



## **Africa's Abundant Treasury<sup>1</sup>**

*David Ashiagbor*

---

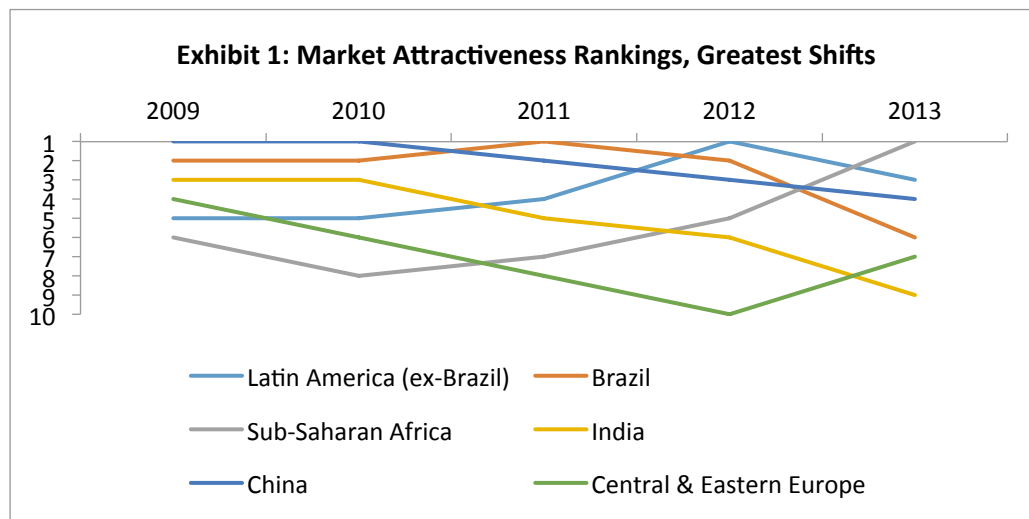
<sup>1</sup> This paper is based on research carried out for the joint MFW4A, EMPEA and Commonwealth report "Pension Funds and Private Equity: Unlocking Africa's Potential", published in July and includes a shorter version of this article.



## Africa's Abundant Treasury

Recent reforms across Africa have created private pension systems that are rapidly accumulating assets under management in line with the continent's explosive demographics. Assets under management by the Nigerian pension industry, for example, grew from US\$7 billion in December 2008 to US\$27 billion in October 2014. Similarly, Ghana's pension industry is expected to expand by up to 400% over the next four years. The recent growth in the African pensions industry brings opportunities to fund the long-term investment in infrastructure and other sectors that the continent so desperately needs. This is especially true in the current context of constrained public finances and falling overseas development-assistance budgets.

Africa's sizeable investment needs, together with high growth rates over the past decade, has made the continent a target for international investors, including private equity funds. The EMPEA (Emerging Market's Private Equity Association) 2013 annual survey of global institutional investors rated Sub-Saharan Africa as the most attractive emerging market region for private equity investment, ahead of traditional favourites like Latin America and China. EMPEA also estimates that a record \$4 billion was raised by Africa-focused private equity funds in 2014 – almost twice the previous record of \$2.2 billion set in 2008, and more than half the \$7 billion raised over the five years to 2014.



Source: EMPEA 2013 Global Limited Partners Survey.

In the context of the significant growth in assets under management in pensions systems, changes in regulatory regimes making available increased sums for investment in private equity, and the potential benefits of the asset class from a diversification point of view, this article seeks to explore the approach of African pension fund to private equity.



The table below, shows assets under management in the ten African countries covered in MFW4A's joint publication with EMPEA and the Commonwealth<sup>2</sup>, range from US\$322 billion in South Africa to US\$400 million in Rwanda. We also estimate how much is available for investment in private equity, based on the relevant investment regulations. Where these are unclear, we have assumed a 5% allocation, which is consistent with the finding that there is historical exposure to private equity in most of these countries. Based on these assumptions, there is some US\$35 billion available for private equity within the pensions system of these countries.

Hard figures for investments in private equity are not available for most of the countries covered. However, based on the data gathered in our research and discussions with various regulators and pension funds, an estimate of between 1% and 1.5% of assets under management (US\$3.8 billion to \$5.6billion) seems reasonable. In Nigeria, for example, where private equity has been an allowable asset class since December 2010, investment in the asset class was estimated at \$56 million (out of a potential \$1.35 billion) on an asset base of \$27 billion<sup>3</sup> in October 2014.

Based on our calculations, there is a further US\$29 billion that could potentially be invested today in private equity by African pension funds. Whilst this may seem insignificant in comparison to larger western LPs (the U.S.-based California Public Employees' Retirement System (CalPERS) alone has a US\$50 billion allocation to private equity), it would almost double the size of the African private equity industry. Why then has so little of this been mobilised? And what are the prospects for local capital in African private equity?

---

<sup>2</sup> Pension Funds and Private Equity: Unlocking Africa's Potential

<sup>3</sup> National Pension Commission Monthly Report, October 2014



Table 1: Assets Under Management and Available for Private Equity

Country	AUM <sup>4</sup> (US\$ million)	Allocation to PE (%)	Available for PE (US\$ million)
Botswana	6,000	2.5%	150
Ghana	2,600	unclear	130
Kenya <sup>5</sup>	7,940	10%	794
Namibia	9,850	1.75% - 3.5%	345
Nigeria <sup>6</sup>	27,100	5%	1,355
Rwanda	400	10%	40
South Africa	322,000	10%	32,000
Tanzania	2,380	5%	120
Uganda	1,200	unclear	60
Zambia	630	unclear	30
<b>Total</b>	<b>380,100</b>		<b>34,984</b>

Regulation has long been seen as the main stumbling block to investment in private equity by African pension funds. However, reforms in some of the continent's key markets are making it possible for local institutional investors to participate in private equity. In none of the ten countries covered in our research is investment in private equity expressly prohibited, although the regulations are unclear (i.e. there is neither a specific prohibition of nor allocation to private equity in the regulations) in countries like Ghana, Uganda and Zambia. Pension funds in Ghana, for example are known to have invested in private equity

<sup>4</sup> The numbers are based on latest available regulatory reports. See Country Profiles in Pension Funds and Private Equity: Unlocking Africa's Potential for dates, except where indicated.

<sup>5</sup> Retirement Benefits Authority, Industry Performance report June – December 2013

<sup>6</sup> October 2014, National Pension Commission



despite the ambiguous rules. Four out of the ten countries (Nigeria, Rwanda, Tanzania, South Africa) have a specific allocation to private equity, with others, (Botswana, Kenya) allowing it within the “other assets” category. Namibia is the exception, with an express requirement for pension funds to invest a minimum of 1.75% of assets in private equity.

However many countries impose qualitative and other restrictions which are not immediately obvious. Nigeria, for example, requires a minimum of ten years’ experience for key principals of the private equity fund manager, a minimum of 75% of the private equity fund to be invested in Nigeria, registration of the fund with the Nigerian SEC, and a minimum investment of 3%<sup>7</sup> in the fund by the GP. Such qualitative restrictions, especially with respect to geography/jurisdiction, are typical on the continent.

Some commentators argue that such conditions are unnecessary and pose a few problems for GPs and pension funds alike. The argument is that regulators should be encouraging pension funds to use private equity to diversify risks, and that the 75% requirement in particular achieves precisely the opposite effect.

From a regulator’s standpoint, the first duty is to protect the pensions of fellow citizens. In that context, it would be unwise to allow pension funds unfettered access to invest in an asset class which neither the trustees nor the regulators fully understand. The idea behind such conditions is therefore to have the pension funds learn from experienced Limited Partners (LPs) (hence the requirement for DFIs), and then slowly liberalise. The strategy is designed to increase local LPs’ willingness to invest in private equity over the long term.

As assets under management grow to significant proportions of GDP (as in Namibia 80% and Botswana 40%), there will be fewer domestic opportunities able to provide the capital protection and diversification necessary for pension funds to meet their obligations. Some countries in East Africa already treat investments in the EAC as domestic investments, and others (South Africa, Botswana and Zambia) already allow offshore investments.

The role that private equity can play in generating returns on the African continent is less of a factor for African pension funds —as of January 2015, the 10-year government bonds in South Africa, Kenya and Nigeria were yielding 7.07%, 12.75% and 15.07%, respectively. With such alternatives, and the African private equity benchmark index posting annualised returns of 11.2% for the ten years to September 2012, the case for private equity for Sub-Saharan Africa’s pension funds (especially outside South Africa) would seem to be more about diversification.

Beyond regulation and returns, familiarity with the asset is an issue for many African pension funds. Given that few African pension funds outside of South Africa have significant, if any, exposure to the asset class, raising local capital in Africa means having a frank and

---

<sup>7</sup> This is reduced to 1% in circumstances where DFIs are invested in the fund.



honest conversation about private equity, and the associated risks and opportunities. The private equity industry has been making significant efforts here. Both the African Venture Capital Association (AVCA) and the Southern African Venture Capital and Private Equity Association (SAVCA), with the support of a number of DFIs, have been running Private Equity Master Classes for local investors for a number of years.

However, investing in private equity is a long and complex process. General Partners (GPs) often talk about the long and thorough due diligence process through which they put investee companies – from looking at the books, to spending time with management and in some cases customers of the target companies, in and out of the office. They will tell you that this hard and time-consuming work is an essential part of risk management, and that it is about building relationships of trust. That is obviously something which takes time. In the African context, where we are starting from a very low base in terms of understanding private equity, it is likely to take even longer.

The private equity industry, through its training initiatives, has made significant progress in answering the *“What is private equity?”* question, which has allowed the conversation in some key markets to move on to the *“Why should African Pension Funds consider private equity?”*, and *“How should African Pension funds invest in private equity?”*

Answering the *why and how* questions means understanding the asset allocation strategies, regulations, investment policies and return expectations of African pension funds. That in turn means understanding that African markets are all at different stages of development in terms of regulation and knowledge about this asset class. Nigerian pension funds, for example, are increasingly able to invest in different asset classes—but are restricted to Nigeria. Since Nigeria is a big market in its own right, it may be possible to raise funds through local vehicles, allowing Nigerian investors to co-invest in local deals alongside regional funds. In other markets (e.g. Ghana, Zambia, Tanzania and Uganda), there is a need for education about the asset class at all levels – from pension fund managers through to regulators. These markets are also yet to accumulate the level of assets that Nigeria has, although they are growing fast.

In contrast, South Africa and Botswana may be a bit ahead of the Nigerians; however, Botswana's internal markets lack depth, so their investment strategy is more externally oriented. Then you have the South African pension funds, which have a great deal of capital, and are only now starting to look beyond South Africa for performance. For them, understanding the challenges and the characteristics of investing outside of South Africa is their learning curve.

Despite the many challenges, the evidence points to African pension funds playing an increasing role in the private equity industry in the medium term. The growth in assets and recent regulatory changes under discussion in countries like Nigeria (with regards to relaxing



the geographic restrictions) and Botswana (on introducing a specific limit for private equity) support this thesis. Some operators in countries like Kenya and Nigeria are exploring the possibility of creating local fund of funds or listed vehicles which could go some way to addressing some of the regulatory and practical constraints private equity poses for local pension funds.

The private equity industry can and should support this process of structuring innovative vehicles that meet the needs of both fund managers and African pension funds in the context of their regulatory and other constraints. It may not necessarily be the cheapest option, nor will it resolve all the challenges from a fund manager's perspective, but it will help to address the critical issue of lack of familiarity with the asset class, and that can only be done through investing and going through the full private equity cycle.

The private equity industry should also take the lead in providing research and analysis that pension funds (and other stakeholders, such as regulators) need to understand the asset class and on which to base investment decisions. In this regard, the launch of the first ever African private equity benchmark study, developed by Cambridge Associates and the African Private Equity and Venture Capital Association (AVCA) in 2013, is a welcome step.

Africa's pension funds will not become mainstream private equity investors overnight. Building capacity within the region for private equity investment will take time. GPs need time to continue to build their track records, regulators need time to better understand the risks, and pension fund managers need time to build up their skill sets to properly identify and evaluate private equity opportunities. But now is the time to start pushing for greater integration between pension funds and private equity (and other alternative assets more generally), building on the exponential growth in asset under management, the urgent need for diversification of investments and with support from the global investment community.

### **About the Author**

David joined the Making Finance Work for Africa (MFW4A) Secretariat in April 2013. MFW4A is a G8 initiative dedicated to supporting the efforts of African countries to strengthen their financial sector by coordinating and facilitating financial sector development initiatives. David leads the Secretariat's long term finance and capital markets development programmes, working with development partners, policy makers, regulators and market participants. He has been conducting extensive research on the pension reform in Africa, and is a co-author of "Pension Funds and Private Equity: Unlocking Africa's Potential".

David's prior experience includes leading the Commonwealth Secretariat's private sector development and investment programmes, where he helped raise US\$800 million for a series of private equity funds, the International Finance Corporation, the Agence Française de Développement and commercial banks in his native Ghana.



He is a graduate of the London School of Economics and The Management School, Imperial College, London.

**The views expressed in this article are the author's personal views and do not necessarily reflect the views of the MFW4A Secretariat.**