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Private Equity Finds Fertile Ground in Africa

Malachy Mitchell
Mmitchell@farrellymitchell.com

www.FarrellyMitchell.ie

Introduction

The difficulty of raising capital for the agri-food sector in sub-Saharan Africa has created an opportunity for private equity investor, who are in a position to invest profitably and knowledgeably in one of the world's highest-potential regions.

Global Demand

The FAO forecasts that global demand for agricultural products will increase by 50 percent between 2015 and 2050, driven by population growth, rising incomes and accelerating urbanisation. However, agricultural production is constrained by a limited supply of land resources and a primary production sector that is reaching peak capacity in many agricultural regions.

The agricultural sector in Africa has the natural resources needed to meet this shortfall. Sub-Saharan Africa has almost 50 percent of the world's uncultivated arable land; vast pools of untapped water resources; and a large, growing and under-utilised agri-labour force.

Access to Capital

In 'The Mystery of Capital', economist Hernando De Soto Polar proposed that the inability of people in low-income countries to access capital is the main constraint on economic development. The reason they can't access capital, according to De Soto Polar, is the lack of a simple, unified legal property system, which would allow people to leverage their assets, thereby gaining access to capital, which would drive productivity and create wealth.

The agri-food sector in Sub-Saharan Africa seems to bear out this theory. Primary production is dominated by smallholders, who lack clear title to their land. The wider agribusiness sector is largely comprised of micro, small and medium enterprises, who also find it difficult to access the financial resources which would allow them to exploit local and international demand.

As a result, the agri-food value chain is under-developed by international standards, with little value-add in the sector, either through processing, manufacturing, distribution or marketing. Primary production dominates the industry, accounting for 72 percent of the agri-food contribution to GDP. This is in stark contrast to the US agri-food sector, where value-add makes a contribution thirteen times greater than primary production.

Quick read

- Private equity investors can seize opportunity presented by the difficulty of raising capital in sub-Saharan Africa
- Global demand for agriculture produce will increase by 50 per cent by 2050, but limitations at the moment mean that demand would not be met
- The agricultural sector in Africa has the natural resources needed to meet this shortfall, possessing almost 50 percent of the world's uncultivated arable land; vast pools of untapped water resources; and a large, growing and underutilised agri-labour force.
- The big reason for developing country difficulty in this area is down to lack of a simple, unified legal property system, which would allow people to leverage their assets, and gain access to capital, which drive productivity and create wealth.
- The issue means Sub-Saharan Africa has the lowest crop yields in the world with per hectare yields between 46 percent and 80 percent below potential and suffers from low rates of productivity
- Private equity investors seeking to benefit from the potential of the region should focus on identifying long-term sustainable investments and should commit to industry best practices and the development of management capabilities.

Productivity Gap

The region has the lowest crop yields in the world with per hectare yields between 46 percent and 80 percent below potential and suffers from low rates of productivity

Although the value of agricultural output has been growing at a CAGR of 12% since 2000, this reflects an increase in resources expansion – as more land is put into production - rather than an increase in productivity on existing land. The region has the lowest crop yields in the world - with per-hectare yields between 46 percent and 80 percent below potential - and suffers from low rates of agri-labour productivity.

Although investment in modern techniques and technologies could increase agri-labour and land productivity, sector participants find it difficult to access financial resources. While agricultural production accounts for 25 percent the region's GDP, the share of commercial lending to the sector languishes in the single digits.

Investment Opportunity

While the broader agribusiness sector receives a relatively higher proportion of commercial lending, it also faces significant credit constraints. Traditional lenders tend to avoid the sector due to high transaction costs; a shortage of usable assets in primary production; the lag times between investment needs and expected revenues; and the high number of inherent business risks involved.

This combination of circumstances creates an opportunity which the private equity sector is able to fill, with its blend of finance and expertise. Private equity is a relatively new funding mechanism in Africa, but Future Agricultures estimate that agriculture-focused funds raised 18% of the US$32 billion total raised over the period 2002 to 2011.

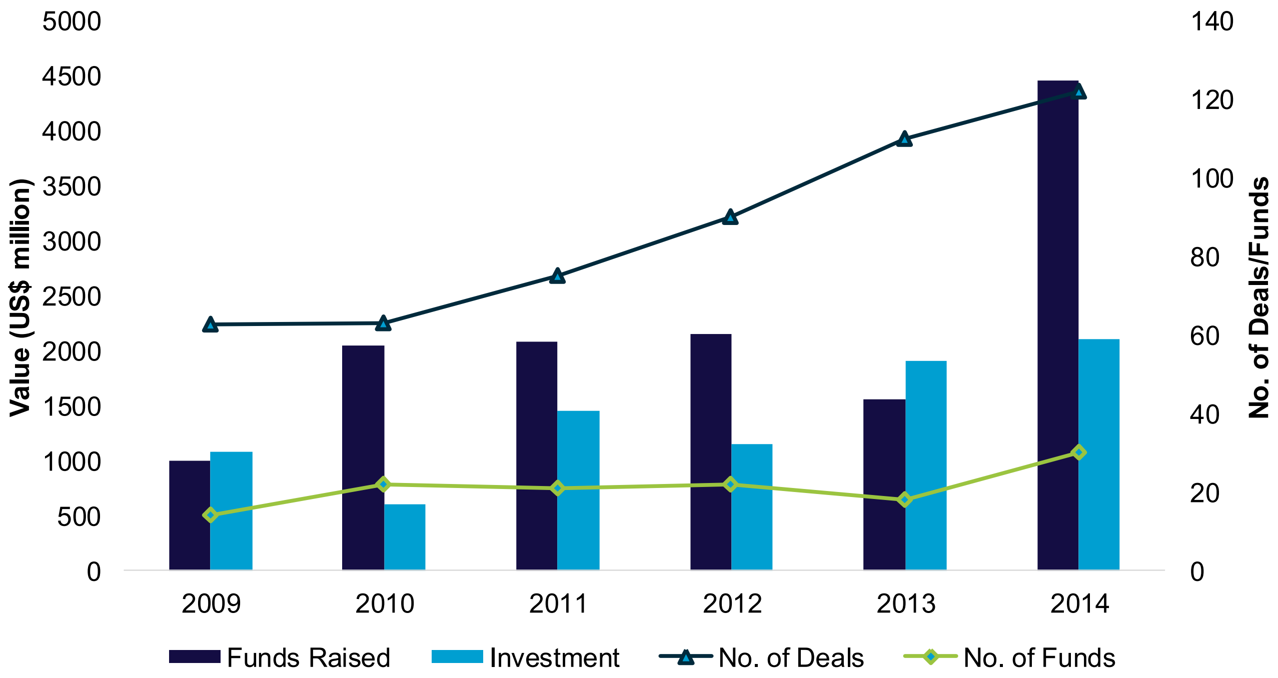
Overall general private equity investment has grown rapidly since 2009, delivering above-average returns. The twelve months of 2014 were a record year for private equity investment in Sub-Saharan Africa, with a total of US$4.4 billion raised and US$2.1 billion invested in the region.

Private equity can be characterised as "patient capital," a source of investment that has an ability to wait out commodity volatility.

Private equity sources can also provide significant sector expertise, maximising individual company performance through active involvement at operational level.

Private equity investors seeking to benefit from the potential of the region should focus on identifying long-term sustainable investments and should commit to industry best practices and the development of management capabilities. Local knowledge and the ability to tailor financing and management solutions to the practicalities of the region are also essential drivers of success in the region.

Figure 1: Total private Equity Fundraising and Investment in Sub-Saharan Africa 2009-2014



Source: EMPEA / Farrelly & Mitchell Research

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Conclusion

Global demand for agriculture produce will increase by 50 per cent by 2050, but limitations mean that demand would not be met. The sector in Africa has the natural resources needed to meet this shortfall. The region is being held back due to lack of a simple, unified legal property system, which would allow people to leverage their assets, and gain access to capital, which drive productivity and create wealth. Private investors seeking to benefit from the region's potential should focus on long-term sustainable investments and commit to industry best practices and development of management capabilities.

Expert in this Insight

Malachy Mitchell
MANAGING DIRECTOR

Mmitchell@farrellymitchell.com

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Contact Details

www.FarrellyMitchell.com

EUROPE

Dublin (Head Office)
Malachy Mitchell, Managing Director

Farrelly & Mitchell
Unit 5A, Fingal Bay Business Park, Balbriggan Co. Dublin Ireland. K32 EH70

Telephone : +353 1 690 6550
mmitchell@farrellymitchell.com

SAUDI ARABIA

Riyadh
Najeeb Alhumaid, Partner (Saudi Arabia)

Branch of Farrelly & Mitchell Business Consultants Ltd
Jarir Plaza Building, Suite 106, King Abdullah Road,
Al Hamra District, Riyadh 12211-3857,
Kingdom of Saudi Arabia

Telephone : +966 11 4634406
Mobile : +966 54 338 7199
nalhumaid@farrellymitchell.com

MIDDLE EAST & NORTH AFRICA

United Arab Emirates
Chaitanya GRK, Regional Director (MENA)

Farrelly & Mitchell (MENA)
Unit 1001, 10th Floor, Swiss Tower, Cluster Y
Jumeirah Lakes Towers, Dubai, United Arab Emirates

Telephone : +971 4 279 8331
Mobile : +971 551991356
cgrk@farrellymitchell.com

AFRICA (SSA)

Ghana
Stephen Awuah, Senior Manager, Africa (SSA)

Farrelly & Mitchell Ghana Limited
Utopia Office, 14 Senchi Street, Airport
Residential Area,
Accra Ghana

Telephone: +233 302 906850
Mobile: +233 59212 1723
sawuah@farrellymitchell.com

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