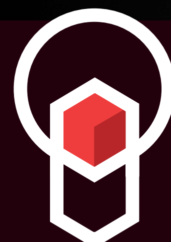
Raising Capital in the Global Market



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Chair's Letter

July 2021

Lord Peter Hain

Attracting Global Capital to the African Market

Youthful. Growing. Huge potential. Immense natural wealth. Despite the COVID-19 pandemic raging through the continent, Africa's population has much to be optimistic about.

Yet that optimism might never be fulfilled without massively ramping up foreign investment,.

So where will it come from?

African leaders at a summit held in Paris in May acknowledged that high public debt levels, tax raising constraints and uncertainty over international aid budgets mean public funding for infrastructure investment is unlikely to be the answer, and the private sector will have to play a much bigger role.

And this means a big shift. According to the IMF, 95 percent of infrastructure on the continent has been publicly financed and Africa attracts only 2 percent of global flows of foreign direct investment, much less than any other region of the world.

How to turn that around?

First, private investors do need to be incentivised, especially to neautralise risk and currency fluctuations – and that's not unusual: in East Asia, 90 percent of infrastructure projects involving private investment are supported by governments in one way or another, and in Europe over 60 per cent.

Proposals for blending public and private investment were encapsulated in the "Billions to Trillions" agenda in 2015, prepared jointly by the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the IMF and the World Bank.

Such 'blended finance' is emerging as a solution to help achieve this 'billions to trillions' agenda, which the Organisation for Economic Cooperation and Development (OECD) has also encouraged.

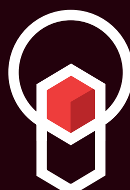
Donor governments and other development finance providers are increasingly using blended finance as an innovative way to mobilise capital, but African governments still have as long way to go to embrace it fully.

For there are also risks for Africa of relying entirely upon international private finance. African Development Bank analysts recently pointed out the dangers of exposing the continent 'to scarce and expensive funding from international markets.'

The Bank and the European Bank for Reconstruction and Development signed a memorandum of understanding in May 2021 to 'catalyse new sources of financing to help bridge the U$2.5 trillion annual financing gap for development in Africa'.

Yet critics such as Daniela Gabor and Ndongo Samba Sylla still warned of the dangers of trapping African states and their citizenry 'into the monolithic rationale of subsidising profit accumulation for European companies and asset managers.

Although blended finance looks like a good – indeed, perhaps the only realistic – option to meet Africa's desperate need for urgent infrastructure investment, everyone needs to go into with their eyes wide open.



Raising and Scaling Capital in the Global Market

*By **Dr Desné Masie, Chief Strategist, IC Intelligence***

As African economies slowly recover from the pandemic's economic downturn, the squeeze on government revenues globally and, in turn, overseas development assistance, capital raising for economic and social development is becoming an ever more key issue.

Increasingly, capital intensive projects, entrepreneurs and governments are looking to private capital to plug the gap.

Indeed, following a call for increased private sector participation by heads of state at the summit on "Financing African Economies" held in Paris in May, an IMF blog explored some possibilities given that its research shows that by the end of the decade, private capital could bring additional annual financing equivalent to 3 percent of sub-Saharan Africa's GDP for physical and social infrastructure (around $50 billion per year).

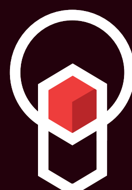
However, the IMF warns that to attract private investors to the continent and transform the way Africa finances its development, improvements in the business environment will be critical. The fund suggests that, in this regard, three key risks dominate international investors' minds need to be overcome: (project risk - where projects are not sufficiently developed); currency risk (where volatile or depreciating currency put capital and profits at risk) and exit risk (where capital controls, weak legal frameworks or political risk endanger getting capital back out of the country).

In this issue of Insights, we explore, along with our subject experts, some ideas on how best to attract, raise and deploy private capital across the African continent against this complex backdrop.

Lord Peter Hain lays out the pros and pitfalls of private capital raising for African countries and points to blended finance as a way forward. Meanwhile, I set the scene and also recap some recent work our team has done on gender-lens investing with private capital. Next, the team at NEU Capital Africa offer some practical solutions in 5 themes for raising $5 to $50m+ of capital in the alternative/private capital mid-market in Africa in light of its own special challenges: opacity of deal-making, insufficient information, weak institutions and powerful politicians. Finally, Eleanor Brown of Invest Africa writes for us on how MSMEs can be supported in the tougher global environment.

One way to tackle the investment risks real or perceived, are as Lord Hain writes, through blended finance in specialist public private partnerships (PPPs) such as those supported by the Private Infrastructure Development Group (PIDG).

Since 2002, PIDG has guided around 200 infrastructure projects to financial close, mobilising billions in private sector investment supported by



funding from six countries – the UK, Switzerland, Australia, Sweden, Netherlands and Germany – and the International Finance Corporation. These state and multilateral agencies have provided equity and worked together in PPPs that have included insurer Allianz; Standard Chartered Bank; the African Development Bank; the German development finance institution, KFfW; and FMO, the Dutch development bank. Remaining revenues come from interest payments and the repayment of loans towards the projects, taking PIDG's model of self-sustainability closer to reality. PIDG has been particularly active in bringing energy, especially renewables, to the African continent, including in fragile and post-conflict states through investing in credit opportunities with its Emerging Africa Infrastructure Fund (EAIF) .

While PPPs are certainly a solid framework to tackle the range of issues raised by the IMF, a mix of options is really what's needed to raise and scale varieties of capital. Alongside PPP, private capital markets also need deepening and development.

Looking to the future, and to particularly to support equity capital over debt capital, African companies could look for more diverse and innovative routes for private capital raising such as venture capital, special purpose acquisition companies (SPACS), and even initial coin offerings (ICOs).

Both SPACs and ICOs need very specialist advice and regulatory oversight for going to market, but could be a more flexible route than traditional initial public offering.

ICOs, where new crypto tokens, or coins, are issued to raise money from private investors, could be particularly useful in markets with wide-scale crypto adoption such as Nigeria.

As far as I am aware, only one SPAC has been implemented in Africa so far, but the opportunities are vast particularly as the global economy comes out of recession. Law firm Norton Rose Fulbright says a SPAC is "a company with no existing operations that is incorporated for the sole purpose of making one or more unspecified future acquisitions could offer investors a lot of flexibility and that they "are particularly attractive buyers for potential targets seeking to benefit from private equity expertise and a less burdensome, more stable route to the public markets than an IPO."

Gender-lens investing

Attracting private capital to the continent is one side of the coin, once investments are made into the continent, the question is where should they go?

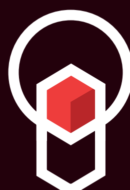
One route attracting a lot of attention for its great investment and social outcomes is gender-lens investing, or taking gender-based factors into consideration to advance gender equality and better inform investment decision making. Research has also shown that investing in women is good for business as well as equality.

A webinar recently organised by Educate Global and African Business explored the opportunities of gender lens investing.

In the webinar it was revealed that women currently oversee just 6% of the total funds managed in Africa, with their roles often restricted to the micro and small-scale sectors, but growing interest in gender lens investment could see real change in the investment landscape.

Recent research by the International Finance Corporation of the World Bank calculated that gender balanced teams in private equity generated 20% higher rates of return than average. If you fund more women fund managers, you will fund more women entrepreneurs. By contrast, it is widely recognised that people invest according to their bias, so women-led and owned businesses are less likely to attract funding if those allocating that funding are overwhelmingly men.

Read more at: https://african.business/2021/07/finance-services/bringing-gender-lens-investment-centre-stage/



How to raise private capital for African deals: 5 key themes

*By **Mark Taylor, Barry Hawke and Gordon Bell, Neu Capital Africa***

Raising $5-$50m+ of capital in the alternative/private capital mid-market in Africa has its own special challenges: opacity of deal-making, insufficient information, weak institutions and powerful politicians. Here are 5 key themes from the USAID Southern Africa Trade and Investment Hub and Neu Capital Africa to help you raise capital.

Make sure you have a good investment opportunity

a. It obviously helps if your business has a good track record and growth prospects, and is fairly valued. If you are stretching reality, you will almost certainly fail investor due diligence.
b. Investors want committed management who have sufficient 'skin in the game' that you will not walk away when the going gets tough.
c. Investors want to back growth opportunities by investing into companies rather than buying your shares.
d. Do not take guidance from idle chatter in the market – each deal is different and hard to assess without the full detail.

Get professional help

a. The investor market for has been turned upside down by lockdowns. Unless you have an extraordinary investor network and deep capital-raising experience, do not try and raise $5m+ capital yourself.
b. Engaging a corporate finance advisor signals to investors that your mindset is investor-ready. However, good advisors are hard to find, so do your due diligence on prospective advisors. A cheap advisor is very expensive. A good advisor is worth their weight in gold.
c. Be prepared to pay a reasonable retainer – this ensures joint commitment by both parties. The advisor will not want to take the risk that you might fail due diligence, change your mind, or lack the experience to complete the deal.
d. Expect to grant the advisor exclusivity for a professionally run process:
    i. Rather than carve out investors you know, negotiate the overall success fee and pool all investors with your advisor. Advisors do not want to compete against you to find investors.
    ii. Avoid investor collisions. When a deal is received by an investor from two different sources, it signals that you are out of your depth and desperate.
    iii. You need competitive tension at the investor level, but teamwork at the advisory level. If you lose confidence in your advisor, rather exit the relationship than run interference on the advisor's efforts, so include a fair divorce clause in your advisor agreement.
e. You need a good Information Memorandum and anonymous teaser which ticks the financial and regulatory boxes and has a simple, compelling storyline.
f. If you have gone the 'DIY' route and unsuccessfully shopped the deal far and wide, quality advisors will avoid you because probability of earning a success fee has been significantly diminished.

Assiduous deal prosecution

a. If you think you will need capital in the next 18 months, don't wait. Capital is often available from investors, but their chokepoint is human capital because they are swamped with opportunities.
b. Speed of distribution to investors is key, but you need reasonable time expectations about investor responses.
c. Warm relationships with investors are important – most investors work through trusted networks.
d. Make sure that you have up to date information - investors are already evaluating you when they make information requests, so respond quickly and comprehensively.

Know your investor

a. Know your target investors' real mandates, not what they wrote on their website 3 years ago. Investor appetite also changes constantly in response to geopolitical and pandemic shocks.

ABOUT NEU CAPITAL AFRICA

Neu Capital Africa works with leading mid-market corporate finance advisors to secure $5-50m+ of capital in Africa from over 300+ professional investors globally, and is retained by the USAID Southern Africa Trade and Investment Hub to find capital for businesses trading with the USA.

b. Ensure that you know exactly how you satisfy the environmental, social and governance requirements of impact investors, how they will measure this, and what administrative burden this will impose.
c. Research each investor and know why they will find a meeting with you useful.
d. Investors can be strategic or financial.

   i. Strategic investors are easier to contact but harder to convince because they can sniff out implausibilities in your business plan. They may pay more for a deal which adds strategic value to them, but they will eventually want control. They are more suited to exits.
   ii. Financial investors seek a financial return, but not usually control. Expect a tougher pricing negotiation at entry because a financial investor gets no additonal strategic benefits. They are harder to contact, especially family offices. They are more suited to financing the growth of your business.

a. If you get declined because the deal is out of mandate, there is rarely any way to recover from this. What drives mandates?

   i. Private Equity and credit funds are bound by a contractual obligation to their Limited Partners to only invest within their agreed mandate.
   ii. Pension funds typically have to match investment exits to maturing insurance obligations. They are alive to risk correlations in their portfolios and are rarely “high conviction” investors.
   iii. Development Finance Institutions are typically constrained by statutory obligations which often include impact imperatives.
   iv. Banks are regulated, and their credit and investment committees will necessarily be conservative.
   v. Family Offices are typically inscrutable because they have earned the privilege of not having to be bound by a third party mandate.
   vi. If you get declined because the deal has poor economics, you can sometimes re-approach that investor once you have addressed the weaknesses, but you will be on the back foot.

Regulation

a. Neither you, nor your advisor are permitted to send teasers and deals to European or North American investors unless regulatorily compliant in that investor’s jurisdiction.
a. Being regulated in your home market only enables you to approach investors in your home market.

These 5 themes do not guarantee success but, if you can navigate them, you will be well on your way to raising capital.

Next Generation Africa: Supporting growth for Africa's MSMEs

*By **Eleanor Brown, Invest Africa***

MSMEs form the backbone of Africa's economies and are the engine of the region's job creation drive, accounting for 70 percent of employment in the region. With a high proportion of informal enterprises, many of Africa's MSMEs, which already faced significant challenges, have been hit hard by the pandemic. Addressing the structural barriers to growth that small businesses in Africa face will be essential to both the Continent's short-term economy recovery and long-term development.

MSMEs in Africa have historically faced numerous barriers to growth. Sitting at the riskier end of the spectrum, access to private financing for early-stage businesses is challenging. Small market sizes and low levels of regional integration preclude many private investment options, accounting for the so-called 'missing middle'. Meanwhile commercial banks struggle to offer adapted loans where collateral is limited and credit assessments are often unreliable, leaving smaller businesses faced with higher interest rates than their larger peers. In sub-Saharan Africa lending to MSMEs accounts for only between 5 and 20 percent of traditional banks' portfolios compared to a range of 20 to 60 percent for OECD countries. Even where financing can be secured, to be successful it needs to be accompanied by technical support to combat the skills deficit faced by many MSMEs.

Supporting growth in the MSME segment calls for an ecosystem approach, bringing together targeted small scale financial products and wider business development support. Incubators, VCs and angel investors can play a key role in this respect through mentoring, capacity building and advisory initiatives. For larger investors or commercial banks partnering with these smaller locally embedded actors can help overcome the information gap and allow greater penetration with smaller businesses.

The recent partnership between 4G Capital, a company using tech to drive financial inclusion through micro-loans to small businesses accompanied by training programmes, and Citigroup, the American multinational investment bank is a prime example of the ecosystem approach in action. Innovative financial structures, in particular blended finance, have a transformative role to play in facilitating such partnerships and aligning investments with social and financial inclusion goals. The deal between 4G Capital and Citigroup was underwritten by the American development finance institution, DFC, as part of their Scaling Enterprise guarantee facility. This integrated approach allows the patient capital of DFIs to leverage commercial financing and support in-country programmes providing direct support to small business owners.

Stimulating joined-up thinking is the core aim of Invest Africa's upcoming Next Generation Africa Forum, taking place during the annual Africa Debate 14-16th September which will bring together entrepreneurs, DFIs and private investors in a series of workshops and discussions aimed at building solutions to the most pressing challenges faced by African MSMEs. Find out more here.

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