All Hands on Deck

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Over the last two decades, African private equity (PE) has emerged as an expanding asset class, both in funds raised and capital deployed. Last year alone 145 transactions worth a combined $3.8bn were announced. Its evolution has been underpinned by the enduring commitment of DFIs, local and international development banks and favourable growth trends, such as population growth, steady increase in disposable income, diverse (and expanding) economies, new and untapped markets - all unique to the African landscape.

In the 1990s and early 2000s, major local and regional players saw themselves mainly as capital providers; taking a more passive role in portfolio management (compared to today). The tradition was, more often than not, to take a seat on portfolio company boards, drive good governance and guide sober financial decision-making.

It is not fair to generalise, but Africa, as in South America, has seen its fair share of a buyout culture where PE firms operated mainly by acquiring non-core business units of larger corporates. These businesses had often suffered from neglect, stifled growth, a lack of investment and demotivated management teams, which was remedied easily post deal completion.

Stronger competition for ticket deals, north of $25m, macro-economic and political headwinds, operational challenges, limited management resources and constrained levers for liquidity events in Africa, - all required local fund managers to put greater emphasis on value creation to continue delivering attractive returns.

The pure skill of buying well and implementing organisational and/or financial innovations to drive returns was no longer the sole distinguishing factor. With more funds focused on the same sectors, competing for the same deals and greater access to well-priced debt meant that managing portfolio companies to a successful exit became more than just financial engineering. A new approach was required.

THE CHANGING FACE OF PORTFOLIO MANAGEMENT

Over the last five years, a number of African PE firms have transformed their investment strategy and portfolio management model to reflect these changes; requiring a bigger investment of human capital into their own in-house portfolio management team. There has been a conscious shift towards the appointment of skilled,, operational, value addition, portfolio partners (marketing, sales, engineering, technical, logistics), supported by in-house transaction, finance and ESG teams.

Portfolio management (boots-on-the-ground) is playing a pivotal role as a key value addition tool. As recently as February 2017, Phatisa, a sector-specific African PE firm, announced the appointment of two additional portfolio partners with strong industry and pan-African experience to bolster their existing food-focused team.

Phatisa is an active investor, regardless of its percentage shareholding, with a ‘buy and build’ investment strategy. We combine two disciplines; optimising operational efficiencies to maximise value on exit, and development impact. Our sector specific investment portfolio – focused on food production, processing and the African customer - runs across nine portfolio companies in more than 15 countries. The challenge is significant.

Many mid-cap companies (turnover between $10m - $25m) are run by the original founders or their families, some reluctant to relinquish some/any control to new investors. Others have children who are either ill-equipped, working overseas or not interested in taking the helm. The common thread is a lack of succession planning to prepare the business for the founder’s ultimate exit. Active fund managers can bridge the gap, as a team member, to optimise the value of the business for exit and longer term growth.

Changes can include hands on advisory in marketing and production, building Bottom of the Pyramid routes to market, attracting and retaining a professional management team through appropriate incentives, skills transfer, guiding the company's board and improving overall efficiencies through focused interventions. Portfolio partners may even assume a middle management role to achieve specific improvements.

The focus on active portfolio management has translated into a measurable component of PE returns. EY stated in their 2013 report ‘Global Private Equity Watch’ that for exits between 2006-2012, 50% of total cash return for the portfolio companies was driven by PE strategic and operational improvements. Operational engineering is likely a key contributor to this outperformance for the foreseeable future.

We believe that purpose-built multifaceted portfolio management teams with experience and proven track record can create value that is a durable component of the private equity investment strategy. In the next five years we might see portfolio partners influencing the focused deal pipeline and investment strategy.

To unlock Africa’s growth potential, PE as an asset class cannot remain the same. Africa is changing and African PE needs to follow suit. Turn their attention to undervalued investment sectors, engineer and launch new purpose built, non-traditional investment vehicles and strategies with portfolio management playing a larger role than ever before.