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## Developing Private Equity and Venture Capital

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CBN Governor, Sanusi Lamido Sanusi

Nigeria will do well to include developing a robust private equity and venture capital industry as an important component of its economic transformation agenda. South Africa, Kenya, Ghana have done so, not to mention India, Malaysia and Brazil.

Specific states, zones, regions, ministries, key economic sectors and target groups such as agriculture, youth and women, would also do well to explore how to channel the billions of naira of recently unlocked sources of investment capital for private equity and venture capital into their constituencies.

Recently, two new sources of funds have been unlocked for investment in growth businesses in Nigeria through private equity and venture capital. They are pension fund assets and the Sovereign Wealth Fund (SWF).

Pension regulations were changed in December 2010 to allow up to 5 per cent of pensions assets to be invested in private equity and venture capital. According to the Nigerian Pension Commission's (PenCom) recently released 2010 annual report, pension asset as at the end of 2010 stood at N2.029 trillion.

This means that the amount available to be invested in private equity and venture capital is in excess of N100 billion as at the end of 2010. This amount will grow as pensions assets grow by an estimated 20-30 per cent per annum in the next few years.

The SWF bill was passed towards the end of the 6th National Assembly. The Act states that the fund can be invested in private equity and venture capital among other types of assets. The exact allocation of the SWF to private equity and other types of assets has not yet been specified.

However, seed capital of \$1 billion was set aside to kick off the SWF and even a 1 per cent allocation to private equity will unlock an initial \$10 million or about N260 million. This amount will grow significantly as excess crude income accrues to the SWF.

Unlocking funds is one thing, getting those funds into the economy to stimulate business growth and in turn create much needed jobs is quite another. Many examples exist of well-intentioned domestic and international investment and grant funds being set aside yet not utilised for one reason or another.

To give just one example, the last major attempt to stimulate the private equity and venture capital industry in Nigeria was the Central Bank of Nigeria (CBN) and Banker Association initiated programme for banks to mandatorily set aside 10 per cent of their pre-tax profits for equity investment in small and medium sized industries – Small and Medium Industry Equity Investment Scheme (SMEEIS).

According to the latest CBN reports on the scheme, as at June 2009, a total of N42,024,988,746 was set aside under the scheme and N13,820,910,454 (over 32 per cent) was unspent.

The key lesson to be learned from this example is that private equity does not exist in a vacuum. Providing a single supply side intervention to kickstart the Nigerian private equity industry is similar to building a table with one leg – it will not stand.

The provision of investment capital, through SMEEIS, pension funds or the SWF is only one part of the equation and a more holistic approach is needed if the intervention is to have the desired effect of growing businesses and creating jobs.

A holistic approach to developing a private equity industry begins with (i) identifying each stakeholder group, (ii) raising their awareness of the nature and opportunity of this relatively new type of finance and (iii) building their capacity to harness the private equity opportunity. A systematic approach is needed which is well informed, cohesive and sustained.

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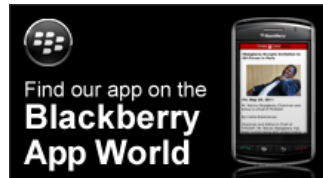
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There are five private equity stakeholders – investors, fund managers, entrepreneurs, policy makers and business service providers (accountants, lawyers, M&A bankers, business consultants, entrepreneurship advisors etc).

Investors are the first private equity stakeholder group. Private equity investors are typically domestic or international sovereign wealth funds, pension funds, insurance funds, government and development finance agencies, endowment funds, high net worth individuals, foundations and corporations.

SWF's and pension funds constitute the largest investor groups in private equity. In Nigeria, most of the indigenous actors I meet within these investor groups do not understand private equity and how to invest in it. There are a few exceptions.

Fund managers in private equity are the second private equity stakeholder group. They are typically domestic or international financial institutions that raise funds from private equity investors and invest in business with a potential for high growth and high returns and are typically higher risk than average.

Their investments are typically not collateral based, nor interest based nor repayment based. Instead, private equity managers take a share of the business in exchange for the financing they provide, actively assist the business to grow and "exit" the business by selling their share back to the entrepreneur or another investor after a few years.

In Nigeria, there are about 10 indigenous private equity fund managers and another 16 international fund managers actively looking to invest in Nigeria. Private equity fund managers can be "generalist" investing in all sectors or they can be sector and/or geographically focused.

Almost all the fund managers in Nigeria today are generalists. If one compares us to our African private equity peers, South Africa has over 80 private equity fund managers, Kenya has over 40 private equity fund managers, Egypt has over 30 private equity fund managers.

If we compare ourselves to our Visions 20:2020 aspirational peers - Brazil has over 130 private equity firms, India has over 160 funds and Malaysia that has a "Malaysian Venture Capital Development Council". This suggests that Nigeria needs many more fund managers and funds. We need more sectors, target group and geographic focused funds like tourism, women and Niger Delta private equity funds.

Entrepreneurs, their bright ideas and businesses form the nucleus of a private equity industry. This third stakeholder group includes innovative start-ups developed in garages (Microsoft for example) by military technology (the Internet for example), in corporate and academic R&D laboratories, to small and medium-sized businesses (who by the way typically create over 70 per cent of jobs and receive less than 1 per cent of bank credits) and large corporations (Dangote group for example) who have the potential for high and exponential growth.

All these entrepreneurs and innovators are fertile ground for private equity investment. But unfortunately, most Nigerian entrepreneurs I meet do not understand private equity as a source of financing for starting and growing their businesses.

To meet our Vision 20:2020 ambitions, we need to identify and finance our fastest growing entrepreneurs, ideas and businesses especially start-ups and small and medium enterprises (SME's) - including those who have not yet built up a collateral base or are not able to borrow and repay high interest rate loans within short time frames.

Policy makers are the fourth private equity stakeholder group. Relevant policy makers at the executive, judicial and legislative arms at federal and state levels need to understand private equity to avoid policy conflicts and somersaults that so often and so sadly destroy well-intentioned policy interventions.

A review of private equity policy interventions in Ghana, Kenya, South Africa, Brazil, Chile, Israel, Thailand, Malaysia, Europe, UK and the birthplace of modern private equity – the United States - is instructive and provides a starting point for considering what policy interventions will be appropriate for Nigeria.

Policy interventions in these countries include supply side interventions like sponsoring sector and geographic specific private equity funds, sponsoring private equity "fund of funds", tax incentives for investors in private equity, establishing SME stock exchanges (like Nasdaq and Aim) as well as demand side interventions such as SME technical grants, technology transfer grants and funds, predefined SME allocations for government procurement, business start-up incubators and perhaps most importantly providing legal frameworks for their policy interventions such as PE Fund of Funds ACT (in Ghana, USA, UK and Israel for example), National Innovation Acts and Venture Capital Acts.

Each stakeholder group is important and will need nurturing. The banks SMEEIS addressed the investor stakeholder group and largely ignored the others. Herein lies the lesson for successful pensions and SWF investment in private equity.

Having identified each stakeholder group – step one, an effective government intervention programme to develop a robust private equity industry should be a next step – step two, raise the awareness within each stakeholder group of the nature and opportunity of private equity and their role in bringing about a robust private equity industry to grow businesses and create jobs.

For those individuals, public and private sector organisations who are interested in building a robust private equity industry, step three should focus on building their capacity to harness the private equity opportunity through sponsoring private equity funds, more detailed training

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programmes, organised industry associations (the International Limited Partners Association (ILPA) for example is a very active association of investors in private equity – they develop guiding principles for investing in private equity which will be especially useful to new investors in private equity including Nigerian investors in private equity, secondments and on the job training, on-going industry transparency, analysis and a feedback mechanism.

Even the most developed private equity industry, the US industry, continues till this day to fine tune and implement specific government interventions in private equity. So do European Union (EU) and the UK. They measure the impact of private equity on their economies (private equity-backed businesses generate 20 per cent of jobs, private equity-backed SMEs grow 40 times faster than average, revenues of private equity- backed businesses are equivalent to 20 per cent of GDP) and understand the need for government to continue to enable and maximize the private equity opportunity.

Nigeria needs an effective holistic programme of government interventions to develop the private equity industry in Nigeria, grow businesses and create jobs. Without one, it will be difficult to achieve our ambitious plans of creating millions of jobs and joining the top 20 economies of the world.

•James is former Managing Director, African Venture Capital Association.

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