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The Evolving Nigerian Private Equity Landscape: *Finally Coming of Age?*

INTRODUCTION

The fact that there has, over the last five years, been a shift in the balance of power from south to west as regards private equity in Africa is somewhat ubiquitous as it is underscored in virtually every recent study or report on private equity on the continent. Over the last five years West Africa's share of private equity transactions has risen to 25% whilst South Africa's share of transactions has decreased from 28% to 22%. Much of this shift is due to the increasing levels of activity in Nigeria and it has recently been reported that Nigeria alone may currently be receiving up to 31.4% of the total private equity investment into Africa. Private equity in Nigeria is exploding. From roughly about three general partners managing around US$75 million in 2003, the industry has grown to upwards of ten "indigenous" fund managers with more than US$2 billion under management.

With numbers like these it may be tempting to assume that perhaps the Nigerian private equity industry has come of age but looking at the numbers in a broader context reveals the truth. Granted Nigerian private equity is on the rise relative to South Africa. However, as far back as 2013, there were more than 86 fund managers in South Africa with assets under management in excess of US$11.6 billion. In 2011, private equity investments as a percentage of GDP in South Africa stood at about 0.24% compared to 0.06% in sub-Saharan Africa (prior to the rebasing in Nigeria).

In context what the numbers actually show is that Nigeria has a long way to go but it is making progress, and good progress we are bold to add!

The Nigerian private equity landscape boasts a good mix of international managers such as The Carlyle Group, which in 2014 closed a US$698 million fund targeted at sub-Saharan Africa and The Blackstone Group; as well as regional firms like Actis, The Abraaj Group, which closed its third sub-Saharan fund at US$990 million in 2015, and Helios Investment Partners, which raised the first African billion dollars fund in 2015.

There is also a growing brood of indigenous firms including established fund managers like the 17 years old Africa Capital Alliance with more than US$532 million under management and smaller budding firms like Sahel, Synergy and Verod, all with funds of around a US$100 million each. The main investors in this latter category of private equity funds tend to include developmental financial institutions and other impact investors as well as various fund of funds and foreign institutional investors looking for some exposure to the continent.

More recently however, the Nigerian Sovereign Investment Authority ("**NSIA**") has started to show some interest in supporting indigenous private equity firms and, although it tends to come with its own complications as discussed below, indigenous firms are increasingly courting investment from Nigerian pension funds.

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REGULATORY FRAMEWORK

For the most part, the massive expansion of private equity in Nigeria has occurred in spite of government. While some other African governments have been known to offer sweeteners to court private equity, in Nigeria almost nothing has been done.

Save for adjustments to the Pension Fund Investment Regulations issued by the National Pension Commission ("**Pencom Regulations**") and the introduction in 2013, of rules for the registration of certain private equity funds by the Securities and Exchange Commission ("**SEC**") there is only one other law, which arguably relates to private equity in Nigeria, and that is the Venture Capital (Incentives) Act ("**VCA**")[1].

There is no federal legislation regulating the registration of limited partnerships, which are the preferred structure worldwide for setting up and managing private equity funds. The Companies and Allied Matters Act ("**CAMA**")[2] only provides for the registration and regulation of business names and the Corporate Affairs Commission ("**CAC**") does not specifically register limited partnerships. Although the CAMA does not specifically restrict the categories of activities for which business names can be registered, over the years the CAC has developed a shortlist of activities and has configured its systems based on this limited list. In practice, it is still possible to register a private equity limited partnership as a business name at the CAC however the process will normally entail some alteration of object clauses.

On the other hand, Lagos State currently maintains a limited partnership registry pursuant to provisions of the Partnership Law of Lagos State, Cap P21 Laws of Lagos State 2003 (as amended) however it is not clear if other states in Nigeria are bound to recognize the registration with the Lagos State Limited Partnership Registry.

With the SEC Regulations that apply to private equity, there are also some challenges. Firstly, the rules only apply with respect to funds with a minimum commitment of N1billion of investors' funds. Notably, the rules do not include any specific obligations for fund managers to be registered *(although they stipulate that fund managers must have a minimum share capital as prescribed by the SEC)*. Secondly, the rules define private equity funds as "*a type of collective investment scheme...*"[3] but further stipulate that private equity funds are not to solicit funds from the public. The foregoing aside, the SEC rules mainly prescribe details to be contained in the information memorandum to be shared with prospective investors together with basic reporting requirements; but sadly do not include any significant provisions for investor protection.

Not all gloomy, as the provisions with respect to private equity investments in the Pencom Guidelines[4] are significantly more detailed. They seek to prescribe the kinds of private equity funds in which Nigerian pension fund assets may be invested. Critical criteria for eligibility include – (i) that the manager is registered with the Nigerian SEC as a fund manager, (ii) that up to 75% of the fund is to be invested in Nigeria[5], and (iii) that the fund manager retain a minimum investment in the fund[6].

The VCA was enacted in 1993 and does not strictly speaking, relate to private equity. It seeks to provide certain tax incentives to *venture capital companies* who are defined in the law more restrictively than the term is generally used in practice. However, most of the incentives in the VCA are either

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redundant or already available to companies generally, under the provisions of the Industrial Development (Income Tax Relief) Act. For instance, one of the main incentives in the VCA, the relief from tax on the disposal of equity in a venture capital company is currently redundant due to a general exemption from capital gains tax in respect of any gains from the sale of shares.

STRUCTURES

The result of the foregoing, challenging regulatory framework, is that virtually all of the fund managers (including the wholly indigenous ones) typically establish their funds outside Nigeria. Mauritius tends to be the base of choice due to its collection low tax rate, network of tax treaties and private equity specific legislation, which allows for significant flexibility and certainty.

Typically the funds will be registered as a limited partnership with the Partnership Registry in Mauritius and will be licensed by the Financial Services Commission as a Closed-end Fund.

In practice, Nigerian private equity funds will only look to register with the SEC where there is an intention to source investment funds from Nigerian pension funds. In such instances, the fund manager will normally seek to register a parallel fund with the SEC, in addition to the fund registered in Mauritius.

DEALS

While jurisdictions like Mauritius help to bridge gaps that might otherwise have existed in approaches to fundraising, as regards deal structuring and execution, African private equity is not without its peculiarities.

Private equity deals on the continent tend to be much smaller (typically below US$10 million) and with family owned businesses, which are reluctant to relinquish control. Furthermore, given the particularly high domestic borrowing costs and relatively limited exit options (few, if any, regional stock exchanges), investments tend to be held for longer periods[7].

The impact of the foregoing is that sometimes deals need to be pieced together to achieve scales sufficiently attractive for private equity investors. Also, minority protection issues tend to be a greater concern and, increasingly, fund managers are considering less common (but more easy to exit) structures like equity-linked notes.

Likewise in relation to exits, because most private equity investments are relatively small and, unlike their western counterparts, African private equity is generally not in the habit of loading acquired investments with debt as a means of boosting returns, exits generally tend to be at the stage where businesses are ripe for standard private equity investment. The result of this is that exits tend to be by way of secondary sales to either financial investors like larger private equity firms (e.g. Verod's partial exit from GZ Industries Limited, Actis' full exit from Mouka Limited) or to international or regional businesses looking to expand into the Nigeria market (e.g. AfricInvest's sale of its 77% indirect shareholding in Mansard Insurance Plc to the Axa Group of France).

MISSING PIECES

While the Nigerian private equity industry continues to grow, it is easy to see it still has some way to go.

In a January 2015 Article titled, "*Unblocking the Pipes*", The Economist Magazine identifies private equity as one of the main alternatives for bridging funding gaps in countries like Nigeria where normal routes to capital have been blocked or are yet not fully developed. It is not enough to not impose barriers, Nigerian regulators need to actively court private equity to Nigeria.

Although regulation of private equity funds tends to be light, more needs to be done in terms of registering and monitoring fund managers. This should make it easier for local funds to find investors and for investors to diligence funds. Furthermore, rules regarding investment of pension funds in private equity need to be revisited with a view to facilitating more pension fund investment. The value of restricting such investments to funds registered with the SEC is unclear given the limited monitoring of such fund managers. Focus needs to be on more substantive issues like the investment regions, flexibility of exit and other terms. Clearer rules are also required regarding private equity investments by insurance companies. Furthermore, a federal limited partnership registration regime is urgently required.

Beyond rules regarding fundraising, the regulatory framework is lacking in other areas too. The CAMA, the main legislation regulating companies in Nigeria was enacted in 1990 and has barely been revised since. Urgent reform is required here to strengthen minority protection rules and introduce some flexibility around control and voting issues in private companies.

The future outlook for private equity in Nigeria remains positive. More however needs to be done to accelerate the progress.

END NOTES

1. Cap V2 Laws of the Federation of Nigeria 2004
2. Cap C20 Laws of the Federation of Nigeria 2004
3. Collective Investment Schemes are however specifically defined in the Investments and Securities Act No. 29 of 2007 ("ISA") to mean schemes "in pursuance of which members of the public are invited or permitted to invest …".
4. The Pension Guidelines are currently being reviewed.
5. This is currently being considered for revision to 60% in the revised draft of the Pension Guidelines.
6. Between 1% and 3%, depending on the rating of the fund and whether or not its investors include multilateral agencies or DFIs.
7. A sub-Saharan Scramble, The Economist, January 24, 2015

The Grey Matter Concept is an initiative of the law firm, Banwo & Ighodalo