Exernal Case Study Evaluation 2019/2020

Evaluation of BIO's Private Equity Activities in Sub-Saharan Africa

Summary findings – September 2020

steward redqueen

BIO
Investing
in a Sustainable Future

Background

BIO's mission is to support a strong private sector in developing countries, enabling local companies to grow and develop sustainably. Investments in private equity (PE) funds are an integral part of BIO's strategy. However, due to the indirect nature of investing through PE, development effects can be perceived as less visible and straightforward compared to direct investments. BIO wanted to fill this knowledge gap by conducting an evaluation of its Sub-Saharan Africa PE portfolio. The study aims to provide a more comprehensive understanding of the PE model, investment activities, performance and, ultimately, the development effects. Because Sub-Saharan Africa is strategic priority region for BIO, the evaluation focuses on PE funds in this geography.

Methodology

The evaluation is structured around five focus areas: (i) the rationale for PE investment; (ii) fit with BIO's strategy; (iii) analysis of the portfolio; (iv) BIO's value adding role; and (v) findings from an in-depth focus on four funds and five companies invested in to by these funds. For each of these key areas specific evaluation questions were formulated. Based on findings from answering the evaluation questions, the evaluation draws conclusions, lessons and recommendations. Inputs for this evaluation were collected through extensive data collection and analysis, online surveys as well as in-depth interviews with BIO investment staff, funds and companies, and a field visit to three fund managers and five indirectly invested companies.

Portfolio overview

As of December 31, 2019, BIO had committed a total of €126m to 20 PE funds in Sub-Saharan Africa. This represents 56% of BIO's overall commitments to private equity funds globally. The 20 invested funds held a total capital of just over EUR 2 billion and made investments in 226 companies across 21 different Sub-Saharan African countries (based on data available for 14 out of the 20 funds).

Conclusions

Rationale for PE

The private equity model is an effective and well-used model for sustainable private sector development in developing economies. The main benefits of the model are a longer-term investment horizon, focus on capacity building, ability to target underfinanced business segments and opportunities to improve environmental and social aspects.

There is a clear rationale for BIO to invest indirectly through PE funds in Sub-Saharan Africa. Private equity investment through funds allows BIO to (indirectly) diversify and take on more risk by moving into frontier markets and high development impact sectors. In addition, BIO gains access to market intelligence and investment opportunities.

Strategy

PE investment is at the heart of BIO's strategy and has relevant targets. PE investment through local investment fund managers has been and is at the heart of BIO's strategy, and its role is expected to increase under the current strategy to 2023. The main targets for PE are additionality, catalytic effects, project sustainability and contributing to the Sustainable Development Goals (SDGs).

BIO's selection criteria fit the targets although impact could be analysed more structurally. BIO's fund selection criteria support its overall strategy and targets for PE with a focus on smaller-sized, local funds in Sub-Saharan Africa that target MSMEs. The expected development impacts of funds are considered a crucial element of investment decision-making, although BIO staff identified improvement potential in further structuring the analysis.

Portfolio composition

BIO generally has smaller stakes in a multitude of funds. On average, BIO committed €6.3m per fund, with an average stake of 8%. The relatively low exposure per fund enables BIO to diversify its portfolio and reducing risk, but it also means that BIO is usually

among the smaller investors in a fund, which reduces its leverage.

The selected funds fit BIO's strategy. In line with its mission, BIO selects funds that are mostly sector-agnostic funds focussing on equity investments into SMEs in multiple African countries within BIO's target universe. In general, BIO invests in smaller funds, with the average fund size in BIO's portfolio at just over EUR 100m. Despite BIO's primary focus on multi-sector funds, single-sector funds tend to score the highest on BIO's screening criteria. Just under half of funds include a specific focus on themes such as gender equality, the fight against climate change and preservation of natural resources, and practices or food security and rural development.

BIO's PE investments are more exposed to less developed markets compared to overall PE flows[1]. BIO's additionality is likely highest in low-income countries and/or fragile states where relatively fewer other PE investments take place. BIO generally has substantial exposure to low-income countries in its target markets, especially in Madagascar, Uganda and Tanzania. For the non-frontier countries, BIO has a relatively high exposure to Côte d'Ivoire and Kenya compared to overall PE investment flows. At the same time, the funds do not reach several least developed countries, including some of BIO's target countries, where PE activity does take place. This can partly be explained by BIO's limitations in terms of capital and funds it can support but does provide an opportunity for further improvement by pushing towards the frontiers of the market.

Performance

A solid financial performance is important to generate impact. A solid financial performance is of importance because the returned capital can be re-invested by BIO, it can generate a demonstration effect to other investors; and the financial return usually goes hand-in-hand with achieving development impact.

BIO's current PE investment portfolio is likely to generate adequate financial returns. The solid performance is mostly driven by the funds with a larger exposure to investments in the financial sector. Overall it should be noted that due to increasing commitments of the funds over the past few years, the portfolio on average is young. 65% of the 20 funds are still in their investment period.

Impact

BIO PE portfolio supports almost 25k jobs directly and 177k jobs indirectly. In 2018, the most recent year for which data is available, the portfolio companies of BIO's PE funds employed a total of 25,083 people.[2] Most jobs are in Kenya and DRC, followed by Tanzania, Uganda and Madagascar. In terms of sectors, most jobs are supported in financial services, manufacturing and agribusiness sectors. Jobs are generally well-paid, but there are large differences between companies, and some workers might live on less than USD 3.20 per day. On top of the direct jobs the portfolio companies supported an estimated 132,360 supply chain jobs, and 44,670 induced jobs;

The indirectly supported companies generated a cumulative turnover of close to a billion euros. In 2018, the portfolio companies of BIO's PE funds reported a cumulative turnover of EUR 932 million. The highest contributions to turnover are in the DRC, Kenya and Côte d'Ivoire. In terms of sectors most economic results are in the manufacturing and services sectors.

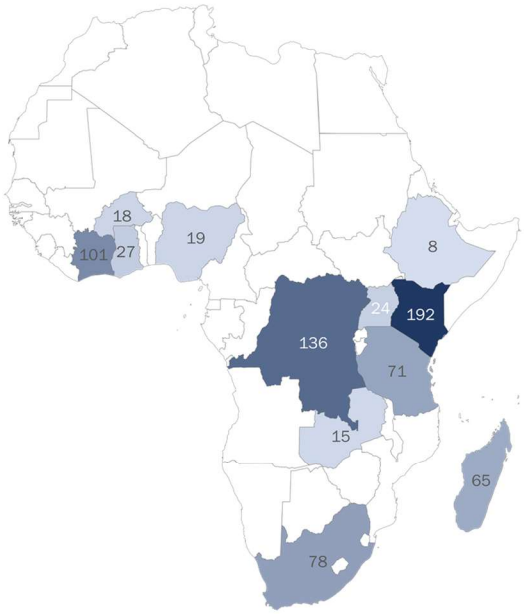
Value added by BIO

BIO is perceived as an agile and constructive investor. In line with its strategy, BIO has a seat on the Advisory Committees (ACs) of the PE funds it invested in. BIO is seen as a constructive and pragmatic partner, actively engaged in discussions, and particularly valued for its good understanding of the context in which fund managers operate. Most fund managers

1 Overall PE flows as measured by the Africa Private Equity and Venture Capital Association (AVCA)

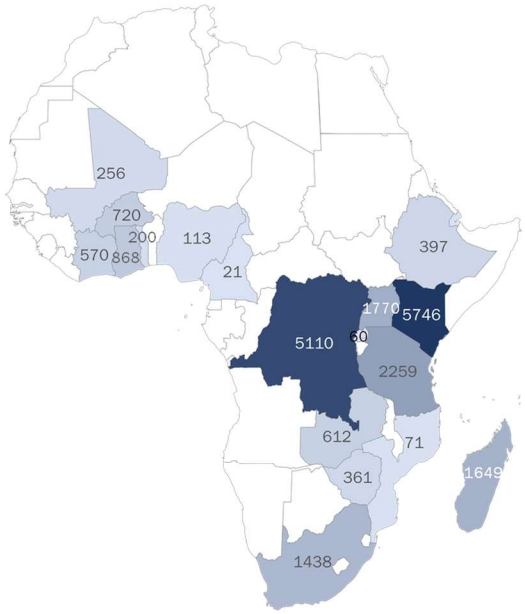
2 The numbers are likely to be much higher, as they are based on data for 62% of the portfolio companies for which development data is available. Further, data availability on impact is limited, ranging from 80% for direct employment to less than 50% for most economic indicators. As it concerns a snapshot for 31 December 2018, it means that results on exited companies are not considered, as funds usually not track any performance data after exit. See Section 2.6 more info on data limitations.

Direct sales supported in companies invested In 2018 per country* (mEUR)



*"Various Africa" region not included above. mEUR 82 direct sales were supported in this cluster.

Direct jobs supported in companies invested in 2018 per country** (absolute)



**"Various Africa" region not included above. 2015 jobs were supported in for this cluster.

received advice from BIO on environmental, social and governance (ESG) management and support on impact measurement tools, which they found useful. However, BIO could do more, for instance on fund structuring and governance.

BIO could improve on its additionality and catalytic effect at the time of investment. Although most fund managers indicated that BIO's capital could not have been replaced, they would have been able to close their fund without BIO. Furthermore, there is improvement potential in BIO's support to new fund managers. Although there are examples, notably its structuring support for AfricInvest's evergreen platform FIVE and its engagement of Belgian impact investors through the SDG Frontier Fund its catalysing role could be further enhanced. While BIO cannot be the cornerstone investor in all funds, it could consider more clearly defining its ambition in terms of additionality and support, balancing this with risk perceptions.

BIO's technical assistance is appreciated but limited. As of 31 December 2019, BIO committed EUR 306k of TA funding to two PE funds in SSA. The TA aimed to fund a total of 12 projects at 7 companies, most of which in the portfolio of Adenia III. Despite the strong interest in TA from fund managers, and value BIO staff attaches to TA, only 7% of all companies indirectly invested by BIO have been supported with BIO's TA facility. The funds that received TA from BIO were unanimously positive about the clarity and flexibility of BIO's TA facility. They observed a connection between the TA and improvements on E&S and impact measurement at their portfolio companies.

The study zoomed in on four PE funds. All funds have unique approaches to support African companies.

- **Adenia Capital III** is a EUR 96m fund that holds control positions through equity investments in eight SMEs in the Indian Ocean and the West Africa region.
- **Cauris Croissance II** is a EUR 60m fund that holds minority investments through equity and quasi-equity in six SMEs in Francophone West Africa.
- **AfricInvest II** is a EUR 143m fund that holds minority investments through equity and provides debt to 15 companies throughout Africa.
- **African Rivers Fund** is a EUR 46m fund that primarily provides debt to 28 companies in the DR Congo and Uganda.

The evaluation included five in-depth case studies of companies in Côte d'Ivoire indirectly invested by BIO through funds. All companies have development impact in their society as an employer, local producer of essential products and services and actor with economic knock-on effects. The five companies are:

- **Africa West Industries (AWI)** produces soap bars, soap noodles and cooking oil from crude palm oil. AWI is a unique company, as it is integrated over the entire value, from sourcing to sales, creating and keeping income locally in the Ivorian economy. Moreover, it is actively supporting farmers to optimise yields through 40 advisors that travel around rural areas. By producing quality soap and cooking oil, AWI is contributing to various SDGs, mostly SDG 6, SDG 3 and SDG 2.
- **Cipharm** is a pharmaceutical company specialised in the production and marketing of a wide range of medicines in dry forms (pills, powder), syrups and injectable solutions. By contributing to the localisation of medicine production Cipharm is contributing to the reduction of medication costs and enhancing access to safe, effective, quality and affordable essential medicines and vaccines, thereby contributing to SDG 3.
- **Ademat** services the distribution, installation and maintenance of energy products that ensure the reliability of power supply, such as generators and inverters. Ademat plays an essential role in access to a constant and stable power supply for vital public services, industrials and financials, whose activity critically depends on a constant flow of energy, and thus contributing to SDG 7.
- **Bridge Group** is a financial services group with a core focus on MSMEs. It pioneered an innovative so-called "nanofinance" product together with telecom giant MTN. By contributing to access to finance for underbanked and unbanked populations, Bridge Group is contributing SDGs 1 and 8.
- **Syrse** is a regional leader in electronic payments and ATM distribution and maintenance. As a provider of essential infrastructure for financial services, Syrse is contributing to SDGs 1, 8 and 9.

Lessons from cases

The maturity, structure and management of a company as well as the market circumstances are crucial in tailoring the approach and instruments. The success and (financial) sustainability of companies strongly depend on the right type of investment by an investor. That is what makes selecting quality fund manages so important. They can not only analyse numbers and see market opportunities but also read and assess human factors and market risks.

PE investors can provide invaluable support in business expansion, product development and professionalisation. The cases show that companies can develop and increase development impact through various pathways. There are several notable examples: expanding production facilities at AWI and Cipharm; integrating several production facilities into one at Ademat; pursuing regional expansion at Bridge and Syrse; an supporting a strategic merger for Cipharm. In all cases, the investor played a crucial advisory role in identifying opportunities for growth, drawing up the plans and resources and challenging company management during difficult times. And in all cases, the investors helped further professionalise essential business processes, which are crucial for positioning the companies for further employment generation and impact.

The companies are decent employers and local providers of essential societal goods and services. All company cases contribute locally to the Sustainable Development Goals. This includes improving equal rights to technology and financial services (SDG 1), supporting smaller-scale farmers to double agricultural productivity (SDG 2), preventing health problems (SDG 3), providing schooling grants (SDG 4), achieving access to adequate and equitable sanitation and hygiene for all (SDG 6), providing reliable access to energy (SDG 7), enabling decent employment and access to banking (SDG 8) as well as providing innovative solutions empowering underserved communities to better manage their financial resources (SDG 9). All companies also have important economic knock-on effects, which can either be backward or forward effects.