domestic stock markets in the region. This means there is minimal risk of them creating financial instability in domestic asset markets.

It should also be noted that there is a positive correlation between increasing depth in domestic stock markets and international equity flows. [42] This means that there is no evidence of a negative substitution effect on domestic stock market growth.

However, they are likely to be pro-cyclical in relation to investor sentiment in international markets in relation to sub-Saharan Africa and this may create financial fragility within the corporate sector.

3.6 Mutual and Exchange Traded Funds

3.6.1 Incremental capital, relief of financing constraints and positive externalities

As discussed in Section 2, mutual funds and ETFs involve funds being raised from international investors and invested in listed equity investments within the region.

This means that they are not introducing any new capital into the region as capital is being used for trading on secondary markets only. [43]

Because of this, there are also few or no positive externalities.

In addition, because of these investment patterns, mutual funds and ETF are investing exclusively in countries that are not facing financing constraints, although within those countries, they are investing 74% of funds in medium or high priority sectors. (Figure 16)

Figure 16: Development impact grid – mutual funds and ETFs

Figures are given as percentage of investments made from 2008 to 2014.

Country financing constraints	Low	Medium	High	Highest

[42] LeblebicioğLu, A. And Madariaga, J. 2015

[43] The exception to this would be if they are investing via initial public offerings (IPO) but none appear to have done to date.

Sector development importance				
High	15%	0%	0%	0%
Medium	11%	5%	0%	0%
Low	49%	10%	0%	0%

Source: Author

3.6.2 Risks to financial stability and development

Listed equity can be rapidly brought and sold because they are listed on exchanges and so can be the source of rapid inflows and outflows of capital from asset markets.

Such flows increase the risk of volatility in stock markets and have repeatedly been associated with 'boom bust' cycles in asset markets, with subsequent macroeconomic instability.

This is especially where capital flows are large relative to the host countries financial markets and with increasing financial integration with global financial systems. [44]

In sub-Saharan Africa, the $30 billion of funds raised through mutual funds to date representing about 5% of the total market capitalization for the region and the regions systems currently experiencing increasing global integration.

As noted too, there is also significant concentration and overlap in the individual stocks that the funds are investing in which adds to these pressures.

These issues create the potential for mutual funds and ETFs to be the source of market volatility in the regions' stock markets.

These issues have been highlighted repeatedly by the IMFs' 2014 and 2015 financial stability reports. In particular, they highlight the risks relating to emerging market mutual funds because they are obliged to liquidate assets when investors withdraw funds, adding to downward pressure in declining markets. [45]

They have also been highlighted by the World Bank who are concerned about pro-cyclical investment patterns and asset concentrations associated with mutual funds who are investing in developing countries. [46]

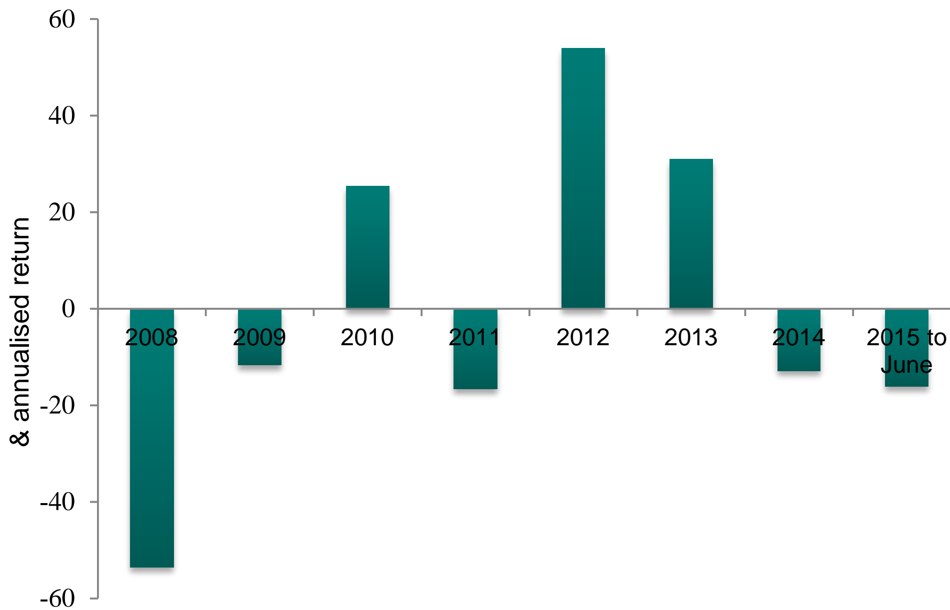
Such collapsing asset prices have already materialised in mutual fund and ETF investments for the region with losses in 2014 and 2015. (Figure 17)

[44] Ananchotikul and Zhang, 2014

[45] IMF, 2014, 2015c. The IMF comment, 'a major concern is the market liquidity risk arising from the mismatch between the liquidity promised to mutual fund owners in good times and the cost of illiquidity when meeting redemptions in times of stress, particularly in the less liquid corporate and emerging market bond markets'. (IMF, 2015c, p35).

[46] Raddatz, et al, 2012, 2013 and 2015.

Figure 17: Frontier Market Africa Index (2008- June 2015)



Source: Morgan Stanley. Index includes North African markets.

This has been a factor in stock market declines in individual exchanges in the region. For example, in Nigeria, in 2014 and 2015, stock market suffered sharp declines of more than 30% accompanied by sharp currency depreciation. The risk of further financial instability in Nigeria has been highlighted by the IMF. [47]

Given the current volatile risk appetite from international investors in markets in response to the possible reversal of quantitative easing and volatility in emerging markets in other regions, these issues are important risks to the regions financial development and stability.

3.7 Conclusion

In this conclusion, we return to the core questions posed in the introduction to this section.

- Is incremental capital being raised for investment?
- Is capital relieving financing constraints on economic development?
- What are the economic growth effects including direct, indirect and induced effects?
- Are there increased risks of financial instability?

We summarise our findings for each type of equity flow below. (Figure 18 and 19)

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[47] IMF, 2015b.

Figure 18: Summary of development impact of different equity flows

	Creating incremental capital	Relieving financing constraints for countries	Investing in high impact sectors	Impact on financial stability
Private equity funds	High	High	High	Positive
International listed equity	Medium	High	Low	Neutral
Mutual funds & ETFs	Low	Low	Low	Negative

Source: Author

Figure 19: Investment in high impact sectors & countries for different equity flows (percent)

	High & highest financially constrained countries	Medium financially constrained countries	Total financially constrained countries	High impact sectors	Medium impact sectors	Total impact sectors
Private equity funds	34%	35%	**69%**	70%	17%	**87%**
International listed equity	37%	27%	**64%**	1%	29%	**30%**
Mutual funds & ETFs	0%	15%	**15%**	15%	16%	**31%**

Source: Author (Note: Percentages are for either countries or sectors and so overlap. Detailed figures reconciling this are given in the development impact grids in figures 13, 15 and 16.

As can be seen, the most positive form of equity flow for developing countries in the region is private equity. It provides incremental capital including for some countries where financing is difficult and for sectors which are developmentally important. Private equity, with its high risk appetite, has used approximately 87% of its funds for sectors with high development impact and 69% for countries facing high financial constraints. It creates limited risks to financial stability. It brings knowledge and technology transfer.

The key challenge for private equity from a policy perspective is how to extend the scope of its investments further into high-risk countries and developmentally important sectors facing financing constraints.

Equity from international listed equity is also positive, but less so than private equity. It is providing incremental capital to developmentally important countries and sectors but levels are more constrained than for private equity, with higher percentages of investments in 'medium' ranked countries and sectors compared to 'high' ranked ones. It offers no benefits of knowledge and technology transfer. It carries moderate risks of financial stability.

However, as discussed, there is a potential for international listed equity to be used for IPOs for capital-raising for these sectors and countries. Encouraging these trends should be the policy focus.

Not only could this be a source of capital-raising for private sector development, but it could have important synergies with private equity investment by providing an exit for mature investments via IPOs.

However, mutual funds currently have little to offer. Not only do they provide little or no incremental capital because they are being invested largely in secondary markets, but they carry the highest risk of being a source of financial instability.

The policy challenge in relation to them is how to neutralise these risks from these flows.

In the next section, we will build on these conclusions by discussing specific policy to encourage the benefits of the various equity flows while addressing negative effects and risks.

4 Policy approaches

4.1 Introduction

In examining policy interventions the starting point is the high levels of liquidity available for investment in the region and the reporting of 'capital overhang' by investors.

This means that the policy focus needs to be on the barriers to applying that capital and how to reduce barriers to investment in countries and sectors facing constraints.

Some of the most important barriers are common to all types of investment flows. These include;

- Infrastructure gaps, especially in electricity and transport, which undermine business activity. These are being tackled through major policy initiatives in the region – many of which, although early stage, appear promising. This includes through co-investment with private equity. [48]

- Macroeconomic risks, including political and currency risk.

- Challenging regulatory, legal and tax environments.

Current policy approaches to these issues include building an enabling business environment, managing financial stability and establishing universal standards for responsible investment. Sections 4.3 to 4.6 present an equity-orientated discussion of these policies.

This includes, in Section 4.3 specific regulatory and tax concerns of equity investors and discussion of an enabling business environment for international stock exchanges and, in Section 4.6, a discussion of how standards need to address private equity investment in socially important sectors, including health and education.

However, private equity investors face a unique problem in the region – the small pool of investable projects. We suggest the further policy innovation is needed. This is discussed in Section 4.2 below.

[48] Severino et al, 2013.

4.2 Increasing investable opportunities: Small firms and 'eco-systems'

In sub-Saharan Africa, many private equity funds wish to engage in 'value investing' – that is in medium-sized companies. For these firms, current policy has focused on providing seed capital for the funds themselves.

However, there are barriers to further growth. The region is suffering from an 'overhang' of unused capital. This is because of the lack of suitable companies for investment.

Instead, the regions firms are dominated by family firms with small-scale and weak human capital.

Such firms are also often within underdeveloped sectors that lack the economic "eco-system" that supports individual firms. This includes infrastructure – such as energy and transport – as well as sector clusters, developed value-chains and supportive business services.

Private equity investors have responded by investing in a smaller scale of companies than in other regions. They use a 'build, not buy' strategy with a hands-on approach that adds value through management and human capital development.

However, such strategies have low economies of scale because of the need for intensive on-the-ground teams and longer time frames – such as 10 years or more compared to a preferred investment horizon of 3 to 5 years - to execute it. This is making investment less attractive.

Sub-Saharan Africa has seen a number of policy initiatives to tackle this problem including project preparation, co-investment vehicles, credit enhancement and risk mitigation.

They have been especially active in infrastructure and have been sponsored by multilateral development banks. [49] International equity investors – particularly large global funds with specialization in the infrastructure sectors - have been partners in these initiatives,

They also include the provision of seed capital to private equity funds. These include newly established firms of small scale and without a track record in other regions. This includes via CDC Group and the IFC.

However, these approaches do not tackle the demand problem of the lack of companies of the scale and quality sought by private equity funds.

It may even be adding to the problem of 'capital overhang' but adding to the supply side of capital.

This could contribute to emerging asset bubbles in relation to company valuations. Interviews reported that, because of the relatively few investable firms and the large amount of un-invested capital available, company valuations have been inflated. The IFC have reported this concern

[49] In Sub-Saharan Africa this has included the Infrastructure Consortium for Africa which coordinates investment by G8 donors, multilateral lenders, the private sector and African regional institutions, the EU-Africa Infrastructure Partnership launched in 2007 that focuses specifically on regional infrastructure, using a new mechanism, the EU-Africa Infrastructure Trust Fund to blend grants from EU donors with long-term project finance from development finance institutions, the Program for Infrastructure Development in Africa which prepares pipeline of potential projects and the NEPAD Infrastructure Project Preparation Facility for project preparation.

commenting that there is a risk that 'markets will be flooded… driving up entry points'. There have been similar reports in the financial press. [50,51]

New policy approaches are needed to create more investable companies - not more investment funds.

Possible options could include re-orientating current incubator funds to smaller-scale or highly innovative businesses that are 'below the radar' of existing private equity funds. Development finance institutions could provide finance and technical assistance to grow their scale and capacity to a level suitable for them to then be sold-on to private equity funds.

Policy could also focus more strongly on tackling the weak human capital for developing businesses. There is a need for mass business education and work experience to develop a more skilled labour force. More could be done through policy support and through partnering with equity investors in, for example, staff training.

However, there is also a second issue that policy needs to consider – constraints to private sector growth at the sector, not firm, level.

As mentioned earlier, this includes, for example, infrastructure such as energy and transport. Tackling such constraints is already an important policy focus.

However, growth is also constrained by the weakness of industry clusters and value-chains. These are difficult for individual private actors to overcome alone. This is especially for private equity funds with small-scale – such as those receiving seed capital from development institutions under current policy.

There is a need for policy to be less piecemeal and more holistic and aim to develop 'eco-systems' for sectors and industries. This needs to be done in close partnership with the private sector to ensure policy interventions are effective.

We suggest that this policy consideration is of particular relevance to manufacturing and agriculture because of the importance of industry clusters and value-chains in their development and because of their role in low–skill employment creation, a critical policy goal in sub-Saharan Africa.

Greater policy research is needed to develop these new possibilities to create a greater pool of companies for private equity investment and integrate private equity development at the firm level into development of industries and sectors in a more holistic manner.

[50] Institutional Investor, "Private equity in Africa: The promise and the challenge". December 6th, 2014.
[51] The Financial Times. "Private equity in Africa: a lot of money chasing scarce opportunities". July 9, 2015.

4.3 Improving sophistication and pricing of risk mitigation

Risk-taking and management is at the core of the economic value of equity investors. Their ability and willingness to assume and manage risk – including difficult to manage risks such as political and currency risks – is the economic rationale that justifies their high returns.

They do so through portfolio management and diversification. They also act through partnering and risk-sharing with other private sector participants, especially for high risk deals or very large scale deals.

However, as highlighted in Section 3, there remain sectors and countries where risk deters investors. In these instances, risk mitigation by the public sector can be important in crowding equity capital into sectors and countries facing financing constraints.

Policy intervention needs to make sure it is extending the risk being taken – not simply mitigating risk that would have been taken anyway or that is better managed by private actors. It also needs to ensure that where risk is transferred to the public sector there is appropriate adjustment of returns for private actors.

However, interviewees in private equity commented that many risk mitigations provisions by development institutions are not as value-added as they could be. A number reported not using them because of their disadvantages. Disadvantages included high costs, inappropriate structuring that does not match the sophistication of risk management techniques by private funds and lengthy and burdensome conditionality.

An example of this is political risk. Development agencies currently provide political risk insurance. This includes, for example, the World Bank's Multilateral Investment Guarantee Agency and the African Development Bank. Risks insured include losses relating to currency restrictions, expropriation of income and assets, conflict and legal disputes.

However, some private equity funds have commented that the pricing for such guarantees is not competitive when benchmarked to market instruments such as sovereign bonds or credit default swaps. In order for these policy interventions to be effective they must be competitive in relation to pricing.

In addition, as sovereign bond markets in sub-Saharan Africa deepen – which has been rapidly occurring since 2008 – it would be expected that private alternatives will develop.

An alternative policy to being the guarantor, would be for development agencies to provide seed capital to brokers or market-makers of more sophisticated hedging instruments such as credit default swaps to accelerate private market development.

This would have the advantage of ensuring market-based pricing and liquidity for investors as well as the secondary benefits of developing bond markets.

A second example is currency risk. It is of particular current concern because of the high level of volatility in sub-Saharan African currencies since 2014. [52]

Managing currency risk through private markets is difficult because of a lack of liquidity in basic currency hedging instruments, such as futures and options.

Development agencies do provide some assistance such as acting as principal in currency swaps and sponsoring incubator projects for private market providers of currency hedging instruments. For example, TCX Fund is a special purpose vehicle financed by DFIs to help develop currency hedge instruments in frontier markets.

However, further development of liquid and well-priced currency hedging is needed. This includes greater flexibility in how development agencies provide risk mitigation. Provision of currency swaps, for example, needs to be extended including through partnership with private providers of currency swaps in host economies in the region.

Overall, there is a need for risk mitigation by development agencies to be better priced, more sophisticated and more flexible. This needs to be developed through a closer partnership with private equity investors to provide risk mitigation that is more closely aligned with their risk management and financing structures.

4.4 Further improvements in business environments

Private finance flows more readily to markets when policymakers establish a predictable, transparent, and conducive investment climate. This includes in relation to regulation, tax and the rule of law.

Such an environment is particularly important in relation to long-term investments and those that are dependent upon government policy or legal frameworks to support their investment rationale. Infrastructure is one sector where both factors are present.

There has been private equity investor concern about the regulatory and legal environment in some sub-Saharan African countries. Equity-specific concerns include the following;

- Long timeframes for regulatory and legal approval of investments
- Lack of transparency and consistency of business information, such as companies financial statements and weak disclosures from stock markets and other financial institutions
- Uncertainty about capital and profit repatriation requirements
- Lack of clarity and explicit standards and methods for fair taxation including lack of double taxation treaties

Tackling such issues - whilst balancing the need to attract capital with a fair deal for host economies on issues such as tax payments and regulatory standards - should be a policy focus.

[52] IMF, 2015.

Development agencies have been effective in providing policy support through technical support in developing legal, tax and regulatory frameworks. This should continue to be a source of development assistance.

A specific aspect of the business environment is the engagement with international stock exchanges. They offer sub-Saharan African companies an immediate source of capital. This is especially the case where there are established markets for smaller companies such as the London Stock Exchange AIM.

Policy should support initiatives for both exchanges and companies to raise capital on such exchanges. The LSE has already established partnerships with regional exchanges supported by DFID providing technical support for capital market development in sub-Saharan Africa. [53] [54]

This approach could be extended to companies seeking listings on AIM. Preparing and maintaining listings can be onerous for companies. For example, listings preparation requires audited accounts and prospectus documents. Overseas companies require specific preparation including meeting requirements for corporate governance and listings legislation and disclosures. [55]

Technical assistance and advisory services to companies seeking stock exchange listings could be policy options which will assist in meeting these requirements. It would also providing an opportunity for broader knowledge transfer.

Tax exemptions for newly listing companies from the host countries of international stock exchanges are also important. In the UK, for example, this already includes stamp duty exemptions and various exemptions for investors. These exemptions should be maintained and extended to reduce the cost of listings and encourage development of an investor base for sub-Saharan African listings.

4.4 Ensuring financial stability

As noted, international equity can make countries vulnerable to disruptive capital flows. Of the equity types we have examined, the highest risk flows are those from mutual funds and ETFs.

Flows can be managed during stable financial conditions through prudent macroeconomic policies in relation to fiscal, monetary and exchange rate management and macro-prudential regulation of domestic financial markets.

However, these risks can derive from exogenous shocks. Currently, there is particular concern relating to the reversal of quantitative easing in advanced economies. [56]

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[53] The Financial Times. "London Stock Exchange to pursue African company listings". September 28, 2014.[54] https://www.gov.uk/government/news/uk-promotes-business-links-in-east-africa-to-end-poverty

[54] https://www.gov.uk/government/news/uk-promotes-business-links-in-east-africa-to-end-poverty

[55] The London Stock Exchange. "A Guide to AIM".

[56] IMF, 2015a and 2015b

Management of such shocks through domestic macroeconomic policy instruments is not always feasible. For example, this may be the case where outflows are large and sudden, when reserves are not adequate to manage exchange rate movements or where effective macroeconomic policy requires time to be effective. [57] Countries with relatively small and underdeveloped financial systems - such as those in sub-Saharan Africa - are particularly vulnerable.

A policy to protect economies in such circumstances is capital flow management (CFM). Such policies have proved effective in protecting countries from financial instability. Examples include Malaysia during the 1997-98 Asia financial crisis and Spain, Indonesia, Brazil, Hong Kong and Korea during the 2007-08 global financial crisis. Because of this CFM is gaining a broad consensus as acceptable policy and should be prepared by sub-Saharan African countries. [58]

In the longer term another policy option is to seek a more positive engagement with mutual funds and ETFs. They offer a significant source of capital. The problems is that they invest in host countries through liquid asset markets with short investment timeframes.

If such funds could be diverted – for example into co-investment funds with development agencies – flows would be more positive for development and present lower risks to financial stability.

Policy action should be taken to partner with institutional investors to tailor products within co-investment vehicles that meet their investment criteria. This might include, for example, senior tranches in structured financing vehicles or guarantees from highly rated development agencies.

4.5 Responsible investment standards

The private sector needs to engage in responsible corporate practises. This includes in relation to sharing the risks and rewards of deals between the public and private sector fairly, taxation, employment standards, environmental standards and social and community issues. [59]

This is especially for unregulated investors – such as private equity funds – who have a need to self-regulate their industry.

Responsible investors recognise the value of establishing standards for corporate practises. This is because they provide them with a consensus of what is acceptable practise. They also provide a ‘level playing field’ so that those who adhere to responsible standards are not penalised in business dealings because of greater levels of cost or more onerous deal terms.

Industry bodies – such as EMPEA - and responsible investors are seeking to adopt similar standards to development agencies. For example, this includes adoption of World Bank and IFC global standards and adherence to the UN-backed Principles for Responsible Investment.

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[57] IMF, 2012.
[58] IMF, 2012; Leung, 2014
[59] UNECA, 2015; UNGA, 2015.

For those investors who are partnering with development agencies, they are also typically matching the development agencies requirements and being assisted in implementing them by those agencies.

However, it should be recognised that there is a need to make sure that standards are not overly burdensome and costly and so act as a disincentives to investments. Issues can include adoption of ‘best practises’ from advanced economies or international agencies that are excessively burdensome and costly in the sub-Saharan African context.

This is particularly the case for smaller funds where ‘short-form’ standards might be more appropriate to their cost-bearing and execution capacity when compared to larger-scale investments.

However, it should be recognise that some sectors require higher standards because of the potential positive or negative externalities that they create. This includes sectors where environment concerns are high such as extractive industries and energy.

It also includes healthcare and education where private equity is rapidly expanding. It has the potential to provide higher quality and affordable services to the growing middle classes that will complement and alleviate public welfare provisions in sub-Saharan African countries. However, standards of service, costs and customer protection need to be maintained.

In addition, policy-makers could consider if there is an opportunity to partner with private equity investing in health and education to take these services ‘down market’ to serve not only the middle classes, but the poor. There are already a few examples of such projects but they are limited. [60]Further expansion of these initiatives would make the development impact of private equity more inclusive.

Policy should promote universal adoption of responsible standards in relation to these issues tailored to the scale of the investments, the sector and the sub-Saharan African context and that balance the need for appropriate standards with the danger of creating disincentives for investment.

Development agencies and national governments should lead and continue to work with industry bodies to establish and seek compliance with standards.

[60] For example, the partnership of Abraaj Groups with Swedfund to expand the Nairobi Women’s Hospital.

5 Conclusion

As the analysis in this paper has shown, there is significant investor appetite and liquid funds available for international equity investment in sub-Saharan Africa.

More than $50 billion has been raised since 2008. Based on average flows and investor surveys – which indicate that flows will continue to increase - we estimate that net annual flows going forward will be between $10 and $20 billion. This means they are likely to match FDI flows and exceed cross-border bank lending in the next few years. (Figure 20)

Figure 20: Funds raised and available (2008- June 2015)

Equity type	Amount (2008-June 2015)	Annual forward-looking estimate
Private equity funds	$16.4 billion	$5-10 billion
International IPOs	$21.7 billion	$3-5 billion
Mutual funds and ETFs	$16.1 billion	$2-5 billion
Total	**$54.2 billion**	**$10-20 billion**

Source: Author, EMPEA

They offer an opportunity to accelerate financing for private sector development in a much greater scale and shorter timeframe than will be possible if the region relies only on domestic or public financing. [61]

However, they also have the potential to create financial instability. As noted some equity flows – particularly from mutual funds and ETFs – carry this risk.

At the time of writing, these risks are elevated. In 2015, as reversal of quantitative easing in advanced economies is anticipated, portfolio flows to emerging markets became negative. $40 billion was withdraw from global emerging markets in the second half of 2015, the highest levels since the financial crisis of 2008. [62] The IMF have repeatedly highlighted these risks in their 2015 financial stability reports. [63]

[61] ODI, 2015

[62] The Financial Times. "EM portfolio outflows worst since global financial crisis". September 29, 2015.

[63] IMF, 2015a and 2015b.

Countries in sub-Saharan Africa need to guard against the risk of financial instability by preparing policy options including capital flow management.

Of the equity capital flowing into the region, private equity funds offer the best source for development. They share many of the positive characteristics of traditional, corporate-led FDI – incremental and stable capital for private enterprises accompanied by knowledge and technology transfer. Flows from international stock exchanges are also positive. Policy to support and develop such flows should be encouraged.

However, there is a need for further policy development. This includes in relation to creating a greater pool of investable companies – as well as a greater pool of funds to invest – and to consider policy that take a holistic approach to 'eco-system' development including value-chain and sector development.

Development agencies need to develop better risk mitigation measures that are more sophisticated, more flexible and more fairly-priced if they are to be taken up by international equity investors.

In this regard, we would recommend further research into the impact of private equity funds in specific sectors including manufacturing and agriculture in the region - because of their importance for employment creation – and how growth of not just individual firms, but of value-chains and sectors can be integrated into policy.

In addition, although the methodology is assessing the development impact is being developed by CDC and others, improved methodology and deeper empirical research is needed. This includes in relation to assessing whether policy action is creating incremental, or substitutive, capital and for assessing the impact of different forms of equity investment in relation to financing constraints and development impact. We also suggest that examination of financing constraints is reviewed for Nigeria, financial services and telecommunications where recent trends in international equity flows may have significantly relieved financing constraints making their reclassification in the CDC grids appropriate.

Our finding also challenge whether policy should focus less on domestic capital market development and more on capital-raising through established international financial centres in advanced economies. This has been the successful pattern of development in other regions. For example, Asian economies capital markets are dominated by Hong Kong and Tokyo and Latin American markets by New York. A similar integration of sub-Saharan African capital markets into London might be the most rapid path to sourcing private capital for the region.

It also means that they need to see international equity flows in the context of long-term development. These flows can provide an immediate source of equity of the scale and liquidity needed to accelerate structural transformation. But the risks of financial instability – and repatriation of investment capital and returns by foreign investors - makes them less attractive as a long-term solution.

The long-term solution is deeper development of domestic financial markets. Most important is development of savings mobilization. This relies on long-term increases in per capita income. But

it can also be encouraged by policies that develop savings mobilization through the bank deposits and pension and insurance funds. This will provide, in the longer-term, more stable, lower cost forms of finance for development.

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Investment Difficulty = Rank (GDP) + Rank (GDP per Capita) + Rank (DCPS) + Rank (DB)

Appendix

CDC Development Impact Grid

The CDC Development Impact Grid scores an investment based on two factors: the difficulty of the geography where the investment is made and the propensity of the business sector in which it is made to generate employment.

Sectors have been divided into three categories – low, medium and high. The propensity of each business sector to generate employment was assessed with regard to: (i) the potential to create employment directly, measured by the employment (both skilled and unskilled) to capital ratio; (ii) the potential to create employment through backward linkages in the supply chain, measured by the local procurement to capital ratio, and; (iii) the potential for investment into essential infrastructure to remove business constraints and build an environment for jobs. (Figure 21)

Figure 21: Sector development impact score outcomes

sss

	Sector	Emp. (U)	Emp. (S)	Linkages		Score
High	Construction	H	H	H	H	12
	Public services	H	H	M	M	10
	Food processing	M	M	H	H	10
	Textiles	M	M	H	H	10
	Heavy manufacturing	M	M	H	H	10
	Light manufacturing	M	M	H	H	10
Medium	Transport	M	H	M	M	9
	Agricultural crops	H	L	M	M	8
	Meat & livestock	H	L	M	M	8
	Utilities* (electricity only)	L	M	M	M	7
	Forestry & fisheries	M	L	M	M	7
Low	Trade	M	M	L	L	6
	Financial services*	L	H	L	L	6
	Business services	L	H	L	L	6
	Communications*	L	M	L	L	5
	Mineral extraction	L	L	L	L	4

Source: CDC

Geographies have been divided into four categories – low, medium, high and highest. The investment difficulty of countries was assessed with regard to: (i) market size; (ii) income level; (iii) ability to access finance, and; (iv) the ease of doing business. (Figure 22).

Figure 22: Proposed investment difficulty indicator

Ranking	Countries
Low	Mauritius South Africa
Medium	Botswana Cape Verde Ghana Namibia Nigeria
High	Angola Ethiopia Gabon Kenya Rwanda Senegal Sudan Swaziland Tanzania Uganda Zambia
Highest	Benin Burkina Faso Burundi Cameroon Central Africa Republic Chad Congo DR Congo Rep Cote D'Ivoire Djibouti Gambia, the Guinea Guinea-Bissau

	Lesotho Liberia Madagascar Malawi Mali Mauritania Mozambique Niger Sao Tome and Principe Sierra Leone Togo Zimbabwe

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ISSN (online): 1759-2917

ISSN (print): 1759-2909

Cover image: Author

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