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**Private Equity in Emerging Markets: A comparison between South Africa's and Brazil's
private equity industries**

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Abstract

Purpose

The annual Global Venture Capital and Private Equity Country Attractiveness Index which is sponsored by IESE Business school, Ernst & Young and Emlyon Business School, benchmarks the attractiveness of 116 countries for receiving institutional private equity and venture capital allocations, The factors used in determining this ranking are based on the findings from a study conducted by Groh, Liechtenstein and Lieser, (2008). South Africa was ranked 26th above Brazils' 43rd for the 2010 year meaning that as per the indexes criteria's, South Africa should be a more attractive destination for private equity and venture capital investments over Brazil, yet the aggregate private equity deal value in South Africa in 2010 was US\$1.5 billion (2009: US\$980 million) placing South Africa in a ranking of 21 globally in terms of deal value(2009: 24), while Brazil ranked 11th with aggregate deal value of US\$6.3 billion (2009: US\$940 million, ranking 26th) for the same period (KPMG 2011; Ernst & Young 2011).

The objective of this study was to gain understanding into the factors that are contributing to the attractiveness of private equity investments into Brazil through the testing of the key drivers as documented by Groh et al. (2008), and incorporating the findings of Leeds (2003) and Klonowski (2011).

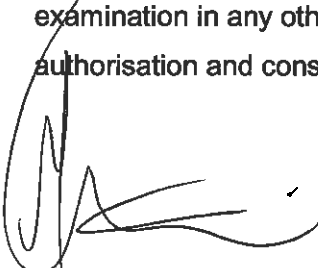
Through the use of semi-structured, in-depth expert interviews, this study supported earlier studies such as that by Klonowski (2011) who attributed growth in PE investments inflow to not just the population size of a country but the ability of the inhabitants of that country to drive or stimulate local demand through the purchasing power of the emerging middle class. In the case for Brazil, the norms that have applied in other emerging markets including South Africa in relation to investor and property protection rights, administrative burdens, corporate governance and the quality of legal enforcement do not apply, or at least not to the same extent as experienced in those markets. Lastly the Study established that private equity industry itself can impact attractiveness levels both positively and negatively.

Keywords

Private equity; Emerging markets; South Africa; Brazil

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirement for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research



Jacobeth Chikaonda

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“Stay hungry. Stay foolish.” Steve Jobs, 2005.

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1. Introduction to the Research Problem

1.1 Introduction

This research report does a comparative analysis of two emerging market private equity industries, namely Brazil and South Africa in order to gain understanding into factors that are contributing to the attractiveness of Brazil as a private equity investment destination and inversely those which make South Africa less attractive.

This chapter introduces the research problem; as well as allows the reader to attain an understanding of the background of the problem, the motivation for and including the purpose of the research.

1.2 Background to Research Problem

The Emerging Markets Private Equity Association (EMPEA) survey for 2011 found that investors had identified Brazil as the most attractive market for private equity fund manager deal making for the next twelve months, leapfrogging China as the preferred destination from the 2010 survey (EMPEA, 2011).

The annual Global Venture Capital and Private Equity Country Attractiveness Index ("The index"), which benchmarks the attractiveness of 116 countries for receiving institutional private equity and venture capital allocations, ranked South Africa 26 above Brazils 43 for the 2010 year (Groh, Liechtenstein and Lieser, 2011), meaning that as per the indexes criteria's, South Africa should be a more attractive destination for private equity and venture capital investments over Brazil, yet the aggregate private equity deal value in South Africa in 2010 was US\$1.5 billion (2009: US\$980 million) placing South Africa in a ranking of 21 globally in terms of deal value(2009: 24), while Brazil ranked 11th with aggregate deal value of US\$6.3 billion (2009: US\$940 million, ranking 26th) for the same period (KPMG 2011; Ernst & Young 2011).

In choosing to compare South Africa to Brazil, consideration was given that despite the disparities in economic size and population, as per Timm (2011), there is a case for contrasting South Africa and Brazil as not only do both countries form part of the India Brazil South Africa (Ibsa) initiative which was formed in 2003 with the aim of acting as a forum to share various developmental and economic learning's and experiences, the two countries also share a lot of similarities as both countries are grappling with similar development issues which include a

lack of quality education and shortage of infrastructure, included in the challenges is that although both countries are rich in natural resources, they are amongst the most unequal in the world, with Brazil having a Gini coefficient factor of 54.7 and South Africa 63.1 per world bank 2009 data.

1.3 Problem Statement and Research Objectives

The research report aims to establish the factors that are contributing to the attractiveness of private equity investments into Brazil.

Using a comparative perspective the research will analyse using the criterion from The index, the strengths and challenges with reference to the two markets economic activity, depth of the capital market, taxation, investor protection and corporate governance, human capital element as well as the extent of the countries entrepreneurial culture and deal opportunities, and how these factors act as enablers or disablers to attracting private equity investment flow into the respective countries.

The main objectives of the research include:

- Establishing the broad set of factors that explain country PE inflows by using Groh *et al.* (2008); Leeds and Sunderland (2003) and Klonowski (2011) as well as other existing literature on private equity, these articles will be used as pillars to develop an integrated framework of factors which explain PE inflows
- Verify the proposed framework of factors to test if it explains the success of Brazil
- Verify the proposed framework of factors to see if it explains the poor inflow to SA
- Determine the relative impact of each factor in the proposed model on the PE investment decisions in Brazil and SA
- Integrate the framework with additional factors stemming from the findings of the study to be presented into a new model

1.4 Research Motivation

“In South Africa the private equity industry represents a significant sector within the overall financial services industry. Investments by private equity funds into companies hold great benefits besides the mere cash effect to develop businesses. Private equity investments have considerable impact in terms of productivity, skills development and job creation, as it includes the transfer and exchange of know-how and not only the flow of capital” (KPMG, 2011, p. 10).

In the report conducted by the Southern African Venture Capital and Private Equity Association (SAVCA) on the economic impact of Venture Capital (VC) and Private Equity (PE), the findings were that not only was the outline of the local PE industry a beneficial contributor to the growth of the South African economy, private equity has also contributed in addressing economic imbalances of the past through the facilitation of Black Economic Empowerment (BEE), private equity also promotes entrepreneurial initiatives (SAVCA, 2009). Ernst and Koziol and Schweizer (2011) highlight the contribution that private equity investors make as an additional source of financing to companies.

Both the KPMG and the SAVCA survey highlight the importance of the need to grow the South African private equity industry as well as attracting more investment capital into the local funds, Andrykowsky and Barbary (2011) state that despite the attention that Sub-Saharan Africa has received recently, private equity investment in the area remains at modest levels, which makes the understanding of why investors currently prefer to invest their money into the Brazilian industry as opposed to the South African one and the lessons that can be learned from how the Brazilian industry market has managed to make itself more attractive even more important.

Although private equity funds have been operating in South Africa for over 20 years, the industry is still under researched in comparison to those of the developed and other emerging markets. Missankov, Van Dyk, Hayes and Van der Veen (2008) highlights the danger of this problem in relation to research done on the South African private equity industry performance, by stating that the lack of credible performance investigations and analyses has contributed to slow or poor adaptation of private equity in South Africa despite the countries strong perceived track record.

Suman, Sharan and Sachan (2012) conducted research into the different research methodologies conducted in PE from the years 2005 - 2011. Through the review of 284 published papers, the authors identified some of the following gaps from the literature:

- The bulk of the literature was focused on the United States and United Kingdom
- Further need for comparative study of PE in emerging economies versus developed economies
- Inadequate cover of the socio-economic aspect of PE
- Of the 284 published papers only 1.1% and 0.4% of authors on the non-combined research list came from South Africa and Brazil respectively.
- Research in the Middle East, African and South American regions to be “scanty or non-existent” (Suman *et al.* 2012, p. 41). Therefore increased attention in terms of research to these regions would result in the opening of “new doors for the expansion and growth of private equity, both as a discipline and for practitioners.” (Suman *et al.* 2012, p. 41)

While Mariz and Savoia (2005) run a comparative study on the Brazilian and the US private equity markets to determine how the Brazilian market would likely develop, Ribeiro and Carvalho (2008) conducted a study which benchmarked the Brazilian private equity industry model to that of the United States, and Klonowski (2011) conducted an economic analysis and evaluation of the PE dynamics of the “BRIC” countries (Brazil, Russia, India and China) to present their comparative assessment, to the researchers knowledge, no similar research as those conducted by Mariz and Savoia, Ribeiro and Carvalho and Klonowski have been done on the South African private equity industry.

Suman *et al.* (2012) states that the attention that PE has received in the aftermath of the financial crisis, has highlighted the facts that the discipline is still relatively young and that research is in its infancy. This research will not only contribute to the existing research on the South African and Brazilian private equity industry, but also that of emerging markets, and is motivated by an attempt to help fill the gap in the lack of studies conducted to date on not only the region but the discipline of Private equity itself.

The surveys conducted by Groh *et al.* (2009, 2010, & 2011), (determinates of which were compiled from the authors work of 2008), and what is happening in practice as evidenced by the SAVCA and EMPEA surveys show that there is a gap between the potential or ability of

countries to attract private equity funds as per theory (Groh *et al.* 2008) and the actual investments taking place in practice (SAVCA, 2011 & EMPEA, 2011) especially in the emerging markets of South Africa and Brazil.

This study aimed to fill the gap in current theory by attempting to determine what is currently missing from current theory that could explain Brazil's success over South Africa in attracting private equity investment flow.

Furthermore the study can also provide insights to existing and potential private equity investors and fund managers aiming to either invest or attract investment capital.

1.5 Research Scope

The scope of the research is described by the following definitions:

- Private Equity (PE) will be used as an umbrella term covering seed funding, venture capital, growth capital, buy-out and mezzanine investments.
- Limited Partners (LPs) are investors in private equity funds
- General Partners (GPs) are private equity fund managers
- Experts are individuals with a high degree of knowledge of the private equity industries of Brazil and/or South Africa.

Although the US industry will be used for mature market benchmarking emphasis, and the US, UK as well as other emerging market industries will be used for literature review purposes, the scope of the research will be limited to the South African and Brazilian private equity industry for the periods 2001 to 2011.

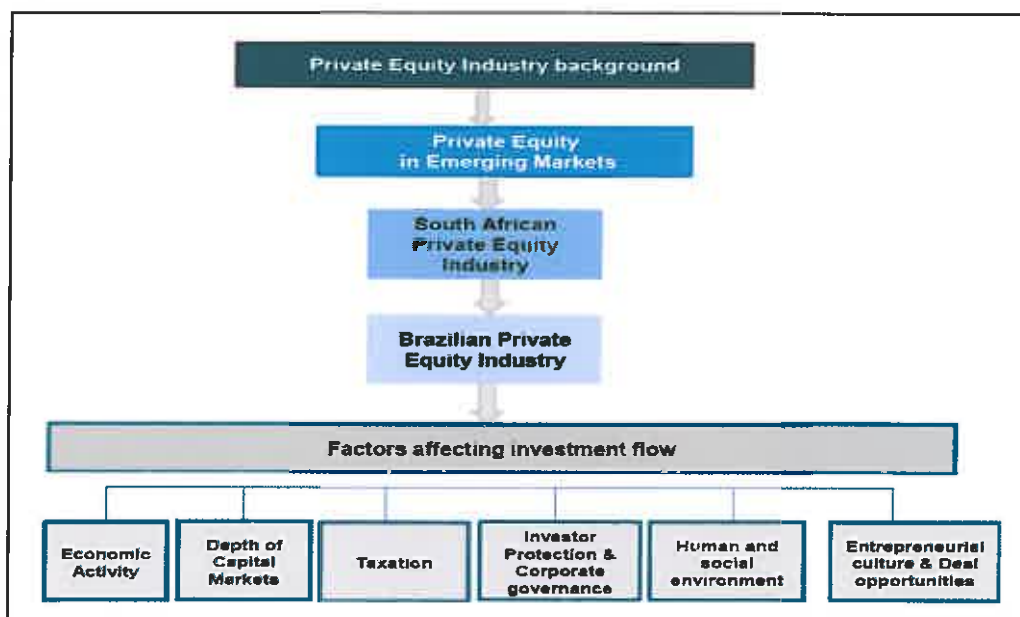
2. Theory and Literature Review

2.1 Introduction

Chapter one was an introduction into the setting, the research problem and included a description of the research and the prospective contribution to existing body of knowledge around factors determining attractiveness of PE investment to investors. This Chapter will review applicable literature on private equity the presentation of which is described below:

The literature and theory review will be subdivided into ten sections (see figure 1 below for a structure of the literature review flow). The first section will concentrate on the general definition and structure of the global private equity industry, including this section is done to give a brief introduction to private equity as an investment class. The second section reviews literature on private equity in emerging markets in general. The third section and fourth section is an overview of the private equity industries in South Africa and Brazil. Using some of Groh's et al (2008, 2010, 2011, and 2012) identified key drivers of country attractiveness for PE investors; a literature review cover is done separately on the identified factors as an attempt to gain clarity into the research question by reviewing what is currently known about private equity investor's investment destination attractiveness determinants especially in emerging markets.

Figure 1: literature review structure

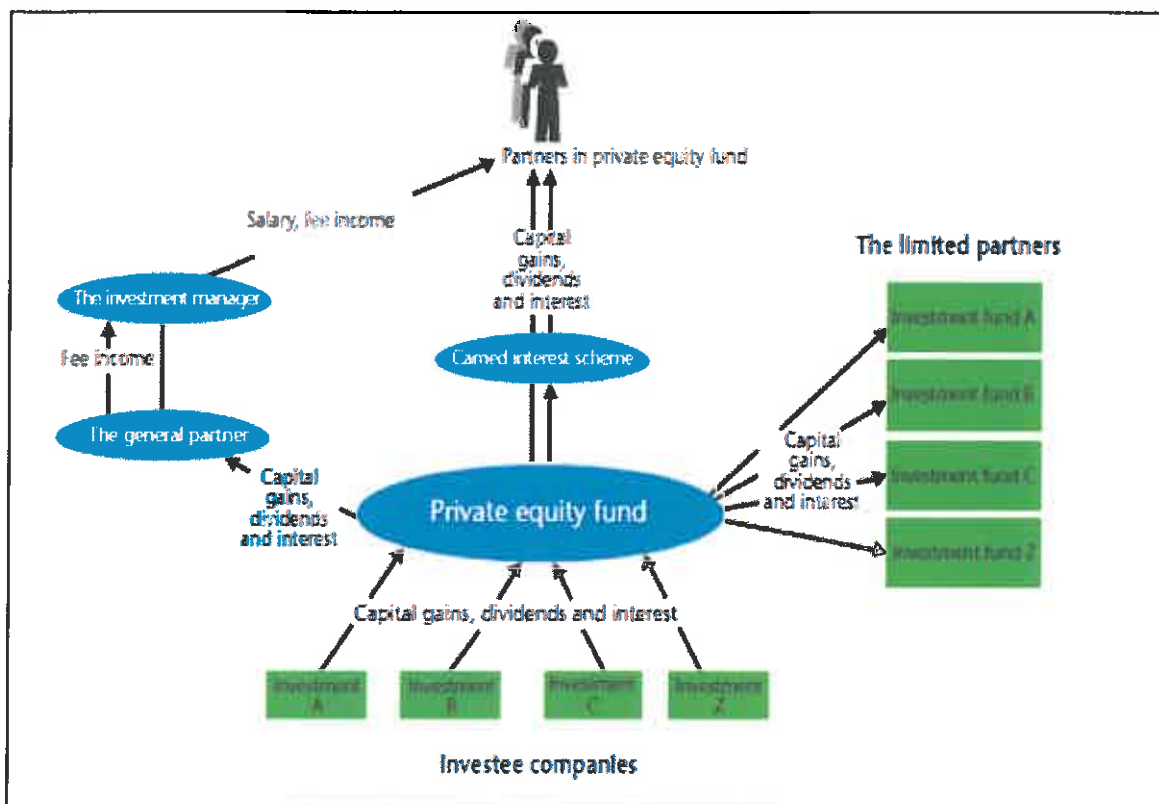


2.2 Private Equity Industry background

Wood and Wright (2009) define private equity as involving investments in unquoted companies and being inclusive of both early stage venture capital and later stage buyouts and by Heed (2010) as a merger and acquisition activity which is carried by high amounts of debt and is mainly aimed at privately held stocks.

The transactional structure of a typical private equity fund as represented in Figure 2 below would normally consists of the raising of capital by private equity firms (known as general partners) from investors (known as limited partners) through private equity funds (known as limited partnerships).

Figure 2: Structure of a typical private equity fund: Source Gilligan and Wright (2010, p.29)



General partners (GPs) have the responsibility of managing the partnership business and are liable for all of the debts and commitments of the partnership, while the liability of the limited partners (LPs) is limited to the amount contributed provided that the LPs are not participants in the management of the partnership. Heed (2010).

Institutional investors which include but are not limited to corporate companies, public pension funds, wealthy individuals as well as insurance companies make up the limited partners of a fund, Kaplan (2008).

Kaplan (2008) describes most private funds as being “closed-end” vehicles in which investors commit to provide a certain amount of money to pay for investments in companies as well as management fees to the general partner.” These funds therefore represent the equity pool that is subsequently invested by the general partners. Heed (2010).

Heed (2010) further explains that private equity firms can have different types of investment strategies as well as goals for funds that are set up, such as:

- Generalist funds which are set up to invest in any type of private equity transaction from venture capital to buyouts
- Specialist funds that are specifically set up to invest in specific investment types ranging from infrastructure, technology or health care.
- Secondary funds which acquire limited partnership interests in other funds or
- Funds of funds which are funds that invests in other funds.

From a legal standpoint, private equity funds are structured as limited partnerships, in which the general partners manage the fund and the limited partners provide most of the capital, Kaplan (2008). Heed (2010) explains that limited partnership do not have a legal personality, which makes the limited partnership unable to enter into contracts, as a result a holding company is usually set up to acquire or invest into a targeted company.

Mkhawane (2010) details the functioning of a private equity firm as involving the acquisition of private companies with the intention of providing founders of that entity the required capital to expand the company’s performance. It may further encompass the buying of a division of a corporate together with the management of that division in order to provide that management team the motivation and means they might need to attain new strategies. Private equity as explained, could further involve the purchase of a block of shares in a publicly listed company, this is done with the intention of delisting that company in what is termed as a public-to –private transaction, in an attempt to implement enhancements that would not be possible or challenging to achieve in a listed company.

KPMG (2011) talks of private equity as having three sub classes of investment stages which are categorised as venture capital, development capital and buy-out funding. These sub classes as defined, are further detailed in Table 1 below:

Table 1: Private equity investment stages. Sources: KPMG (2011, p.11); Mkhawane (2010).

Category	Stage of business development	Typical application
Venture Capital	Seed Capital	Funding of research, evaluation and development of a concept or business before the business starts trading
	Start-up and early stage	Funding for new companies being set up for the development of those which have been in business for a short time (one or three years)
Development capital	Expansion and development	Funding for growth and expansion of a company which is breaking even or trading profitably.
Buy-out	Leveraged buy-out or buy-in	Funding provided to enable management teams or other strategic partners, either existing or new, as well as their backers to acquire a business from the existing owners, whether a family or cooperation or other. the main difference between venture capital, development capital and buy-outs is that proceeds of a buy-out generally go to the entities previous owners and that the buy-outs are often leveraged.
	Replacement capital	Replacement capital is funding provided for the purchasing of existing shares in a company from other shareholders, whether they be individuals, other venture-backers or the public through a stock market. like buy-outs and buy-ins proceeds of replacement capital transactions are also usually paid to an entities previous owners

2.3 Private Equity in Emerging Markets

Agmon & Messica (2009) describe PE investments in emerging markets as another representation of foreign direct investments, wherein organisations from developed markets transfer their ownership advantage (factors of production) to new locations (emerging markets) for the purpose of generating stakeholder value. Banerjee (2008, p.159) defines an emerging market economy as “an economy with low-to-middle per capita income.” Of which the BRIC countries are the key players.

Banerjee (2008) states that emerging countries have made great progress in the past decade by enriching their accounting and disclosure standards as well as reducing taxes on capital gains taxes thus boosting equity investment and the growth of their stock markets. The author argues that changes such as those have together caused in dropping the costs associated with investing in these countries and also lessening the information irregularities that are faced by foreign investors. Banerjee's argument is further heightened by Klonowski (2011) who predicts that private equity in emerging markets will grow as a result of the foundation that improved regulatory frameworks and expected economic growth have provided for the developing industry in these markets. Another growth factor according to the author is the perception by international investors in the financial turmoil resilience of emerging markets.

Banerjee (2008) attributes the growth of PE activities to emerging markets to constrained opportunities in developed markets. The author found that institutional investors have demonstrated scepticism about the sustainability of the attractive returns that VC and LBO investments have enjoyed in most developed markets and are therefore always on the lookout for new markets to invest in. While Klonowski (2011) attributes the significant capital flows to emerging markets to the rapid economic growth which has mainly been driven by an expanding middle class and investments to domestic infrastructure, as well as less reliance on foreign markets and what the author terms as responsible public finance decisions.

Lerner, Stromberg & Sorensen (2009) state that although the structure and the significance of private equity investments in the United Kingdom and the United States is known, the private and social consequences of it are far less understood in emerging economies.

Agmon & Messica (2009) argues that Private equity funds can be a powerful contributor to both the economic and business growth in emerging markets as the short term nature of the

investment class allows PE firms in emerging markets sufficient time to transfer information and knowledge and also allow local stakeholders the ability to resume full ownership once the process is complete. The authors further state that the lack of sufficient developed capital markets in most emerging markets are overcome through the creation of international alliances which generate local comparative advantages.

As private equity is associated with high risk, private equity investors expect higher financial returns than those of regular investment assets. In emerging markets, De beer and Nhleko (2008) deducts the risks of private equity investments to be higher than those of developed countries as a result of the “inherent political and economic risks, information asymmetry, financial markets volatility, serious corporate governance transparency concerns, and government corruption” De beer and Nhleko (2008, p41). But he argues that despite these risks, emerging markets such as China have still managed to raise 60-70% of fund capital from international investors.

On their review of entry decisions of investors into foreign destinations, Buckley, Devinney & Louviere (2007) found that investors with extensive international experience gave increased priorities to markets with higher levels of uncertainties or those that others could perceive to be as being less attractive. Their study showed that host country culture variables played a greater role in the invest as opposed to the consider decision and that the final investment decisions of managers to be not only highly idiosyncratic but also subject to potentially unaware biases at the time of the investment.

Agmon & Messica (2009) found that the majority of money provided by LPs to PE funds earmarked for emerging market investments came from American financial institutions. In terms of foreign investors, Agmon & Messica (2009) found that it is more important for domestic actors in emerging markets to attract American and European private equity into their countries than it is for those investors.

According to Klonowski (2011) personal relationships drive the emerging market deal environment and investors often cite the underperformance of GPs as being the chief reason for re-evaluating their investment thesis in emerging markets. The study also found that strong GDP growth in these markets has not necessarily translated into consistent and premium returns.

Although difficulties experienced in each BRIC country appear to be similar, the countries differ in terms of the uniqueness and severity of some of the challenges and problems, private equity firms have had to present themselves as local players rather than western entrants in order to effectively penetrate emerging markets, as the traditional private equity expatriate model could be ineffective in these markets, Klonowski (2011).

Banerjee (2008) found that in contrast to the US and other developed markets, not only do emerging nations lack the equity markets that provide feasible outlets for the sale of PE portfolio companies, but that the poor infrastructure and lack of financial transparency in these markets retard the growth of PE investments, this view is further expanded on by Klonowski (2011) who states that not only does an emerging market country have to generate strong economic growth, but that country would also need to dedicate significant resources in the improvement of the finer foundational blocks of private equity, that is the legal infrastructure, the encouragement of entrepreneurship and avoidance of political interference.

Meerkatt and Liechtenstein (2010) state that although the GP business model in developed markets is built on taking full ownership and differentiation through size of equity investments and governance models, by analysing International Finance Corporation (IFC) data it was found by the authors that in emerging markets, a very different model is required for PE firms to succeed with the following points of difference being identified in emerging markets:

- Minority deals to be more successful than majority deals.
- Investments in businesses focused on domestic markets outperformed those targeting internationally oriented companies.
- Sector selection made a difference with the telecommunications, health care and materials sectors having the highest returns.
- First-time funds matching and sometimes even exceeding the returns achieved by experienced fund managers.
- Those funds with a strong local presence significantly outperformed international funds without a local presence.
- Top-quartile funds' performance were strongly driven by increases in revenues of portfolio companies not by leverage and that;
- Bigger funds outperformed smaller ones and therefore proved that fund size matters.

2.4 The South African Private Equity Industry Overview

Though the South African PE industry is small compared to that of the US and UK industries, relative to contribution by the industry to the country's GDP (3.6% in 2010), the industry is quite significant especially in comparison to many other countries, KPMG (2011).

De beer and Nhleko (2008) describes the South African emerging private equity industry to be the most sophisticated of all the emerging economy industries, and as having funds invested at various business development stages. KPMG (2011) further describe private equity in SA as a "distinct asset class" within the broader capital market sector, which in SA is supported by a well-defined industry that is made up of various stakeholders as well as players.

According to KPMG (2011), the South African private equity industries current profile is as a result of certain various historical developments both within the country and global capital markets. The industry in South Africa was further boosted in the 1980s by leveraged and management buy-outs from the disinvestment of multinationals from South Africa, De beer and Nhleko (2008). KPMG (2011) states that these leveraged as well as management buy-outs were organised, funded and managed by the big banks which existed at the time.

From the 1980s private equity in SA distinguished itself as a separate sub-asset class of equities and has benefited from foreign investment as a result, De beer and Nhleko (2008). KPMG (2011) also recognises the benefit the South African industry has gained due to the global trend of recognising the asset class as a very attractive investment vehicle for investors, the authors further highlight another contributor towards the popularity of private equity in SA as being the asset classes growing reputation as an effective means of economic development within governments and development agencies, KPMG (2011).

The domestic PE firms in South Africa are divided into two categories, independents and captives, De beer and Nhleko (2008). With Independents described by De Beer (2008) as fund managers who manage funds on behalf of third parties, while captives are described as managers who direct on-balance sheet investments funded by a holding company or group.

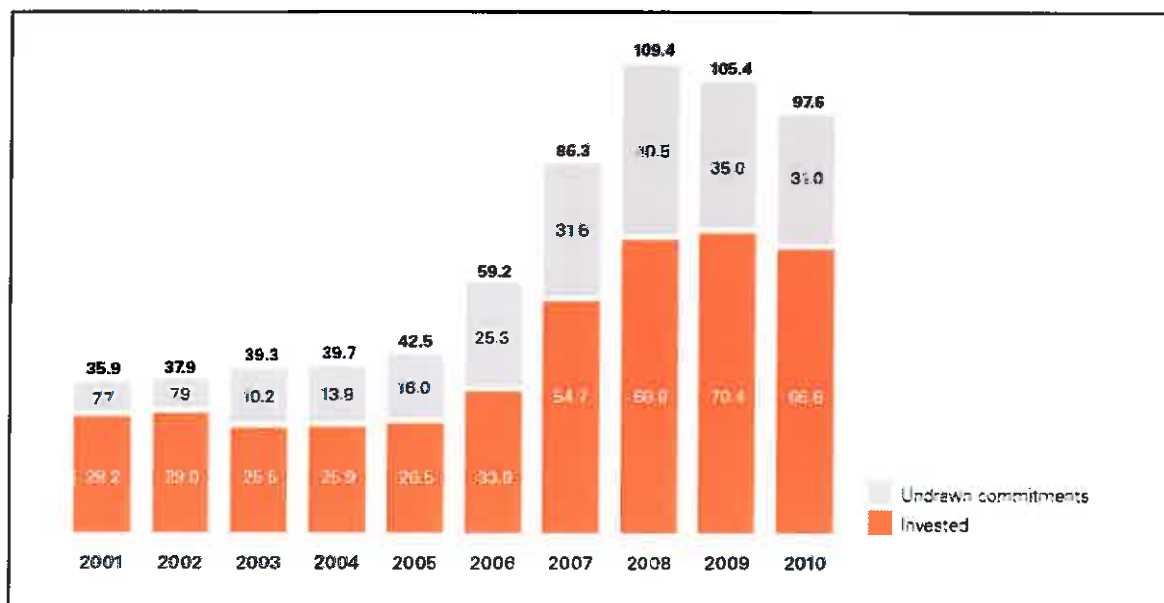
In terms of the role of private equity in SA, De beer and Nhleko (2008) states that the industry has played a big role in expanding the scope of black people to partake in business activities as most recent private equity deals in SA have involved a significant Black Economic

Empowerment (BEE) component. While KPMG (2011) describes private equity in South Africa as an important source of foreign direct investment, whether indirectly through the raising of offshore capital by local fund managers or as a result of direct investment by foreign fund managers.

Missankov et al (2008) found that private equity in SA displays absolute significant returns; displays significant premium relative to other conventional asset classes in particular SA listed equities and small-cap equities; has shown significantly better risk-adjusted performance than other classes and that the funds have relatively high costs of investing which however, according to the authors, do not eliminate the significant premium to listed equities and other asset classes.

As at the end of 2010, the SA private equity industry had a total of US\$12.2 billion (inclusive of US\$4 billion undrawn commitments) in funds under management a decrease of 8% from 2009. Independents made up 87.10% of total funds under management with the remainder going to captives. This has equated to a 10.7% compound annual growth rate in funds under management since 1999 as per KPMG (2011). Figure 3 below is a presentation of total funds under management in South Africa as at the end of 2010.

Figure 3: Total funds under management 2010, split by undrawn commitments and investments (ZARbn). Source: KPMG (2011, p. 19)



The changes to the Pension Fund Act (Regulation 28) which came into effect on 1 July 2011, will permit further investment by pension funds of up to 10% into private equity, KPMG (2011) points out that the importance of this change in the Act is that amounts invested into the industry and specific funds by local participation investors is a key component when international investors are considering investing into a fund or industry. Limitation of local participation such as was the case before Regulation 28 came into effect, hampers the extent to which international investors are willing to invest which in effect limits PE as an FDI source for South Africa.

The majority of funds raised in South Africa are by South African funders (2010: 42.4%), the second highest being from Europe (2010: 31.10%) with the US coming in third (2010: 12.6%). In 2010 34% of PE investments went into the infrastructure sector, 20% into the services sector and 15% into the manufacturing sector, with the biggest increase from 2009 being in the services sector (400%). KPMG (2011)

2.5 The Brazilian Private Equity Industry Overview

From Klonowski (2011) and Ribeiro and Carvalho (2008), we find that the first private equity firms were established in Brazil in the 1970s, although the industry only reached significance in the mid-1990s after the Brazilian currency stabilised. The Brazilian government has been an active participant in the industry since the early 2000s after discovering that functioning capital markets which include the PE industry play a very useful role in developing strong entrepreneurial sectors, by reducing regulatory barriers to the development of local businesses and also providing incentives towards the entry of foreign capital, Klonowski (2011).

Regarding the economy, Klonowski (2011), identifies Brazil among the BRICs (Brazil, Russia, India and China excluding South Africa) as not only being the most mature private equity market, but also the best balanced and self-sustaining of the four economies due to the countries strong manufacturing base, large labour pool, access to raw materials, diversified export base and agricultural orientation. On the other hand Klonowski (2011) makes mention of Brazils problematic issues of organised crime, and strong industrial groups.

Using data obtained from 65 PE/VC PE fund managers with offices in Brazil, Ribeiro and Carvalho (2008) found that although trade sales appeared to be the main exit route, that there were limited amounts of LBOs taking place in Brazil due to the scarcity of credit and that the regulation of Brazilian PE/VC forces the use of arbitration due to the inefficiency of the legal system.

Klonowski (2011) describes Brazil's regulatory environment as being bureaucratic, with time needed to start a new business being the longest in any emerging market (four months), a complex taxation system that is based on multiple procedures. Although the author makes note of Brazil's recent benefits as a result of introducing its bankruptcy laws, modern arbitration mechanisms and stricter corporate governance practices which include higher levels of financial transparency, protections of minority shareholders and external directorships, it was found that where private equity is concerned, GPs had to contend with not only dysfunctional boards, but also poorly enforced legal rights and disregard for minority shareholders.

Klonowski (2011) found the local exchange to be one of the major sources of competition for private equity firms, and that tender situations to be rare as deal competition was minimal between funds. The author also describes Brazil as an entrepreneurship driven country, dominated by family firms and like in most emerging markets, deal generation ability to be relationship driven, with local private equity firms spending most of their time nurturing their local contacts and new entrants to the industry needing a significant time in which to generate deal flows.

According to Ernst & Young (2010), some industries within Brazil are characterized by a high degree of fragmentation which represents great opportunities for investors with expertise and resources to consolidate. They contribute the lack of concentration of industries to the high level of family owned businesses in Brazil.

In terms of favoured sectors, Klonowski found that with 50% of Brazil's total population being classified as middle class, investors preferred industries such as retail, education and consumer goods as the sectors have shown significant growth due to the demand from the growing middle class. These findings are a slight shift from Ribeiro and Carvalho (2008) who found that although the PE/VC portfolio in Brazil was fairly dispersed across industrial sectors to a large extent, the IT and electronics industries appeared to be the most preferred by

investors. As per Klonowskis' (2011) predictions, the future hot private equity deals in Brazil appear to be in the medicine, health, and other life sciences areas.

The study of Klonowski (2011) found that in terms of capital allocation, although the average deal size was found to be US\$ 30 million, the majority of capital was allocated towards expansion and growth deals, while 25% towards start-ups and early stage firms with the majority of investors preferring to hold a minority rather than a controlling stake in the investment companies, with exit options ranging from public listings, trade sale and secondary sales. This is in line with Ribeiro and Carvalho (2008) who made reference to a growing trend indicating IPOs becoming a bigger exit route in the future.

The majority of funds raised in Brazil are by Brazilian funders (2010: 60.49%), the second highest being from the US (2010: 25.58%) with Europe coming in third (2010: 6.93%). In 2010 the three highest sectors to get PE investments were IT and electronics (20%), energy and oil (10%) and construction (9%), Furtado (2010).

2.6 Factors Affecting PE Investment Flow

Local business environment factors which affect any industry operating within a specific country include political, economic, social, technological, environmental and legal factors. All these factors are important in the decision of LPs to invest in and GPs to set up private equity funds.

Meerkatt and Liechtenstein (2010) argue that as countries improve their socioeconomic environment, their attractiveness for private equity will increase and that ultimately the countries themselves control their relative attractiveness and their ability to attract investment to accelerate their development.

The focus of this review will be on economic activity, depth of capital markets, human capital elements and deal opportunities. Legal factors will be limited to taxation, investor protection and corporate governance legislative and regulatory factors.

2.6.1 Economic Activity

Groh et al. (2012) mentions the importance of emerging countries economic factors such as favourable measures of economic prosperity, variation in corporations, entrepreneurship activity, and general economic size and employment levels in estimating the attraction of foreign private equity deal flows. Moss, Ramachandran, and Standley (2007) found that small market size and low levels of liquidity are binding deterrents for foreign institutional investors.

Erel et al. (2012), state that macroeconomic conditions affect the ways in which firms raise capital as well as the firm's ability to do so. According to the authors, macroeconomic conditions impact the types of securities a firm will use, the way those securities are structured and more especially the kind of firms which are able to receive financing at different points in time.

Watson and George (2008), conducted a study to establish the relationship between the size of the economy and the rate of return generated by an investment, although the study conceded that those countries with larger economies present greater opportunities especially in relation to exit opportunities, there was no significant correlation found between the size of a country's economy and the rate of return of an investment acquired in that country.

Groh et al. (2008) links economic size as a general indicator for body of corporations as well as of deal flow opportunities, stating that where an economy is growing quickly, there exists more attractive opportunities for entrepreneurial activity

Infrastructure is important for the growth of any economy, Gilligan & Wright (2010) argue that infrastructure is very important for a private equity industry to grow, as PE funds are strongly dependant on advisers both for delivery of services and for deal flow, added to this is the availability of exit opportunities that well established exchanges can provide.

2.6.2 Depth of capital markets

According to Banerjee (2008), any country's PE cycle is motivated by the ease of exit from the market within a usually predetermined time-frame. This is in agreement with Leeds and Sunderland (2003) who stated that each feature of private equity cycles is compelled by an authority to arrange a profitable exit within a given time period.

Agmon & Messica (2009) found that most countries are missing out on their potential to attract private equity funds fully as a result of the absence of appropriate financial systems. Groh (2008) found that besides investor protection, the size and liquidity of a country's capital markets being a proxy for the professionalism of the financial community, ultimately affected a country's attractiveness to PE and VC investment.

Lerner et al. (2009) conducted a study in an attempt to find if less developed infrastructure, financial and regulatory systems created obstructions or prospects for PE in emerging markets, the results of the study concluded that although financial markets matter for private equity activities in general, only the development of equity markets matters in the development of private equity rather than debt provision.

The use of debt finance in PE transactions was found to be a key element in enhancing the potential returns for investors by Heed (2010) while Barber and Goold (2007) identified the financing and tax advantages through the aggressive use of debt as a contributing factor to the high returns achieved by private equity firms.

The study by Schertler and Tykova (2009), found that countries with less viable stock markets had higher probability of foreign VC's participation compared to those with more developed stock markets due to large competition from domestic VC's in the more developed markets as developed stock markets have been found to encourage venture capital investments.

Speaking on the importance of capital markets, Groh et al. (2008) highlights the necessity of entrepreneurs finding backers whether banks or VC/PE funds, who are willing to bear risk.

Schertler and Tykova (2003) in Groh et al. (2008) found the stock market's liquidity having a significantly positive impact on VC investments.

2.6.3 Regulations and legislative factors affecting the PE industry

Watson and George (2008) findings proved that countries with lower legal and regulatory burdens offer investors greater opportunities for maximising returns of investments made. While Banerjee (2008) argues that one of the most significant aspects needed to be addressed in order to develop a healthy PE market in an emerging economy is the protection of shareholder's rights. Groh et al. (2012) talks to the role played by a country's legal environment in determining the magnitude and coverage of its capital market and the ability for the local companies to obtain outside financing.

Leeds and Sunderland (2003) highlighted that weak corporate governance where further compounded when legal systems were unable to offer reliable outlets for resolving disputes. The authors also state that previous painful experience by fund managers under minority shareholding forced them to alter their investment strategies or pull out of countries altogether if they were unable to gain majority controlling stakes.

Roe (2006) in Groh et al. (2012)" reiterates the importance of strong shareholder protection through a comparison of the political determinants of corporate governance legislation for the major economies." While Lerner et al (2009) found that although venture activity and to some extent growth equity as well as private investment in public equity activity were impacted, LBO activities were not affected by investor protection.

De beer and Nhleko (2008, p. 500) argues that there is no need for specific private equity industry regulation, the authors views are that " the evolution in size and influence of the industry has led to increased transparency and awareness with regard to good corporate

governance practices.” Nielsen (2008) on the other hand credits a significant part of the growth in PE investments over the last twenty years to regulatory changes that have permitted pension funds to raise their private equity investments.

De beer and Nhleko (2008) is in contradiction with Ernst et al (2011) who found that regulative action aimed at limiting excessive leverage coupled with increased awareness for better transparency standards would help limit potential negative effects caused by PE investors, while Lerner et al. (2009) found that although complex business regulation did not significantly affect venture capital activity, they had a significant negative impact for private equity activity in general and were particularly strong for LBO activity specifically.

2.6.4 Taxation

Very few countries have specific tax regulations on investors in private equity funds, in most countries, LPs are taxed on the income derived by the invested funds and are subject to capital gains tax on exit. Knoll (2007) states that private equity funds are structured as pass through entities for tax purposes. Wherein the fund does not pay any tax, and all income gains or losses as well as expenses earned or incurred by the fund are passed through to the LPs.

Watson (2008) was able to prove a negative correlation between a countries tax burden and the rate of return generated by investments or acquisitions, which could explain why in most leveraged buyouts or LBOs internationally, much effort is placed in the creation of efficient tax structures. Gilligan and Wright (2010, p.13) argues that even though the tax efficiency structuring is not unique to private equity transactions, it comes into sharp relief when a company changes the way that it is funded, as in a buy-out.”

Schertler and Tykova (2009) proposed that a high effective personal income tax rate might dampen venture capital investments in a country due to the possibility of the higher rate discouraging the accumulation of human capital in that particular country. This would therefore mean that those countries received lesser foreign VCs from entering that country for the same reason. One the other hand the study found that higher personal taxes were an incentive for individuals to become entrepreneurs which in turn lead to more venture capital activity from both domestic and foreign investors.

As per Groh et al. (2008), the two types of taxes that affect PE activity are those that are directly related to the asset class such as dividends and capital gains tax and those which impact corporations and entrepreneurship such as corporate taxes, they also emphasise that taxes matter for business entry as well as business exit.

2.6.5 Human and social environment

Like any other industry, the PE industry also competes in the market for talent. Heed (2010) defines the core roles of GPs as being the provision of an investment management strategy as well as investment decisions to the limited partnership.

Talent is especially competitive in the private equity industry as the model of private equity fund investing due to the nature of its high risk, is highly reliant on the skill set and experience of fund managers to offer the returns required by LPs. De beer and Nhleko (2008) illustrates this point by attributing the gaps in performance among funds to be the result of wide differences in the experience of fund managers. Performance of funds is emphasised as being important by Barber and Goold (2007) who links the ability of a fund to raise future funds as being driven by the track record from previous funds, while Meerkatt and Liechtenstein (2010) proved that where emerging markets are concerned, LPs traditional concerns about first-time funds to not be necessarily warranted as forty six percent of the top-quartile performers of the funds tested where first time funds.

As per Metrick and Yasuda (2012) private equity firms that successfully stay in business do so by raising new funds every three to five years, according to the authors, when the funds performs well and LPs deduce that performance to be as a result of skills rather than luck, the curve ball of LPs demand for new funds will shift out.

A study conducted by Walske & Zacharakis (2009) found that LP's identified the quality of the GPs team (quality expressed as experience) as being an important criterion for investing with that GP. They further explain that LP's interviewed confessed to rarely investing in first time venture capital funds (VCFs) but opted to rather monitor new VCFs and only invest in those VCFs third or fourth fund if the performance stayed stellar over the period. They also found that GPs senior management experience to be an significant variable in predicting the success of VCFs. While as Smolarski (2007), found poor management track record to be a deal killer.

The necessity of highly skilled managers also comes in when private equity funds are required to assist in the up scaling of value of their investee companies. De beer and Nhleko (2008, p.38-39) speaks to the transformation of private equity fund roles from capital providers to also include “the active participation of value creation processes of the portfolio firms.” He further argues that this value enhancing role at the post-investment stage of the private equity investor in emerging market investments is also important when you factor in the challenge of viable exit opportunities. This is in agreement with Leeds and Sunderland (2003) who argues that the management role of the private equity investor is more important in emerging markets than it would be in developed countries due to the particular challenges faced when creating viable exit opportunities. General business skills are required for the fund manager to be able to provide variable management and operations experience to the portfolio company.

Due to the complexity of most private equity deals, high skill sets are also required in the structuring of these deals, Gilligan (2010 p.73) gives an example of a large private equity fund buy-out, which is complicated by the multiple layers of debt, mezzanine and equity carrying different risks and rewards. He argues that prudent use of financial engineering skills are needed in private equity structure set up, and even though the detailed technicalities of the structure can be outsourced to legal and accounting experts, the private equity managers still have to be able to assess the investment risk and assist in the development of a structure that delivers the appropriate reward.

Regarding the reputation of fund managers, Gilligan and Wright (2010, p.43), further highlights that the ability of a fund to attract investment demand is largely dependent on the investment track record of that particular fund. He goes on to qualify by stating that, the investment decision of an LP will however also be “influenced by the way it is proposed to share investment returns between the LPs and the manager. There is therefore, competition between funds based upon the management fees charged, the hurdle rate of return, and the priority of the returns between LPs and the GP and the carry percentage.”

Speaking to the prior experience gained by GPs, Walske & Zacharakis (2009) found that entrepreneurial experience to be both a significant and negative predictor of a funds success due to the ability of the entrepreneur’s ability to manage a portfolio of investments as opposed to one business. Consulting experience is mentioned by the authors as being a significant predictor for VCF success (although less than prior experience as a GP). Of interest were the

findings that prior financial and technical experience was not a significant predictor in a GP firm's ability to raise follow-up funds. The authors suggest that since a GPs duties involve the finding, evaluating, structuring, monitoring and the exiting of investments, a successful GP should have more than financial acumen which supports De beer and Nhleko (2008) suggesting for the requirement of general business skills.

2.6.6 Entrepreneurial culture and deal opportunities

There is a bi-directional relationship between venture capital investments and innovations as not only do investments stimulate innovation but innovations are also an attraction for venture capitalists investments, Schertler and Tykova (2009). In the study conducted by Schertler and Tykova (2009) companies from the IT, machinery and biotech sectors were more likely financed by foreign VC than those in other industries.

Groh et al. (2008) states that investment opportunities are directly related to local entrepreneurial activities and are associated with innovations, restructurings, pure size of the economy, growth expectations as well as the entrepreneurial spirit of the countries people.

Watson and George (2008) describes the reasoning for a foreign acquisition by a private equity firm to be the maximisation of the investments return, whereby attractive country markets are described as those "that present the best opportunities to maximize return."

In explaining the attraction of private equity to investors, Gilligan and Wright (2010) explains that investors are motivated by the need of having balanced portfolios with investments which will achieve a mix of capital growth and income yield " Private equity forms a part of the asset allocation of those portfolios that seek capital gains through higher risk/higher return investments." Gilligan and Wright (2010).

2.7 Summary of the Literature review

The review on the private equity background shows that most private equity transaction are formed as a result of the raising of capital by GPs from LPs. The roles of GPs in terms of the responsibilities that are carried by them within the partnership are highlighted as discussed by Heed (2010).

The literature review also covered some of the existing theory on private equity in emerging markets, the key findings of which are that many emerging countries have made great progress in improving the fundamentals needed by private equity firms to function in within those markets (Banerjee, 2008 and Klonowski, 2011), that PE can be a powerful contributor to both the economic and business growth in emerging markets (Agmon & Messica, 2009), that higher financial returns are expected by investors from emerging markets due to the risks associated (De beer, 2008).

The South African PE industry although young and considered small, was found to be the most sophisticated of all the emerging economy industries (KPMG, 2011), while the Brazilian industry was described to be operating under a bureaucratic environment but having some of the greatest deal opportunities in terms of the availability of a high number of fragmented industries from which to source from, (Klonowski, 2011).

Lastly a review of factors (adopted from Groh et al. 2008), affecting PE investment flow was also done which highlighted the importance of factors such as the economic activity of a country, the role played by legislations and regulations, human and social environment elements, the entrepreneurial culture and deal opportunities to the attraction of PE investment into markets.

The next chapter details the core research question as well as the supporting sub questions that formed the basis of the exploratory research. The aim of the core questions is to gather insight into the factors that are contributing to Brazil overtaking South Africa in private equity investment inflow.

3. Research Propositions

3.1 Introduction

The preceding chapter reviewed the literature which covered the factors that are considered to contribute to the attraction of PE investment into countries in general and emerging markets specifically.

The aim of this chapter is to detail the core research question as well as the sub-questions that formed the basis for of this study, the purpose of which is to gather insights into the factors that are contributing to the Brazil overtaking South Africa in PE investment inflow.

3.2 Research question

The principal question of this research is:

What are the factors that are contributing to Brazil overtaking South Africa in PE investment inflow?

The fundamental question as given was answered using the following sub-questions where used in the benchmarking of the Brazilian and South African private equity industries:

- Do the economic activities of Brazil/South Africa prove/disprove the reasons as to why Brazil is receiving more PE investment inflow?
- To what extent do the legislations and regulatory burdens of the two countries encourage or discourage PE investment?
- What role do the capital market structures of the two countries play in being an enabler or disabler of PE investment?
- How do the entrepreneurial cultural differences between the two countries affect investment inflow to the respective country?
- Which of the two countries offer better deal opportunities and why?

4. Research Methodology

4.1 Introduction

The principal question including the sub-questions which formed the basis for this study was outlined in the preceding chapter.

The purpose of this research was to obtain deeper understanding into the reasons why Brazil is overtaking South Africa in private equity investment inflow. This chapter details the research approach, methodology and design that were used by the researcher in the purpose of gathering and analysing of the data used in the study. The justification of the qualitative approach used is outlined and the research process followed is also explained. Also defined are the sampling parameters, followed by a discussion on the data collection process and analytical approach taken.

4.2 Methodology

The research followed a qualitative empirical research design, Kothari (1990) describes qualitative research as one which is concerned with qualitative phenomena while Yin (2011) describes qualitative research as being different from quantitative research due to its ability to represent views and assessments of respondents in a study especially where the capturing of the respondents views is the main purpose of the study as this research was.

Qualitative research is beneficial as it can be used to analyse numerous factors that encourage people to perform in a specific manner or that cause people like or dislike a specific thing (Kothari, 1990). Yin (2011) says of qualitative research that the methodology is an attempt in capturing the meaning of events as well as the events unique timing, place and distinct historical moment.

In terms of the definition by Kothari (2011) the use of a qualitative design approach to this research is valid as Limited Partners (LPs) and General Partners (GPs) are made up of individuals, and the aim of the research is to understand the motivation of LPs and GP's in preferring to invest with Brazilian Private Equity (PE) funds over those of South African funds.

As the researcher intended to gain deeper insights into the reasoning's behind the Brazilian PE investment phenomenon, an exploratory research such as the one proposed adds to the description of qualitative research. This view is supported by Saunders and Lewis (2012, p.110) who define exploratory study as "research that aims to seek new insight, ask new questions and to assess topics in a new light." Furthermore Kothari (1990, p.2) terms studies with the objective of gaining "familiarity with a phenomenon or to achieve new insight into it" as exploratory research. Exploratory research has been chosen as it is flexible enough to address why, how and what type of research questions.

Yin (2012) also explains that, not only is qualitative research contextual, but events and ideas that might emerge from qualitative research can represent meanings given to real-life events by those people who live them, and not those of researchers as a consequence of the researcher's values and preconceptions.

Separate from the researches nature, the researcher was of the belief that the experts interviewed would need to be have reflections from their experiences, which was an opportunity that the qualitative style of this study could provide, instead of valuable material or stories lost being lost in the struggling of completion of questionnaires for example, the interaction of the interviewees was captured as they shared their views, experiences and opinions.

The need to increase levels of response through shifting of tactic or reordering of questions, or probing responses given necessitated the need to select a qualitative rather than a quantitative method.

4.3 Data Collection

As per Ayer (2010), several data collection attempts support the "grounding of theory by the triangulation of evidence." A two-phased qualitative approach was undertaken for purposes of the study, one involving secondary data and the other primary data collection.

4.3.1 Phase one of data collection

Phase involved the use of secondary data collection. Saunders and Lewis s (2012) defines secondary data as "data used for a research project that were originally collected for some other purpose."

The aim of phase one of the data collections was not only to test the data of Brazil and South Africa against the reviewed theory but also to use the data to serve as a complement to and benefit the data collected under phase two.

As suggested by Acaps (2011), the choice to collect secondary data was decided on as a way to:

- gain clearer, more detailed and up-to-date analysis of the situations in both countries;
- Support the identification of what and where the problems might be as per theory and from the primary data collection;
- Provide a baseline to compare the primary data collection results;
- Obtain a tool for identifying information gaps and determine the most appropriate method to access the information
- Design subsequent primary data collection phase.

The types of secondary data used included both compiled quantitative and qualitative data that was in existence in the public domain. The secondary data collected that was relevant to the study took the form of:

- Census type data which covered demographics and the economic trend data of both Brazil and South Africa, sources included for example, the World Economic Forum global competitiveness report and data obtained from Trading economics,
- Continuous industry surveys such as the KPMG and SAVCA annual surveys, the Emerging Market Private Equity Association (EMPEA) annual surveys and the Ernst & Young Global venture capital and private equity country attractiveness index.
- Data and information was also obtained from other documentary text data in the form of journals, reputable newspaper and magazine articles, organisations' websites and reports conducted by institutions and individuals, as well as government publications.
- Relevant/appropriate academic surveys.

Multiple source secondary data in both snapshot and longitudinal form was also used in the conducting of this research. Snapshot multiple source secondary data is described by Saunders (2012) as that which relates to a specific or single time and includes data drawn from more than one source, while longitudinal or time-series data is “created by combining comparable variables collected through different surveys at different times, or through the same survey that has been repeated over time.” (Saunders & Lewis, 2012, p. 95)

The researcher experienced some pitfalls and frustrations as a result of using secondary data such as the impartial fulfilment of the research needs, especially as most if not all the data collected had already been processed and summarised for the purpose of which it was conducted.

The researcher was able to place reliance in the data collected during phase one as the bulk of the secondary data collected were done so for the purposes of conducting research for PE industry associations from both South Africa (SAVCA) and Brazil's Associação Brasileira de Private Equity e Venture Capital (ABVCAP) as well as Governmental institutions.

4.3.2 Phase two of data collection

Primary data was collected through the performance of in-depth expert interviews with the objective of gaining insight through the PE expert participants' views, experiences and opinions around the key research questions, which is, what were the factors that were contributing to the attraction of PE investment into Brazil.

Primary data is defined by Hussey and Hussey (1997) as original data which is collected at source. Although Hussey and Hussey (1997) suggest unstructured questions where questions have not been prepared beforehand for phenomenological approaches, Semi-structured one-on-one interviews was selected to be conducted with Brazilian and South African PE industry experts for the purposes of this study.

Even though focus groups are considered more efficient (Yin, 2011), individual interviews were chosen for this study as a way to gain depth during the interview process. Both closed-end and open-ended questions were asked using prepared questionnaires, as a reference point (see appendix 1 for a draft of questionnaire).

The choice of a questionnaire over that of a survey was made mainly due to surveys being “constrained by need to manage carefully the degrees of freedom required to analyze the responses to a set of survey questions” (Yin, 2011, p.8), this management limits the number of questions one can devote to any contextual conditions. And although history addresses contextual conditions, it studies the dead past in its conventional form and not ongoing events as in the case of qualitative research, Yin (2011).

Phase two consisted of in-depth semi-structured interviews conducted using the questionnaires as a guideline. The population, unit of analysis, sampling method and size are summarised in Table 2 and detailed further below:

Table 2: Summary of research sampling and data collection method

Research description	Aim of the phase	Data collection method	Sample technique	Sample size
Expert interview	To gather views and opinions drawn from the experts experience	Face to face or telephonic, semi-structured interviews	Purposive and Snowballing	10 Male and 1 female PE practitioners of whom three were from Brazil and eight from South Africa

4.3.3 Phase two population, unit of analysis, size and nature of the sample

4.3.3.1 Population

The population for this research phase encompassed eleven (11) individuals that can be regarded as experts in the field of PE, the make of the population, details of whom are given in Table 3 below:

Table 3: Descriptive list of expert interview participants

Expert Identification	Country of PE industry represented	Designation
Participant 1	South Africa	Female PE firm director who also serves on the boards of SAVCA and TIA
Participant 2	Brazil	Male, Principal director of a large international PE firm
Participant 3	South Africa	Male, Head of a Johannesburg based Pan African PE firm, also serves on the board of SAVCA
Participant 4	Brazil	Male, Partner at large Brazilian PE firm
Participant 5	South Africa	Male, Director of a VC & SME financing firm, SAVCA board member
Participant 6	Brazil	Male, Co-manager of a VC and growth capital firm
Participant 7	South Africa	Male, Senior Manager of a DFI VC unit. Former Director of SAVCA
Participant 8	South Africa	Male, Senior Manager of A medium sized PE firm, Former CEO of SAVCA
Participant 9	South Africa	Male, Director of a medium sized PE firm
Participant 10	South Africa	Male, Manager of PE unit of international auditing firm
Participant 11	South Africa	Male, Director of a large international PE firm

4.3.3.2 Unit of analysis

The unit of analysis for phase two of the study was the criterion for both LPs and GPs in the investment decision-making process for investing in either South Africa or Brazil.

4.3.3.3 Sampling

The decision was made to interview participants from both Brazil and South Africa in order to gain different views from each country related to the research question, and also as a way to

avoid bias perceptions of the participants as well as the researcher, this is why convenience sampling was avoided as a technique in this research.

Experts were identified using a purposive sampling method, which is described as chosen with the attempt to get the most relevant, broadest range of information and perspective on the research question by Yin (2011). Member list directories were obtained from SAVCA and ABVCAP, and were then used by the researcher to carefully select an initial sample of 15 firms in each country to approach covering multinational and large firms, Small to medium firms as well as VC firms and DFIs and LPs who were identified on the investor lists, this was done with the intention of getting as many different perspectives from all the different PE investment stages.

Emails were then sent out to the selected sample of firms to ascertain their willingness to participate in the research, an explanation of the objective of the research was also included in the initial email. Out of the thirty firms approached initially, seven responses were received from Brazilian firms agreeing to be a participant in the interview while eight were received from South African firms, none of the responses received except in the case of the South African DFI, were from LPs.

After the initial low response, ten additional firms from each country who hadn't been initially approached as well as follow up emails to some of the ones that were in the initial list of targets were sent, this time there were no responses.

From the firms that had indicated their willingness to participate in the research, only members from two Brazilian firms accepted meeting invite requests that were sent to them and of the South African firms only five accepted. The rest of the interviews were obtained through snowballing techniques. The questionnaire was then sent to the participants on acceptance of the meeting request to get them familiarised to the tone the interview as expected to take.

4.3.3.4 Data gathering

The one-on-one in-depth semi-structured interviews were conducted at the participants offices, homes and telephonically. All the Brazilian interviews were done telephonically. The length of the interviews ranged from 110 minutes to 30 minutes the average time covered for all 11 interviews was 45 minutes per interview.

The process of the interviewed followed a three step approach, where the researcher introduced herself and the purpose of the interview as well as a need to record the interview process form which the participant was allowed to deny, none of the interviewees declined the use of a recording device or for the commencement of the interview.

Although at the time of the interview, participants would have already seen the questionnaire, participants we encouraged to use their own words, not those predefined by the researcher to discuss topics, Yin (2011). (See Appendix 2: Interview guidelines)

During the data gathering process strategies employed by the researcher to improve the value of the interviews included:

- Firstly creating a connection with the participants through the discussion of current affairs, interesting aspects about deals they had been involved on, interviewee's backgrounds as well as elements of common interest where they could be found.
- One of the was at home recovering from an operation when the interview was conducted a rapport was established by talking through the procedure underwent as well as how he was spending the time until he had to return to the office.
- Where energy levels or interest seemed to wan, humor was introduced.
- Avoiding antagonising the participant by insisting they answer questions they were hesitant to.

A probing approach was used throughout the interview in order to get the participants to reveal as much as possible especially where a new theme or factor that the researcher was not aware of was discussed.

4.4 Pre-testing

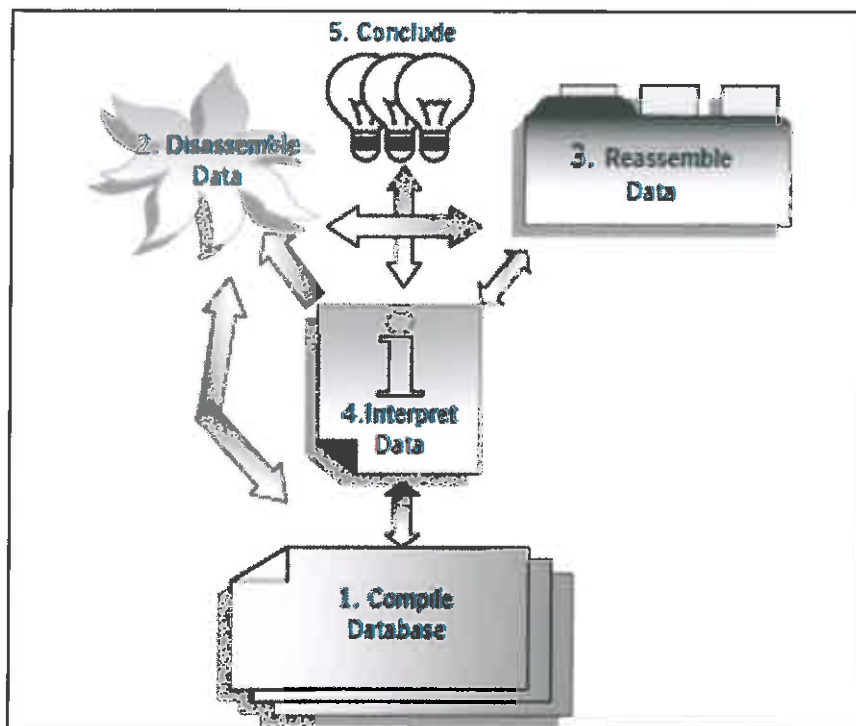
Mock interviews were conducted with two former colleagues of the researcher who work in the private equity sector; this was done to enable the fine tuning of the research instrument. Conducting the mock interviews proved to be very beneficial as the pre-testing revealed that

one of the questions on the questionnaire relating to transaction structures was ambiguous and therefore necessitated rewording.

4.5 Data Analysis

Yin (2011) five-phased qualitative analysis cycle in figure 4 below was used in the data analysis process.

Figure 4: Five phases of analysis and their interactions: Source: Yin (2011, p. 178)



In phase 1, data collected from the interviews and the secondary sources Data was compiled and sorted a database.

Disassembling of the data was done through the use of comparative and content analysis methods in order to test or build on the theory and literature. Comparative analysis was done by comparing new sets of data to previous sets. While in content analysis, the data collected such as interview notes or transcripts were examined and the frequency of categories or words were labeled or coded, counted and presented into a frequency table (phase 3 as per figure 1), all this was done with the intention of looking at patterns or links between the theory and the research question as well as any new common themes that emerged from the interviews.

Phase 4 and 5 of the cycle are covered under chapter 6 of this study.

4.6 Potential Research Limitations

The following limitations were inherent in the undertaking of this study.

- Only two countries which fall under the emerging markets category were benchmarked, the findings of the study might not therefore be relevant to other emerging markets or the developed markets.
- The data collected, though discussed with experts, was based on the researcher's understandings and assumptions which therefore gave an element of bias in the study.
- The relatively small sample of respondents (especially from Brazil), although notable experts in their field made it difficult to generalise the meanings of the findings from the results.
- No comparison is done around returns generated by PE firms of two countries, including this element could have revealed different results.

5. Results

5.1 Introduction

The research questions detailed in chapter 3 are analysed in this chapter using the data evidence collected through the semi-structured interviews that were performed by the researcher. As detailed in chapter 4, comparative analysis as well as content analysis was done in order to identify links and patterns between the theory, research questions as well as any common themes that emerged from the data collection process itself.

5.2 Emergent themes from the expert interviews

The factors affecting private equity investment inflow are gathered into the groups that were established during the literature review using Groh et al. (2008, 2009, 2010, 2011) index structure, that is, economic activity, depth of capital markets, entrepreneurial culture and deal opportunities, human and social environment, the two key drivers taxation and investor protection and corporate governance are grouped into one section namely legislative and regulatory factors while an additional category that emerged from the interviews but was not covered separately under the literature review section in chapter 2, being industry specific factors, has been added to the structure of the key factors affecting PE investment flow.

Table 4 is an illustration of the cumulative frequencies and the amount of unique respondents on all themes that were classified within the groups mentioned above. the subtotals in Table 4 highlights that industry specific factors, economic activity and entrepreneurial culture and deal opportunities are perceived to be the most significant factors affecting private equity investment inflow to both Brazil and South Africa. While legislation and regulatory factors are also viewed as being important, although to a lesser extent, human and social environment factors are viewed to be even less so.

Table 4: Factors affecting private equity investment inflow to both Brazil and South Africa frequency table. Source: Groh et al. (2008); Leeds (2003) & Klonowski (2011)

Category	Theme	Count	Unique Respondents
Economic Activity	Size of the Economy (GDP)	30	11
	Political Stability	16	11
	GDP per Capita/Disposable Income/Unemployment/Population/Emerging Middle Class	20	11
	Local Market Vs. External Market	6	6
	Subtotal	72	
Depth of Capital Markets	Stock Market Liquidity	3	2
	IPO Activity	8	5
	M&A Market Activity	6	4
	Debt & Credit Market	11	8
	Financial Market Sophistication	9	7
Subtotal	37		
Legislative & Regulatory Factors	Tax Incentives and Administrative Burdens	16	11
	Corporate Governance	12	11
	Security of Property Rights	4	4
	Quality of Legal Enforcement	6	4
	General Legislation	6	4
Subtotal	44		
Entrepreneurial Culture & Deal Opportunities	Innovation	4	3
	Ease of Starting and Running a Business	6	5
	Industrial Concentration	12	11
	Deal Generation	32	11
Subtotal	54		
Human and Social Environment	Education and Human Capital	10	8
	Labour Market Rigidities	3	3
	Bribing and Corruption	3	2
	Management Teams	9	7
Subtotal	25		
Industry Specific Factors	Openness / Transparency of the Industry	25	10
	PE Firm/Industry Activity (new deals etc.)	13	9
	Cliques/old Boys Club	8	5
	PE Feeder Pipeline	18	11
	Risk Taking	7	5
	Age of Industry	5	3
	Business Model/Transaction Structure	5	5
Subtotal	81		

The themes with the top three respondents with over five unique respondents are highlighted in bold. The emergent themes are detailed below:

5.3 Economic activity

All the respondents were in agreement as to the role that the size of the Brazilian economy plays in the attraction of investment inflow to the country. The general views were that international LPs as well as international fund managers strongly believe that Brazil would “*grow faster than mature economies*” as one respondent put it. Another respondent explained Brazil’s attraction as thus:

“I think that Brazil, India and China should be the largest markets or are going to be the largest markets in the future, and I think that attracts a lot of attention, Brazil has a very large market, and it’s going through several changes that are creating, good opportunities for investment, and I would say that it would be the main reason as to why people are very interested in investing in Brazil”

On explaining why the fund he works for chose to set up an office in Brazil, Participant 1 had the following to say:

“The primary reason for our fund to be here in Brazil is that we believe like maybe also the LPs that Brazil is going to become more and more a relevant market, and even five to ten years from now it’s going to be an even more relevant market for PE players”

He further stated that both he and his firm believed that “*it is important for funds to be well positioned here and that is why we decided to be one of the first or at least one of the first big international funds to build a local team dedicated to the region*”

Although there was unanimous consensus in regards to the role of the Brazilian economy, the view ranged when it came to that of the South African economy with the following comments given:

“The South African market is just too small to make it attractive for big PE players, that’s why with Brazil becoming more and more active in terms of the world economies and they still have a reasonably strong financial sector, they will continue to be dominant.”

"It's a large market, but it's not huge and its relatively insulated from the rest of the continent, clearly the rest of Africa is the potential that most investors see in investing in South Africa, but it will take a lot of work, and it's not obvious that if you make an investment in SA, that you will also be able to extend it to the other African countries."

The overall comments given in explaining Brazil's attraction as opposed to South Africa in regards to the size of its economy included the following:

"When you look at the evidence from this angle the first thing that investors of PE probably chose as the criteria to deploy capital is the size of the economy."

"I think it's a size thing at the end of the day, how big a transaction can I get into and how quick can I get in and out, is there a market for it, are the multiples right."

In explaining the attraction of PE investors to Brazil despite the risks one respondent said:

"I will go where the money is, the returns I might get in Brazil despite the risks makes it all worth it."

All the respondents also highlighted that the attraction factors were not only as a result of the size of the economy but the fact that Brazil's GDP per capital overall has grown by 43% from 2007 to 2011 (South Africa 27%) <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>, while the emerging middle class of Brazil in 2012 now totals 95 million people, <http://www.brasil.gov.br>, meaning that the Brazilian population by and large have more purchasing power.

Views given by respondents around not only the population size but the purchasing power of the Brazilian economy and why that would explain the attraction of PE investment inflow into Brazil rather than South Africa were:

"What we see in Brazil is that a lot of the growth and the key trends in Brazil are related to the income growth that the emerging middle class have had in the last ten years. And all of a sudden you have an estimated additional 50 million people who now belong to the emerging middle class and can afford some discretionary items that they couldn't before, and that creates a lot of opportunities."

“There is more income in the pockets of Brazilians, which has led to a growth in pension fund collection which has further enabled the funds to invest into the Brazilian PE funds”

“My R100 million would be much more secure in SA, but the returns I would get in Brazil would be much higher than those that I could get in SA in the same length of time, due to the sheer volume of people with the ability to spend money in Brazil.”

“Forget the growth but just think about the sheer volume of that population and GDP, let me put it this way, the glass is SA, and the table is Brazil, what are your chances of success then?”

“Brazil is massive. Nearly 200 million people while South Africa has 49million, but realistically 12 million, in terms of the economically actively population, we can maybe push that to 15 million but realistically its actually down to 12 million, so size plays a big part of it.”

“We don’t have a large middle class in SA, it’s growing, and it’s actually sustaining our consumption at this point, but there are still a limited number of people that are economically active, our unemployment numbers are unbelievably high, which also poses a problem”

Comments were also made relating to the size and growing Brazilian domestic market and the role that the size of the domestic market is playing in attracting investment inflow:

“I think also Brazil is an interesting story because a lot of the growth here actually comes from the domestic market and domestic consumption, it’s not an export based economy although we do export some mineral commodities like Iron ore, and soy beans and agricultural products and some other manufactured goods”

“Brazil is mostly a domestic story; I think more than 80% of our GDP is related to domestic consumption and domestic sectors, only I believe 15% now of GDP comes from exports.”

“Investors like the fact that Brazil does not depend as much as other markets on the developed markets to actually grow, so I think that is one thing that investors consider to be positive”

“even though the economy as a whole is not growing at 10% per year, there are sectors in Brazil that are growing 15-20% per year just because the penetration of those items and the

demand for those products locally is completely different from what we see in other countries, for example furniture.”

Some of the economic factors that were found to be negative towards the flow of investment into Brazil were found to be the following:

“I think volatility is probably the main issues for us, we have to have commitment in dollars, and by volatility we are talking about the volatility of economic growth in general, so Brazil grew I think by 10% over the last 10 years, and this year we are looking at I think 1.7%, so this kind of volatility is not very good, and maybe worse than that, I think the volatility in exchange rates is also something very discouraging because people commit funds in dollars”

“You can buy an excellent company and the company grows, you can improve margins and the company can grow, but if you have depreciation in the currency, you can lose money just because of the volatility of the foreign exchange rates. This does not have anything to do with the ability of the fund managers to select good companies or structure a good deal and improve on the companies and sale them well, so I think this is some of the problems that we find.”

All of the respondents gave views on the impact that a countries political stability or lack thereof, whether factual or perceived can have in attracting PE investment inflow:

“What could also be making it worse for us [South Africa] is the state of our politics, I mean we are stable but we have all these ramblings and creeping’s of uncertainty from a political side which further make investors nervous.”

“We [South Africa] don’t have that stable environment and we don’t give a lot of confidence to the world out there that this is a safe haven to invest in”

“Investors are very sensitive, so if we don’t give them the comfort that their investment first of all is safe and that they can operate with relative ease then they don’t come to South Africa, it’s as simple as that.”

“Brazil has been stable from a political standpoint for many years now, so I think those are the factors that people like about Brazil.”

A lot of comments were also given around the on-going South African nationalisation of assets debate as well as how the labour union strikes could be viewed by foreign investors, the comment below summarises the general view that most of the respondents gave:

“Unfortunately from a political point of view, there is too much uncertainty, and that scares off investors, and that goes off from the whole nationalisation debate, and even the resent violence that we have seen with Marikana.”

“When international investors look at these things [nationalization debate and violent labour dispute actions] and they sort of compare stats and they go I don’t like that and I like that, so you will see when you read S&P reports and the like that these are the concerns that are raised and generally those are the things that when people do general macro level asset allocations, those are the things that they look at.”

5.4 Depth of capital markets

When making an investment, the ability to get funding for that transaction, as well as exit opportunities played a big role in whether the respondents would do the investment or not. The general view from most of the respondents was that although the Brazilian capital markets were improving, South Africa’s capital markets were far superior to not only those of Brazil but also better or equal to those of most developed markets.

When asked, the most preferred method of exit by respondents appeared to be initial public offerings (IPOs) with a direct trade sale being the second most preferred method of exit.

Comments and views from respondents relating to the depth of capital markets of both Brazil and South Africa included:

“We [South Africa] have sophisticated capital markets, and we have regulatory systems in place and financial markets which are regulated and very well protected.”

“South African financial systems are great, I think we are much better than Brazil, all the fancy stuff is there, but sometimes fancy stuff makes things restrictive, because there are norms that need to be applied all the time, it doesn’t necessarily have to be applied in Brazil, provided that you are prepared to take the risk.”

“The banking system is also strong so that you can get the debt financing within or outside of South Africa.”

“Getting funding or access to debt is very difficult in Brazil, so we rely very little on leverage, as an important return driver, so typically, the leverage levels we use are around 2 to 2.5x EBITDA, maximum being 3x, I haven’t actually seen a deal which has had more than 3x EBITDA.”

“The typical play that you would see in developed markets, that is, to raise cheap money and leverage like 10:1 and extract returns from leverage, doesn’t happen here in Brazil, because you don’t have access to cheap funding for long term, so typically you would have to rely on two other levers for returns, basically growth and flash that is operating improvements.”

When asked what the effects of the economic crisis have been on exit opportunities in both South Africa and Brazil some respondents replied:

“We have even in these tough times had very good exits which makes me very proud, but if I compare it to the prior years of 2006-2008 then the currently activities are definitely pared much down since then.” (Participant 5)

“More recently, we have had a wave of more IPOs, and I would say probably two thirds of these IPOs or probably a half of the IPOs came from or was led by companies that had PE groups behind them.” (Participant 6)

5.5 Legislative and regulatory factors

Although both countries were equally seen to be more stable from a regulatory and legislative perspective than those of other countries in their respective continents, South Africa's legislation and regulations were viewed to be more enforceable or better enforced than those of Brazil by the respondents. Legislation around taxation in both South Africa and Brazil emerged as a critical factor in determining PE investment inflow.

In explaining how legislation and regulatory factors could further be viewed as being positive or negative in terms of attracting PE investment inflow, the following responses were gathered from the South African interviews:

"LPs may not agree with our [South Africa's] legislation on foreign exchange and others for example, but at least they understand them and they know exactly what they are getting themselves into when they come into the country, there is that stability that makes it attractive from that perspective"

"I think around the Financial Services Boards and the like which are actually the pillars of legislation around the finance industry, there is a lot of good stuff that comes from there from a corporate governance perspective, which actually protects investors, which is a positive for South Africa."

"I mean I have seen one deal that actually fell through because some of the funding that had been organized was going to come from overseas, and it was going to be cheaper than funding from here [South Africa], but because of this tax act the deal fell through."

"There is a lot of work when you have foreign investors that need to be done on the legislation side even before you can sign and say yes I am investing in this fund. Which is a deterrent as there is a limitation as to how much money can go outside of South Africa; there are a few elements from a tax and foreign exchange element that are discouraging for foreign investors coming in."

The Brazilian participants had the following to say regarding the countries legislative and regulatory factors:

“The rules change a lot in Brazil, you find that sometimes the government wants to foster the economy and they sometimes try to favour some sectors and they want to improve consumption in that particular sector, so to do that they sometimes change some rules and its difficult because if you are on the wrong side of the equation, you can suffer a lot, just because the government took a measure that goes against your business.”

“The taxes themselves in Brazil and the tax system is very complicated, it changes like on a daily basis, so it’s very hard for you to be tax compliant even if you are or have sophisticated company.”

When queried as to why despite the highlighted challenges, investors were still willing to invest in Brazil two of the Brazilian respondents had the following to say:

“We acknowledge the weakness, and by acknowledging the weakness of the Brazilian legal system investors have sort of like created a way around this.”

“One thing that really helped the development of the PE industry here in Brazil is a set of regulation that exempted taxes on capital gains for these types of investments which basically paves the way for pension funds to get involved and direct resources to these arenas, and obviously another important thing is having decent or normal interest rates, which is something new to Brazil, as we have always had the record, the infamous record of having the world highest interest rates, right now they are the lowest in history for like recorded history, that is why our pension funds who have quite a lot of money have been directing more and more resources to this arena”

5.6 Entrepreneurial culture and deal opportunities

A very prominent theme that emerged from the interviews conducted in regards to industrial concentration that exist in Brazil, especially in relation to the types of businesses that can offer PE firms transaction opportunities, most of the respondents talked about sizeable businesses in both the key cities and states that are still owner managed and whose owners are likely looking for liquidity or where the business has succession and corporate challenges. Below are some of the views expressed around the issue:

“There are a very big number of big sized or larger companies that are still controlled by families who actually founded those companies and who actually need liquidity and I think that is a good opportunity for PE players.”

“Some of these companies that are family owned, they don’t have the type of governance or management proficiencies that would really take them to a different level if you are talking about growth. When they get to a certain size, the entrepreneurs realize that they need help, that’s why they decide to partner with PE groups.”

“The size of companies out there and the fact that those companies can actually be bought as they still belong to the founders and they can still be improved, so there is still going to be a lot of potential for PE players in Brazil to make profit here.”

“I think it’s a very rich economy in the sense that there is a lot of geographic dispersion and you can find the companies and good stories and good markets even outside the key city centres and the key states in Brazil. So they are different regions and I think different clusters within the country where you can find interesting opportunities.”

Issues raised around lack of deal opportunities in South Africa were that although there were many businesses in the country, the view was that there was a lack of business diversification in terms of business ownership which had to some extent led to as one respondent put it *“unofficial monopolies, duopolies and oligopolies, a space in which PE struggles to operate.”* Other Comments received on the issue included:

“Business is not diversified in South Africa, if you look at the diversification of business ownership in South Africa versus Brazil. You will probably find that there is a big difference, there are very many businesses here in South Africa, but you will find that they are owned by the same people.”

“There isn’t a whole pool of new big companies in SA, or large medium sized companies, that we can actually all go and look at, from a PE basis; there is only a certain pool, whereas I think the Brazilian economy allows for much more in terms of the number of transactions and the type of transactions that you can actually enter into.”

Regarding entrepreneurial culture of the two countries, although the definition of entrepreneurship changed from one respondent to the next, with one Brazilian respondent giving his interpretation of entrepreneurship as thus:

“I would say that Brazilians are very perseverant and they, well you do what you have to do, I mean, if you have been laid off from work and you don’t find work opportunities then what are you going to do? You just start a new business and try to make a new living, so is being entrepreneurial trying to make a living? I don’t know, so yes people are very entrepreneurial they have no jobs, what do you expect them to do?”

All the Brazilian respondents strongly believed that Brazil had a very strong entrepreneurial culture which was gaining much more momentum within the country, while all the South African respondents believed the opposite of South Africa, although some of the respondents conceded that it had existed in the past and that if it did currently exist in South Africa, they could not see much evidence of it or not nearly enough as much as they felt it should exist, one of the respondents expressed his wish to see more work done regarding entrepreneurial training and awareness within South Africa.

“Most of the companies that we actually bought if not all of them were started by the people who actually sold the companies to us, and I think those people started the company from scratch.”

“I think Brazil is still very much an Entrepreneurial society and we can negotiate deals with the people who actually founded the companies and they are still being run by the first generation members.”

“there isn’t enough skilled people, also our education system is another issue, so I don’t know if it will get us to where we want to be competitively, or if we will be able to as a result produce innovators and entrepreneurs, it doesn’t look good from that front” (Participant 3).

“South Africans are actually brilliant; when they put their minds to it they can actually do anything. And in the past we have been extremely bright and innovative about making products, but I don’t see it now, I don’t see many brilliant products coming out of SA that is taking the world by storm. It’s not that there aren’t any it’s more like you don’t really hear that much about them”

When linking the impact of the lack of an entrepreneurial culture to the PE industry, a South African respondent remarked:

“I mean one of the reasons that our venture capital industry is so small is because we don’t really have people coming in with these ideas, the venture capital industry is about getting an idea through and then supporting it and putting a bit of seed funding into it and helping it grow to a point where it graduates to being a proper PE investment, so from that perspective, it does affect the PE industry as it eventually filters through to it.”

To be noted are the responses received regarding competition for deal opportunities in both countries especially from a PE investor and firm perspective:

“Although SA might feature well in the Attractiveness index, in terms of how we do business etc., still when people look into investing in PE, there is still an issue around absorption capacity, so if you invest the funds, will the fund managers be able to find a suitable amount of investment opportunities? Because what you don’t want to do is to overcrowd a space, because when people become competitive, you bid the assets up and your returns go down type of thing, so the economy needs to be big enough to sustain large amounts of investments.”

“The view is that there was much less competition in Brazil compared to other emerging economies, let alone developed markets, so since our firm was one of the first players to be here, we can still avoid, although it’s becoming a little bit harder, but we can still avoid processes that are competitive or we can still try to have proprietary discussions with certain targets which is no longer possible in other markets such as Europe, the US or India or China, the PE activity and the number of players that actually look for the same kind of deals have become so large that you literally have to bid against sometimes hundreds of other funds in order to get a deal.”

“I think that another factor that steers away SA from getting as much PE investment as Brazil, beyond the size is that we think that we are a default position but there is many competitors for SA, but the same is not true for Brazil, there isn’t as much competitors around Latin America, you know, Chile is doing some interesting things at the moment, there government is doing well but the rest of the countries surrounding Brazil aren’t”

5.7 Human and social environment

The main themes that had prominence under the human and social environment category pertained to education and human capital especially at an investee company level and management teams both at a PE firm and investee company level.

Regarding management teams the overall views from respondents were that the caliber was of a very high level in both South Africa and Brazil. The shortfalls especially in terms of their impact on attracting PE investment inflow were found around skill levels of the South African workforce:

“The work force has very poor training and skills and it’s very expensive relative to other economies in the world.”

“I can tell you that all the people I speak to within the PE industry are talking about the same thing, they are struggling at investee company level to find and to keep good people, so for me, I just think that it’s there whether you look at it only from a pure PE perspective or in general.”

The overarching consensus amongst the respondents relating to both PE firm and investee company management teams were that track records of managers were very important, the PE firms in terms of their ranking of investment criteria all had the quality, and track record of the investee company management team in their top three criterion. The view was that the Brazilian PE industry was getting even more competitive and the following comments were observed relating to PE fund managers:

"I think that the best track record that we have in Brazil are coming from local not international managers who actually developed their practices here."

"Brazil will continue to be an interesting place for PE investments in general, but I think investors and LPs will become more selective and they will have the chance to select those managers who actually have a good track record, five years from now track records are going to be the differentiator between the winners and the losers. I think the next funds that the funds are going to try and raise, you are going to see a better discrimination, and I think a better differentiation amongst the managers."

A respondent from Brazil also talked about the importance of a PE firm's track record in convincing investee companies to sale control to them. The South African respondent who works for a development finance institute explained how PE funds managers where chosen as: *"The criterion for choosing the fund managers was based on their previous experience, as well as their intentions for the future."*

5.8 Industry specific factors

In South Africa, industry specific factors were found to be the biggest issues negatively influencing PE investment inflow from both a local and foreign investor perspective. Although both industries were found to not be doing enough to encourage VC activity in their respective countries, the Brazilian industry was found to be more open or transparent to the extent that some firms would go so far as to publish their returns from deals on the company websites, the words used to describe the South African PE industry included "closed", "clubby", "cliquey", "secrecy" and "risk averse" to name a few.

All eight of the of the South African respondents agreed that there was a large problem regarding transparency within and about the industry, 75% of the South African respondents also felt that the industry in South Africa was too conservative in regards to not only deal activity but also the marketing of deals done. Below are some of the comments that were discussed during the interviews regarding the lack of transparency within the South African industry are as follows:

“It is true that it is a clique, especially as the industry is so small and made up of such few players, who even end up doing the deals amongst themselves.”

“There is a lot of competitiveness in that respect, and people are not very comfortable to opening up their books.”

“with the surveys that are run by SAVCA, there is always sensitivity around returns, people don’t want to divulge, they are happy to share that they have done a big deal, and this is the size, and over the past certain number of years, this is how much we have invested, and this is how much money we have raised, but people are very sensitive about returns.”

“Yes there is secrecy, but also what makes it quite sensitive is that whole carried interest structure, that’s another aspect that makes it highly sensitive as players don’t want other people to know how big the pot is and what individuals within the pot are getting. So yes there is a lot of secrecy around it.”

“I don’t think we are that mature as an industry to attract other investors and maybe I guess you can say those issues around secrecy make it difficult for people to understand and trust the industry and there is no comparison, and I don’t know how they are going to compare to others as no one is divulging.”

“20 years is nothing, I mean you will find that people who started the industry are still running the industry, it’s mostly still on a first generation basis to a large extent, as those who founded the industry are still there. You are going to have to get another generation that will come in and hopefully open up the industry.”

“South Africa is very closed up, so guys struggle to enter into the market here, because they will not be let in. so I think that’s also a factor that steers away South Africa from getting as much PE investment as Brazil.”

“They want to keep it [the industry] to themselves, which isn’t helping the country. And it also doesn’t help their investment portfolio to be truthful, because being insular doesn’t work, as a country or as a business, being insular just doesn’t work, trying to protect your turf and being in an insular way trying to control the industry doesn’t work.”

“I think also that maybe there is just a comfort zone, by the PE players, I mean if you look at the deals that have been taking place of late, it’s just the same ones and being passed on from one PE firm to the next, and there is also a high level of restructurings and refinancing rather than fresh deals.”

“Even if you look at the number of delisting’s over the last number of years, I’m not sure about the numbers but I doubt that there have been much, yet there are attractive assets in the market that could be prime assets for delisting or for a PE investment.”

“SAVCA I know has been battling to get firms to report on their returns”

“Our industry is really bad in marketing itself, you find that firms do not want to talk about the deals that they have done, maybe some of it can be as a result of confidentiality clauses but we are just too quite.”

“The industry is very sceptic, they don’t trust one another, I’m not sure why, I was a director of SAVCA for 7 years, and we tried from the start to get more and more firms involved, to get them to open up. Unfortunately, I don’t know at this stage what would get them or persuade them to open up, I think that we are making very slow progress.”

“The SA industry is actually very cliquey, and maybe that might make it difficult for outsiders coming in.”

“We need to improve the level of information and data flow, obviously I am on the SAVCA board as well, and one of the key issues is the lack of information. If we can provide more and more evidence to investors I think they become more comfortable to invest, so the quality of our surveys needs to improve and the level of our information needs to improve, so that people can take comfort there.”

"I think we need to remain relevant, we need to see what's happening in the world in terms of PE and how people allocate capital, and not be stuck in the old way of doing things."

"The industry has been too inwardly focused and looked too closely on internal competition and sort of scaring off investors in the process as you are not open enough."

"I think people or firms have not collaborated enough, everyone wants to do their own thing and they view that what they do is a competitive edge to the other guys."

"I feel that the approach of firms at the moment is that they are preserving their capital, they feel that the market is not conducive for funding right now, so they have the attitude that if something is perfectly in line with what they believe they should invest in then they will look at it, but otherwise they have the attitude that they would rather keep low and protect their capital."

It was found that in both Brazil and South Africa, venture capital as a subdivision of PE was not a developed sector and the existing VC companies were not generally viewed on as significant role players within the PE industries in both countries. The comments regarding VC are presented below:

"You find that within SAVCA itself, the small firms don't necessarily have a seat on the table, so you will find that within the bigger firms, they will rotate the seats amongst themselves and as a result you will find that SAVCA is focusing more on the developed PE issues versus the VC issues, and our VC market is too small quite honestly to make an impact or for it to even be heard."

"There is very little that we do with the VC industry, and we as a result are missing an opportunity as PE players to get that feed through, as VCs form the pipeline."

"I truly think that we are missing in SA support for VC, and maybe we need to get a new type of investor as the nature of our investors is very risk averse. There is therefore much bias towards your pure type of PE rather than your earlier stage type investment."

"When it comes to investors, it's not clear in my mind as to why VC is so small in Brazil, is it because the nature of investors that we tap into don't like the level of risk, or is it the GPs that

are not reaching out to the right type of investors, or is it the GPs themselves who don't have the level of risk appetite?"

"Venture capital companies, although they are some, are far out weighted by the number of PE groups in Brazil."

"what you see in Brazil is an emerging group of angel investors that are promoting very specific type of firms, but you can't really tell that this is a sort of coordinated movement or something that has come to stay, I would say that this is probably the isolated form of effort of some wealthy individuals who have made some money in your likes of technology and now they want to fund similar things, but it's nothing like you see in the PE arena or global PE arena in terms of the amount of money that is directed to the market."

"Companies are very risk averse and they don't want to fund a start-up because of the whole high failure rate. So the whole high risk element, we don't necessarily have the culture or maybe the tenacity to actually tolerant it, or take on risk especially within the South African PE industry."

In terms of the way deals were structured within the two countries by private equity firms, in South Africa, it was found that there was not much difference as to the way that structures were done in other markets, the main difference were around the need to incorporate a Broad Based Black Economic Partner and in order to diversify the risks of putting too much funds into one transaction most deals were usually done on a syndicated level amongst private equity and other strategic partners, while as in Brazil the main difference related to the use of debt in the structure.

"in terms of availability of equity, Europe and North America clearly have very large PE funds and they can do large transactions all by themselves, I think that South Africa has a lot of PE firms that are on average smaller, so by definition that entails that there is a cap to the maximum for a transaction that each one of these funds can do on their own."

"I have also noticed that there are a lot of consortium deals in general in South Africa. I don't know if it's actually because of the availability of capital beyond a certain threshold or the fact that it's more of like a clubby environment here, but that's the context."

“partnering hasn’t become a norm here in Brazil as it has in other countries, but that is usually dependent on the size of the transaction, typically in a private equity transaction if you have the money then you want all the returns for yourself, you don’t want anyone else messing around, and having some sort of conflicting or conflict of interests, so I would say due to the size of the transactions there hasn’t been a general sense of that, we don’t see many opportunities like that here, we had tried to partner on a transaction here, but it didn’t go through, so it’s an interesting proposition I think.”

5.9 Summary

The factors that were found to play significant positive and negative roles in attracting private equity investment into both South Africa and Brazil as a result of the expert interviews were largely indicated to be from a Brazilian perspective, not only the large size of the economy and population base but also due to the purchasing power of the Brazilian population, the lack of reliance on Brazil's part on export market was another element that contributes to the attraction of private equity investment into Brazil.

Although South Africa was found to be superior to Brazil in terms of the sophistication of the country's capital markets and enforcement of regulations and legislations, the main challenges facing South Africa which were found to contribute to the detraction of foreign private equity investment were mostly the perceived political instability of the country, and factors that specifically pertain to the South African private equity industry such as lack of transparency within the industry as well as a general belief that the industry to a large extent appears passive.

Both the Brazilian and South African private equity industries had a very underdeveloped venture capital sector within their industries, which limits opportunities in terms of the investable assets that are available in the two countries.

The findings of this chapter will be analysed in chapter 6 in correspondence to the relevant literature.

6. Discussion of results

6.1 Introduction

The results presented in chapter five provided insights into the reasons as to why Brazil is overtaking South Africa in PE investment inflow. This chapter seeks to discuss and analyse the results from chapter five with the intention of outlining key findings as they respond to the research questions and will be grounded within the relevant literature base.

Table 5 tabulates the factors affecting PE investment flow and does an illustration of the main similarities and differences between what was found through the literature review and the results obtained from the exploratory study. Table 5 demonstrates that the findings of the study are both consistent with and also in contradiction with existing research.

Table 5: Factors affecting investment flow, Source: Groh et al. (2008); Leeds & Sunderland (2003) & Klonowski (2011)

Factors affecting investment flow	Literature review only	Literature review and Study	Study only
Economic Activity			
Size of the Economy (GDP)		X	
Impact of PE on the economy	X		
Political Stability			X
GDP per Capita/Disposable Income/Unemployment/Population/Emerging Middle Class		X	
Local Market Vs. External Market		X	
Depth of Capital Markets			
Size of the stock market	X		
Stock market Liquidity		X	
IPO Activity		X	
M&A Market Activity		X	
Debt & Credit Market		X	
Financial Market Sophistication		X	
Legislative and Regulatory Factors			
Tax Incentives and Administrative Burdens		X	
Corporate Governance		X	
Security of Property Rights		X	
Quality of Legal Enforcement		X	
General Legislation		X	
Human and Social Environment			
Education and Human Capital		X	
Labour Market Rigidities		X	
Bribing and Corruption		X	
Management Teams		X	
Entrepreneurial Culture & Deal Opportunities			
Innovation		X	
Ease of Starting and Running a Business		X	
Industrial Concentration		X	
Deal Generation		X	
Industry Specific Factors			
Openness /Transparency of Industry			X
PE Firm/Industry Activity (new deals etc)			X
Cliques/Old Boys Club			X
Feeder Pipeline			X
Risk Aversion			X
Maturity of Industry		X	
Returns generated	X		
Business Model/Transaction Structure		X	

The overall findings of the study are presented using the same breakdown of categories as was done in chapter 5.

6.2 Economic activity

Even though Groh et al. (2011, p. 15) argues that “there is no consensus about a ranking of criteria” in regards to country attractiveness, all interview participants agreed on the importance of three themes falling under economic activity namely size of the economy, political stability and population related themes such as GDP per capita, disposable income and unemployment and the importance of the emerging middle class.

The size of the economy was found to affect PE investment inflow positively to Brazil and negatively to South Africa; these findings confirmed the findings of Moss et al. (2007) in regards to small market size being a deterrent for foreign institutional investors.

All the interviewees made reference to the disposable income of the population as well as the contribution of an emerging middle class in a country, the study therefore supports the study of Klonowski (2011) in regards to attributing the significant inflow of PE investments to Brazil to the surge in economic growth of the country which has mainly been driven by the expanding middle class as well as less reliance on foreign markets. There is also strong evidence from the study to support the findings of Groh et al. (2008), who also like the interviewees linked economic size to deal flow opportunities.

Political stability as a factor was unearthed during the interview process and was not covered in the literature review section. All respondents remarked that the recent political instability in South Africa, whether perceived or real was having a negative effect on the flow of funds to the country while as Brazil was seen to be more stable from a political viewpoint, especially in relation to what was happening in South Africa at the time the interviews took place.

Although the researcher expected political stability to have a negative impact on investment inflow in both Brazil and South Africa, when queried about the ranking of importance of political stability over size of the economy, respondents still seemed to find that the size of an economy was more important than the political stability of that country, as Participant 9 observed “*would I*

invest in South Africa or would I invest in Brazil where it doesn't really matter what happens with the government, because I am going to sale my product anyway."

This study therefore showed that the economic activities of Brazil and South Africa prove the reasons as to why Brazil is receiving more PE investment inflow than South Africa through supporting earlier studies in economic size, such as that by Klonowski (2011) which attribute growth in PE investments inflow to not just the population size of a country but the ability of the inhabitants of that country to drive or stimulate local demand through the purchasing power of the emerging middle class and the disposable income of individuals through higher wages and drop in unemployment rates.

6.3 Depth of capital markets

In relation to the link between depth of capital markets and their impact on attracting PE investment inflow, the study found contradictions with existing theory especially where debt and credit markets and financial market sophistication were concerned.

Agreement was found between the study and the findings of Banerjee (2008) relating to the motivation of PE cycles by ease of exit, and Lerner (2009) who found that the development of equity markets matters more than the provision of debt. The findings also agreed to Klonowski (2011) and confirmed the predictions of Ribeiro and Carvalho (2008) regarding the preferred method of exit being an IPO in both South Africa and Brazil.

Barber (2007) and Heed (2010) findings are in contradiction to the findings of this study, where in the PE industry in Brazil has proved that debt finance in transactions are not a key element in enhancing potential returns for investors (Heed, 2010) and that financing and tax advantages gained from use of aggressive debt are an attributable factor to high returns achieved in PE firms (Barber & Goold, 2007).

In this research, just as the work conducted by Schertler and Tykova (2003) as found in Groh et al. (2008), the liquidity of the stock market had a significantly positive impact on VC investments, although the study could not link the findings of Schertler and Tykova (2009) regarding stock market viability and foreign VC participation.

This study confirmed the findings of De Beer (2009), who described South Africa's PE industry to be the most sophisticated amongst all the emerging economy industries especially in relation to the country's financial systems and markets, contradiction between the study and the financial market sophistication is centred around the findings in Brazil strongly disproving those of Agmon & Messica (2009) who found that countries were missing out on their potential to attract PE funds due to the absence of appropriate financial systems.

Another contradiction is as a result of the researchers expectations that South Africa's sophisticated financial markets would equal better attraction of PE investment inflow, the contradiction is explained by Participant 10 who links the restriction imposed by sophisticated or "fancy" financial systems due to norms that need to be applied to and which may not necessarily need to be applied to in less sophisticated markets and can therefore be seen to lessen administrative burdens as a result. These findings though do not necessarily prove to be a deterrent in PE investment inflow to South Africa.

The findings of this study in relation to the category of depth of capital markets highlight that there are other factors that are preventing PE investment inflow into South Africa and that in Brazils' case, the norms that have applied in other markets including South Africa in relation to debt and credit markets do not apply, or at least not to the same extent as experienced in those markets.

6.4 Legislative and regulatory factors

Although respondents in both Brazil and South African stressed the burden of taxation legislations and administrative burden of both taxation and regulatory compliance, the general consensus was that in South Africa except for those legislations pertaining to foreign exchange, the strength of the countries legislation and regulations were a positive influencer in the inflow of PE investment into South Africa, while although not expressly acknowledged, were seen more as an irritate rather than a deterrent to that of Brazil.

To add on to the debate for the need for specific PE industry regulation, this study In relation to the inclusion of preference share structures in PE transactions, supports the findings of Ernst et al (2011), who found that regulation action aimed at limiting excessive leverage and

increased awareness for better transparency standards would help limit potential negative effects caused by PE investors, although three of the South African participants found that the new tax act relating to preference shares could potentially be deterring foreign as well as local PE investment, as Participant 9 remarked, “...*but that said people were abusing the system [in reference to preference shares] so government had to find ways to stop the leakage.*”

There was no link between the findings of this study and those of Watson (2008) who found that countries with lower legal and regulatory burdens offered investors greater opportunities for maximising returns of investments made, and a negative correlation between tax burdens and the rate of return as no work was carried out on generated returns in this study.

The findings of this study support the findings of Knoll (2007) regarding the structuring of PE funds for tax purposes, Groh et al. (2008) observation of the specific taxes that affect PE activity as well as those of Leeds (2003) who states that previous experience of fund managers on shareholder rights have forced them to alter their investment strategies and those of Nielsen (2008) who ascribed the significant part of the growth in PE investments over the last twenty years to regulatory changes that have allowed pension funds to increase their investments in PE as being true in the case of Brazil and was seen by South African respondents as being so in the future for South Africa as a result of Regulation 28.

This study especially in relation to Brazil is however in contradiction to Banerjee's argument that shareholders rights are one of the most significant aspects needing to be addressed in order to develop a healthy PE market in emerging markets, Brazil has found through the acknowledgement of the weaknesses in the legal system, investors and locals alike have been able to develop a healthy PE market by finding ways to work around weaknesses such as shareholder rights enforcement through the use of arbitration. “... *if we had to take disputes to justice then, Brazil is in a lot of trouble, because the process is very slow amongst other problems, so now if we have to settle a dispute or something then we just go to an arbitrage chamber, where you appoint a referee and they issue some sort of ruling. This is binding legally.*” (Participant 4)

Like the findings of the depth of capital markets, the results of the legislations and regulatory factors are also at odds with what was expected by the researcher based on the initial literature review, especially where it would appear that factors that are given prominent importance in literature such as the importance of shareholder protection and corporate governance, are somewhat overlooked in Brazil due to the returns that one might expect to get from the country, again it seems like economic size outweighs these risks. A respondent put it eloquently when he said *“South Africa is safe – r than Brazil, however if you have the right thing, the chances of you succeeding with it in Brazil is far bigger than any chance you would have in South Africa.”*

Again the findings of this study in relation to regulatory and legislative factors highlight that although important to a certain degree, there are other factors that are preventing PE investment inflow into South Africa and that in the case for Brazil, the norms that have applied in other markets including South Africa in relation to investor and property protection rights, administrative burdens, corporate governance and the quality of legal enforcement do not apply, or at least not to the same extent as experienced in those markets.

6.5 Entrepreneurial culture and deal opportunities

Although innovation and ease of starting and running a business were mentioned by some of the respondents, the majority of the comments made regarding entrepreneurial culture and deal opportunities, centred on industrial concentration and deal generation. Klonowski (2011, p. 36) defines deal generation as *“... relating to the availability of a stream of high-quality investment prospects available to all investors, domestic and foreign alike.”*

Timm (2011) argues that although South Africa may have an environment which appears to be more conducive to the opening and running of a business than Brazil and India, the two countries make up for it by having populations that are more entrepreneurially minded than those of South Africa.

The arguments of Timm (2011) are reflected in the findings of this study, where all the South African respondents indicated that there was a lack of entrepreneurial culture in South Africa, and although the view of the extent of it varied, all the Brazilian respondents agreed that there was an existence of entrepreneurial culture in Brazil. The link was also made by both country

respondents to the lack of (in the case of South Africa) and the availability of (in the case of Brazil) deal opportunities as a result of the entrepreneurial culture of the two countries.

Relating to deal generation, the study confirmed the findings of Klonowski's (2011) who although found the local exchange to be a major source of competition for PE firms in Brazil, the competition from the local exchange was even more prevalent in South Africa than Brazil, where it was found that the sophistication of the country's capital markets as well as reported returns made it easier and attractive for investors to invest directly onto the Johannesburg Stock Exchange, which reduced the need to form a limited partnership with PE firms.

Brazilian respondents also confirmed Klonowski's (2011) findings relating to the lack of deal competition amongst PE firms in Brazil which prevented tender situations, although none of the respondents believed that this would still be the case shortly in Brazil due to the heightened attention that the country was getting in terms of attracting both international and local PE firms into the industry.

According to Leeds and Sunderland (2003), although the same can be said in all countries, family ownership is more prevalent in developing countries. This study has proven the findings of Leeds and Sunderland (2003) especially in relation to Brazil, where it was obtained that the country had a large number of big sized companies that were still family owned, managed and controlled, and as a result were in need of liquidity and/or corporate governance structures to be put in place in order for them to grow further therefore providing deal opportunities for PE firms.

The findings also found that Brazil had geographical and sector dispersion in relation to deals and opportunities that could be found outside the key states and cities of the country. The study did not prove this to be true to South Africa where it was established that business ownership lacked diversity at both a listed entity and private company level, the criticism was that this had created an environment which was not very conducive for PE operation.

Mention was made of the opportunities that were available to South African PE firms and investee companies to expand outside of South Africa into the rest of Africa and more especially Sub-Saharan Africa, 63% of the South African respondents saw the drive into the rest of the continent as a positive contributor in attracting PE investment inflow into the country. On the other hand the other 37% were of the view that *"most investors who allocate a large*

amount of money would rather sit back and see some firm momentum in Africa pick up before they allocate their own money.” As Participant 3 put it, which could result in a longer time period than anticipated before this element is a contributing factor to PE investment inflow into South Africa.

The other views regarding the expansion into Africa, where that unlike Brazil, South African PE firms and investee companies were facing a lot of competition from the rest of the continent where according to Participant 10 *“investors are more interested in putting money into those countries [Nigeria, Kenya and Ghana] directly than coming through South Africa.”* This respondents views were shared by Participant 5 who was of the view that South Africa was losing its *“gateway to Africa title”*, his views were that *“South Africa is too rigid and too far away from everything, I mean Nigeria’s GDP is growing at a much higher rate than ours and they have the population, Ghana has become much more stable and direct, Kenya is relatively stable.”* This in light of the political instability made South Africa less competitive.

The findings of this study proves a strong case for the link between deal opportunities and the surge of PE investment inflow that Brazil is currently experiencing and the and at the same time can also explain how the lack of similar deal opportunities is affecting South Africa PE investment inflow negatively.

6.6 Human and social environment

This study found that the shortage of skills in both Brazil and South Africa more prevalent at an investee rather than at the PE firm level. This study confirms the findings of De Beer (2008), who found that PE fund managers roles had evolved to include actively participating in the value creation processes of their portfolio companies, this was discovered to be true more so in Brazil where the need of transforming or enhancing the corporate governance of investee companies from a family run to a more corporate structure with proper controls and systems was crucial in the further growth of these businesses, where a family run business would have trouble recruiting skilled managers the study found that the involvement of PE firms in that business made the business more attractive for skilled managers to join.

The reasoning behind professional managers wanting to join a previous family owned business once it was associated with a PE firms was explained by Participant 1 as “...*good managers in Brazil really want to work for PE controlled companies because they know that the company will mostly likely go through many changes, and attracts people who have a certain ambition. Also they like the fact that the financial partner or shareholder will at some point sale the company so they know that at some point there will be a liquidity event, so we use stock options to attract managers which is something that they wouldn't normally get from family owned businesses nor would they get the same upside from multinational corporations.*”

Although Gilligan and Wright (2010) findings are true in regards to high financial engineering skill requirements in the structuring of private equity deals where multiple layers of complex debt structures are placed, the study confirms them to be true largely to the South African context, the lack of debt push down structures in Brazil necessitates that returns be generated through growth, and other skills therefore such as business strategy are thought of as being more important.

This is further illustrated through the response of Respondent M, who compared South Africa GPs skills to those of Brazilian as “...*if you look at Brazil, and other PE firms around the world, it's not just your accountants as it is here, you get a lot more diversified talent, your lawyers, and a lot more business people so strategy is playing a bigger role in PE.*”

73% of the respondents viewed the high unemployment rate in South Africa (25%, <http://www.statssa.gov.za/keyindicators/keyindicators.asp>) as causing a likely preventive factor in the attraction of PE investment inflow into the country, not only in light of its contribution to political instability but also the diminishing capacity of GDP contribution at both a government level through the collection of taxes and an individual in reference to consumer purchasing power. While as in Brazil, the low unemployment rate (5.4% <http://www.tradingeconomics.com/brazil/unemployment-rate>) is seen as seen as positively contributing to the inflow of PE investment into Brazil, as it has a direct contribution to the growth of the local demand, high wages are also not viewed negatively as they have meant higher disposable income which have further fuelled the demand for certain consumer products.

This study has failed to prove the positive neither the negative contribution of the factors that determine PE investment attraction to both Brazil and South Africa in relation to human and social environment factors other than in the context of unemployment.

6.7 Industry specific factors

This study disinterred that macro environmental factors are not the only factors that have an impact on the attraction of PE investment inflow, but that industries themselves also have a role to play in the attraction of PE investment inflow at country level.

In terms of the way transactions are structured and the business model approached by PE firms in Brazil and South Africa, this study supports the earlier study of Klonowski (2011) who found that the traditional PE expatriate model could be ineffective in emerging markets, as the study confirms through the interviews conducted in both countries the importance of having local teams present or *“men on the ground”* in emerging markets. The study further expands on Klonowski’s (2011) finding by concurring that the model can also be ineffective especially in relation to Brazil, regarding the use and reliability of debt in typical private equity transaction models.

As depicted in Table 5(p.57), in terms of factors that were discovered during the study but where not reviewed in the literature, the data highlighted the following to be the most prevalent themes (based on the number of unique respondents) that can affect the flow of PE investment in regards to industry specific factors(see also Table 4, p.35):

1. Openness/transparency of the industry
2. PE Feeder pipeline
3. PE firm/industry activity

The findings from the data collection will be discussed in order of the sequence above.

Unlike the Brazilian PE industry which has focused on expanding the industry through better communication efforts by increasingly improving the quality and level of information of that industry, using channels such as ABVCAP, EMPEA and marketing at a firm or fund level, the

South African industry is regarded as being closed, and lacking in transparency especially in relation to information dissemination at a firm or fund level.

The sample interviewed for this study, included five current or former board members of SAVCA, who revealed that the issue of transparency has been an on-going battle within the organisation. The revelation of these respondents is further evidenced by KPMG (2011, p. 9), regarding the annual survey, where in out of 129 SAVCA registered members , 86 entities indicated that they would consider participating in the survey, and of those 86 entities, 73% of them completed the survey. All South African respondents agreed that lack of transparency within the industry could be seen to be negatively impacting the flow of both local and foreign PE investment.

Rather than expanding the industry, the researcher deduced through this study that individual firms appear to be focused on treating the industry as an exclusive club, where information relating to deals or returns yielded is given on a need to know basis, this is confirmed by Participant 3 who described most fund raising activity as “...*everyone believes that as they individually go fund raising and tell the whole story then those [selected] LPs would know.*”

Although acknowledgement is made to the sensitive nature of most PE transactions, study found that the general view from the South African respondents was that South African PE firms view the hoarding of specific information in regards to deals as being a competitive edge, while as those from the Brazilian respondents was that information dissemination was what was driving the popularity of the industry in Brazil.

A respondent from Brazil made mention of a new code that ABVCAP is enforcing that its members has to adhere to, part of the code requires all members to send information such as return yield to be compiled into a database, When asked about how receptive the industry has been towards this code the respondent replied “*very receptive, it would appear that everyone welcomes this sharing of information on an aggregated basis, and I think it’s positive for the industry as a whole.*”

The study has further shown that both the Brazilian and South African PE industry have not done enough to encourage the build-up of what the researcher terms the Private Equity Feeder Pipeline (PEFP), PEFP is defined for purposes of this study as the deal opportunities available

to later stage growth capital or buyout PE firms of whom the study has shown make up the majority of firms in both the Brazilian and South African PE industry. PEFP is illustrated in Figure 5 below:

Figure 5: Private equity feeder pipeline

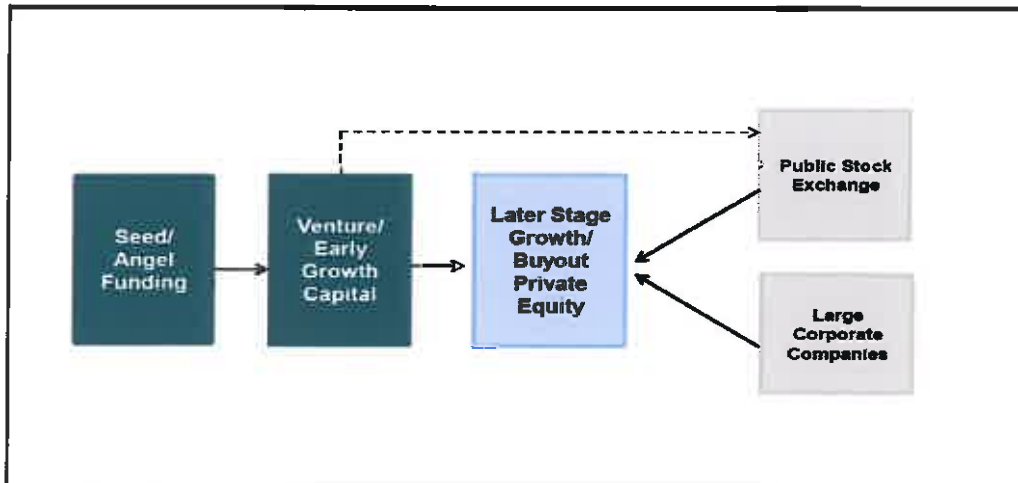


Figure 5 depicts that the private equity feeder pipeline is made up of two feeder routes, the left route represents the early stage component of PE as described by Wood and Wright (2009) and KPMG (2011), the early stage component of PE consists of seed or angel funding that takes a company from start-up phase and is then fed into the venture or early growth capital phase, which would either take a company directly to an IPO or sale the company to a later stage growth or buyout PE firm.

The right route represents deal opportunities that can be realised through a de-listing of a company from the stock exchange or large corporate companies (for the purposes of this study the definition of large corporate company is borrowed from the definition by the South African Revenue Services which defines it as “All unlisted companies and their subsidiaries with turnover above R250 million..” <http://www.sars.gov.za/home.asp?pid=4864>) that need expansionary capital or can be potential LBO targets.

PEFP is not only important in ensuring the supply of deal opportunities to the industry as a whole but also at a macro level in terms of acting as an alternative source of funding for entrepreneurs within a country. The evidence gathered from this study indicates that as it

currently stands, the PE industry in respect of later stage growth and LBO firms in both Brazil and South Africa only have one source from which firms in that category can be fed from which is the right side of the PEFP.

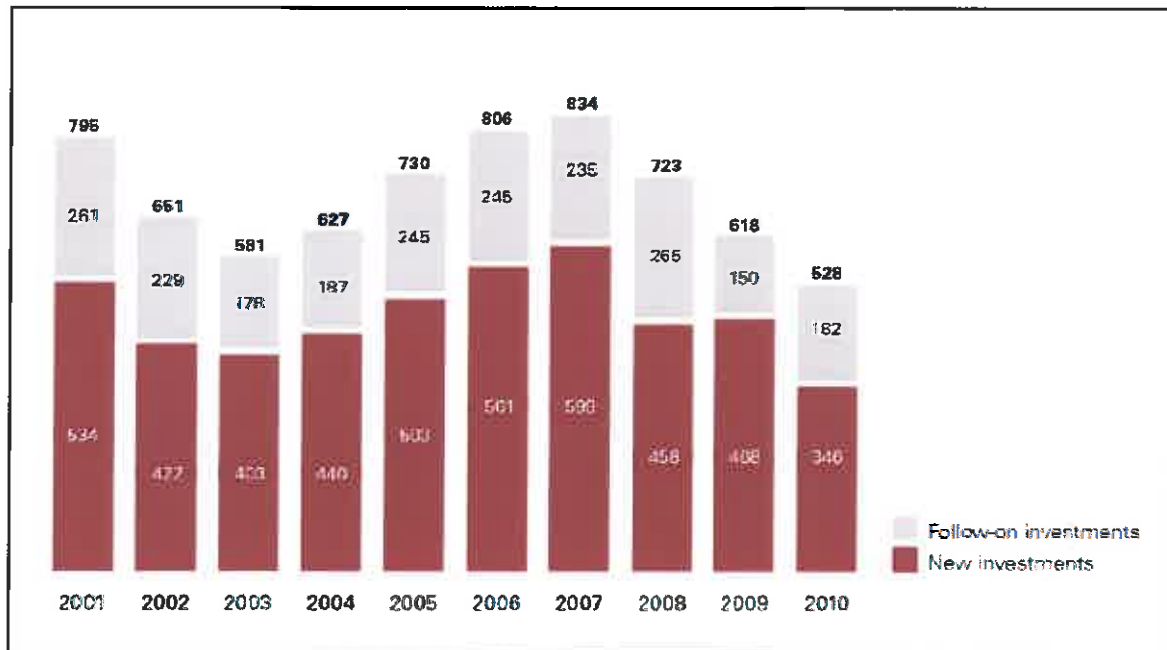
The study found that within both industries, except for three of the respondents, the majority of the respondents felt that the funding of seed and VC type transactions to be the responsibility of local government and Development Finance Institutes within the respective countries. This is a confirmation of Nielsen (2008) who found that institutional investors, and in particular pension funds to be the primary source for financing VC funds and Schertler and Tykova (2009) whose study reported that companies within the IT and Biotech sectors were more likely to be financed by foreign rather than local VC firms.

Although acknowledgement was made by all respondents of the important role played by VC, this study reveals that a big contributor to the lack of development of this sector specifically in South Africa is the risk averse nature of the industry, and the general lack of interest in VC as an investment option, as one respondent expressively put it *"it's just that most players don't want to go there as the amount of effort it takes to participant in smaller transactions such as R50 million enterprise is equally if not more so than that spent on the larger R5 billion business, so the lack of capacity makes it not that much worthwhile. I would rather spend less effort to make more money so there you go."*

Another factor potentially contributing to the lack of inflow of PE investment inflow into South Africa was found to be the level of activity within the industry. The study revealed that unlike the Brazilian industry which was seen to be more aggressive in terms of deal activity (US\$6.3bn raised in 2010, an increase of over 400% from 2009, Ernst & Young (2011), the South African industry, was seen to be less so.

Although according to KPMG (2011), the deal activity increased in 2010 with US\$1.4 billion raised from third party funds and US\$ 1.3 billion of investments made the views gathered by the study was that the industry seemed to be more focused on the preservation of capital and being cautious through reinvesting or restructuring of existing assets or "proven bets" rather than tackling on new assets. Though follow up investments in 2010 represented 35% of the total number of investments done, between 2009 and 2010 new investments decreased by 35% while as follow-on investments increased by 20% as depicted in Figure 6

Figure 6: Number of investments made during 2010, analysed by new and follow-on investments. Source: KPMG (2011, p.32)

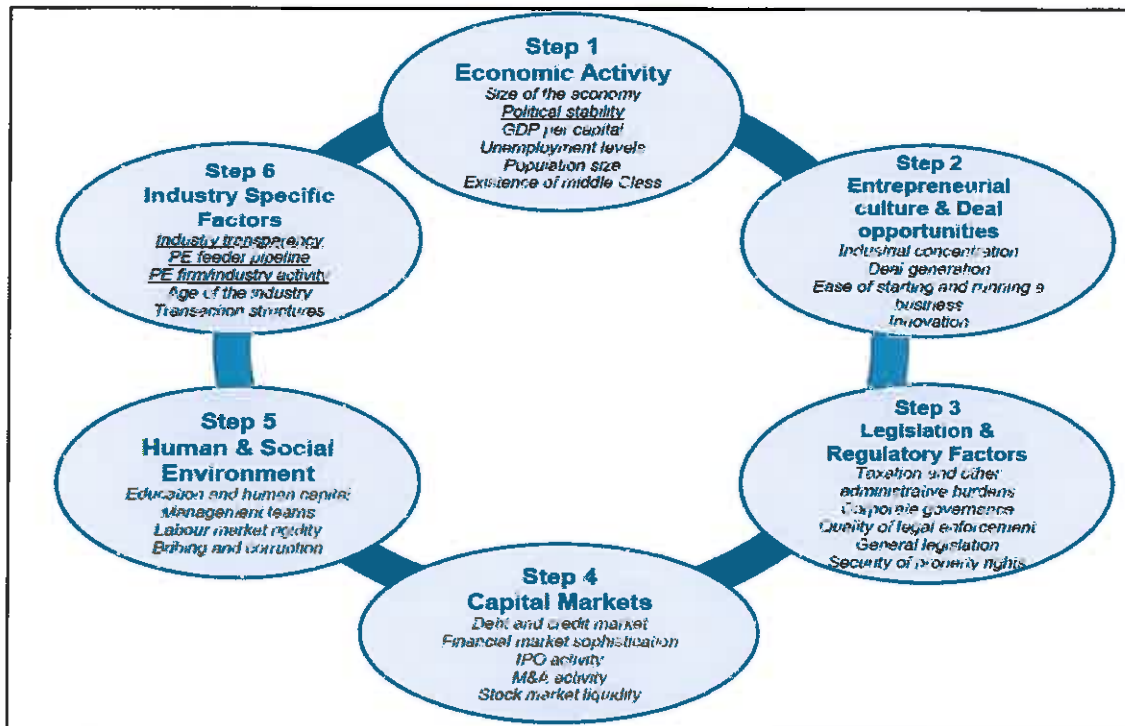


Although industry specific factors except in terms of the structuring of transactions and the general business model used in emerging markets, were not covered in the literature review section and were not expected to be much of a contributing factor by the researcher, this study has shown that factors such as transparency, activity and the PEFP especially in relation to how venture capital is viewed within an industry can either have a positive or negative impact on the attraction of PE investment inflow both from local and international investors.

6.8 Private equity investment attractiveness factors model

Based on the information provided by the expert interviews in terms of industry specific factors and other factors that were highlighted by the interviewees and discussed in this chapter, the researcher expanded on the work of Leeds and Sunderland (2003); Ribeiro and Carvalho (2008); De Beer (2008); Groh et al. (2008, 2009, 2010, 2011, 2012) and Klonowski (2011) and proposed a model that can be used to determine or evaluate factors that contribute to the attractiveness of PE investors from both a local and foreign investor perspective to countries in emerging markets. This model is depicted in Figure 7

Figure 7: Proposed model of factors contributing to the attractiveness of PE investments for local and foreign investors in emerging markets. Adapted from Groh et al. (2008); Leeds & Sunderland (2003); Klonowski (2011)



The underlined factors in Figure 7 relate to the factors that arose during the study. Although no weightings or order of preference are assigned to any factor, the researcher proposes that economic activity factors be evaluated first as this study has not only shown the size of an economy but also the buying power of that economy to be very important when it comes to the attraction of PE investment from both an investor and PE firm level.

Entrepreneurship and deal opportunities are evaluated next, here careful attention should be paid to not only the type of companies that exist in a country but also the diversity thereof of the ownership of those companies, this study found that the best deal generation was found in Brazil as companies on offer included large business that were still family owned or ran, operated in high growth sectors and offered PE companies value add opportunities.

The third consideration should be given to legislation and regulatory factors especially regarding protection of shareholder rights, quality of legal enforcement and corporate governance. It is proposed that depth of capital markets be considered fourth, although the

study found factors such as the existence of exit opportunities to be important, as per Banerjee (2008) and Klonowski (2011), most emerging markets lack the equity markets and infrastructure that provide the foundation blocks of PE.

Human and social elements are depicted as step five as the importance of management teams especially at an investee company level has been found to be crucial in the driving of value in companies.

Lastly it is proposed that industry specific factors be considered as step 6, although this study found industry specific factors to be a main driver in the attraction of PE investment inflow, consideration is given to the fact that these factors are country specific and may not hold true for all PE industries.

Chapter seven reviews the main findings of this study as well as discuss the observations and new insights gained from the study. Recommendations to both future research and PE practitioners are also given in Chapter seven.

6.9 Summary

Chapter six discussed and analysed the results presented in Chapter 5 with the intention of outlining key findings as they responded to the core and sub research question and was grounded within the relevant literature base. Results show that attractiveness of PE investment inflow at a country level do not only include factors such as economic activities, depth of capital markets, legislative and regulatory factors, human and social environment elements and entrepreneurial culture and deal opportunities but that the PE industry itself has a role to play in the attraction of PE investment inflow. Chapter six further proposes a model Figure 7 to be used in determining or evaluating the factors contributing to attractiveness of a country to PE local and foreign investors in emerging markets.

7. Conclusion

7.1 Introduction

Chapter six discussed and analysed the results presented in Chapter 5 with the intention of outlining key findings as they responded to the core and sub research question and was grounded within the relevant literature base. Results show that attractiveness of PE investment inflow at a country level do not only include factors such as economic activities, depth of capital markets, legislative and regulatory factors, human and social environment elements and entrepreneurial culture and deal opportunities but that the PE industry itself has a role to play in the attraction of PE investment inflow.

The purpose of chapter seven is to summarise the main findings and new insights obtained from this research. It also discusses the contribution made by this research as well as provides recommendations for PE practitioners as well as future research directions.

7.2 Observations

The research report sought to obtain better insights into the factors that are contributing to Brazil overtaking South Africa in private equity investment inflow, Using the determinants adopted from Groh et al. (2008), the economic activity, depth of capital markets, regulatory and legislative factors (taxation, property right protection, shareholder rights), human and social environment, entrepreneurship culture and deal opportunities of both Brazil and South Africa were evaluated through the use of expert semi structured interviews to ascertain to what extent these factors were seen to be a contributor or deterrent of PE investment inflow from both an Limited Partner (LP) and General Partner (GP) perspective. The following observations were gathered from this study:

This study therefore indicated that the economic activities of Brazil and South Africa prove the reasons as to why Brazil is receiving more PE investment inflow than South Africa through supporting earlier studies in economic size, such as that by Klonowski (2011) which attribute growth in PE investments inflow to not just the population size of a country but the ability of the inhabitants of that country to drive or stimulate local demand through the purchasing power of

the emerging middle class and the disposable income of individuals through higher wages and drop in unemployment rates.

The findings of this study in relation to regulatory and legislative factors emphasise that although important to a certain degree especially in relation to foreign exchange legislation and regulations as well as those around the taxation treatment of preference shares, the countries legislations and regulations are not seen to be a deterrent, which therefore points to there being other factors that are preventing PE investment inflow into South Africa. In the case for Brazil, the norms that have applied in other markets including South Africa in relation to investor and property protection rights, administrative burdens, corporate governance and the quality of legal enforcement do not apply, or at least not to the same extent as experienced in those markets.

South Africa's financial and capital markets are some of the most renowned and best regulated in the world. The findings of this study in relation to the category of depth of capital markets like that of legislations and regulatory factors also showed that there are other factors that are preventing PE investment inflow into South Africa and that in Brazils' case, the norms that have applied in other markets including South Africa in relation to debt and credit markets do not apply, or at least not to the same extent as experienced in those markets.

The findings of this study proves a strong case for the link between the deal opportunities and the surge of PE investment inflow that Brazil is currently experiencing and at the same time can also explain how the lack of similar deal opportunities is affecting South Africa PE investment inflow negatively.

This study has failed to prove neither the positive nor the negative contribution of the factors that determine PE investment attraction to both Brazil and South Africa in relation to human and social environment factors other than in the context of unemployment.

7.3 New insights

Political stability as a factor was unearthed during the interview process and was not covered in the literature review section. The interviews were conducted a few weeks after the Marikana strike incident (“Marikana”), where approximately 47 people including miners and police officers were killed during a strike in the Rustenburg area near Johannesburg. It is therefore not surprising that the majority of comments around political instability were centred on Marikana although mention was also made relating to the South African nationalisation debate as well as the perceived lack of leadership at a national level. A comment was made by Participant 10 summarising this finding “... *all in all they [Brazilian leadership] say the right things, whether they do the right things is I think is up to debate, we say all the wrong things, we might end up doing the right things but we say the wrong ones, naturalization of mines being a case in point.*”

Although the researcher was expecting political stability to play a significant part in the determination of PE investment flow, the study underline that the size of the economy was mentioned more than political stability and located to be thought of as being more significant in terms of its positive contribution to PE investor attractiveness than political instability was perceived as being a negative contributor to attracting PE investment.

The study uncovered three new factors at an industry level that can have a positive or negative impact on the flow of PE investment both from a local and a foreign perspective, the identified factors are:

1. Openness/transparency of the industry
2. Private equity Feeder pipeline
3. PE firm/industry activity

this study has shown that industry specific factors relating to how open or publicised an industry is, the fostering of VC and early growth capital and the level of activity of the industry either have a positive or negative impact on the attraction of PE investment inflow both from local and international investors.

The study was recapitulated through the development of a model Figure 7(p.71), which was adapted from the factors identified by Groh et al. (2008), Leeds and Sunderland (2003) and Klonowski (2011) as being drivers of attractiveness of PE investment to investors, factors

discovered through this study were incorporated with those of Groh et al. (2008), Leeds and Sunderland (2003) and Klonowski (2011) to develop a six step model which the researcher proposes can be used to determine the level of or evaluate the factors of attractiveness of PE investment to PE firms and not only foreign but local investors too.

7.4 Contributions of this study

The researcher was driven by the need to make contributions traversing both academic as well as business. The contributions made by the study are detailed below:

As the focus of the study was on private equity industries in emerging markets specifically those of South Africa and Brazil, contributions were made by building on the existing body of knowledge in private equity unequivocally in relation to Suman et al (2012) observations regarding the bulk of literature in private equity focusing on the United States and United Kingdom, the need for comparative study of private equity in emerging economies, the inadequate number of qualitative research that is done has been done in private equity and the deficient amount of research in private equity coming from South Africa and Brazil.

The study also contributes to not only the debate around regulation of the private equity industry but by also expanding on existing theories and opened new points of discussion around the transparency, complacency and giving venture capital *“a seat at the table”* within the industry.

From a South African perspective, and as shown with this study, the private equity industry is not a very eminent asset class in the country, as one respondent remarked, *“...it’s also an industry that isn’t very well understood, when graduates leave university or business schools, they often talk about a career in private equity or managing consulting or mining or engineering in Brazil, while when graduates leave school here, they don’t even know what private equity means..”* the lack of awareness of the industry can also be extended to potential investors. This study has contributed in giving cognisance to the South African industry.

The study further contributed through the proposition of a model Figure 7, pg which can be used by private equity firms and investors in determining or evaluating country attractiveness factors in emerging market.

7.5 Recommendations for the PE industry in South Africa

The following lessons gathered from the study and recommendations are proposed to PE firms based on the findings of the study:

The findings of the research regarding the depth of capital markets and the regulatory and legislative factors point out that South Africa in general needs to shift its mindset in terms of thinking that having those elements give the country a competitive edge, as the case for Brazil as covered in this study has proven that it doesn't, a country and an industry needs more than just having the fundamentals in place.

It is recommended that within the industry and SAVCA, better coverage or acknowledgement is given to not only existing venture capital firms, but focus must be placed on the building of a venture capital sector within the private equity industry, to date the role of venture capital has largely been delegated to government departments such as the Technology Innovation Agency (TIA), and Developmental Finance Institutions (DFIs) such as the Industrial Development Corporation (IDC). One respondent suggested that pension funds can also play a role in the strengthening of venture capital in South Africa by allocating funds to venture capital, he also remarked that *"...there also there needs to be some form of innovation in fund raising from the PE fund managers, where for example 10% of funds raised could be allocated venture capital type funding."*

The biggest findings of the study regarding industry specific issues were the deficiency in information from the South African private equity industry especially in relation to data. Competition in the form of other international firms or companies as well the stimulation of local investors necessitates the need for the industry to start disseminating information. Another recommendation in this regard is that the industry should change its current viewpoint on competition within the industry, better collaboration amongst firms, regulatory bodies, government departments, DFIs, institutions of higher learning, and with SAVCA itself needs to

occur if the South African private equity industry is to benefit from what one respondent remarked to as the “..*Second wave of private equity into Africa...*”

7.6 Recommendations for future research in private equity

Lessons gathered from including limitations of the study the following areas for future studies:
Test the proposed model of the study using a quantitative and or a qualitative approach but incorporating generated returns in SA and Brazil to test if the arguments for Brazil’s attractiveness still hold true from that perspective.

The South African private equity industry has been very influenced by the banking sector within the country; it is proposed that a qualitative or quantitative study on the impact Basel 3 on the South African PE industry be undertaken in future.

Regulation 28 allowing increases of pension funds participation in private equity to 10%, came into effect in July 2011. It is proposed that a study be conducted either through a quantitative or qualitative method to assess the impact if any of this regulation on the private equity industry in South Africa.

Another study could look into a follow up on Klonowski’s (2011) study by including South Africa into the BRICS stacking up.

Finally as more research is needed to generate awareness of the private equity industry in Africa, it is proposed that a comparative study on two or four African PE industries. Countries could include South Africa, Nigeria, Kenya and Ghana.

7.7 Summary

It is the hope of the researcher that increasing the attention of private equity research in South Africa through this study will result in “opening new doors for the expansion and growth of private equity, both as a discipline and for practitioners.” Suman (2012, p. 41). This hope is not only extended to South Africa, but also includes the rest of the African continent.

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Appendix 1: Questionnaire

Section 1: Interview Consent Form

Dear Participant

I am conducting research into the Brazilian and South African Private Equity industries, and trying to find out more about the reasons as to why Brazil is overtaking South Africa in the inflow of PE investments. Our interview is expected to last about an hour, and will help us understand better why Brazil is currently more attractive as a destination of funds as opposed to SA, and possibly identify areas for improvement in SA's case.

Your participation is voluntary and you can withdraw at any time without penalty. Of course, all data will be kept confidential. If you have any concerns, please contact me or my supervisor. Our details are provided below:

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Phone 082-906-6890

082-957-7416

Signature of participant: _____ Date: _____

Signature of researcher: _____ Date: _____

Section 2: Questionnaire guideline for GPs

Introduction to questionnaire

The annual global venture capital and private equity country attractiveness index which is sponsored by Ernst & Young and IESE Business schools Centre for International Finance (CIF), measures the attractiveness of countries for investors in the venture capital (VC) and private equity (PE) asset classes. The index ranks the attractiveness of countries for PE & VC investors according to the following criteria: economic activity; depth of capital markets; taxation; Investor protection and corporate governance; human & social environment and entrepreneurial culture and deal opportunities. For the last four years South Africa has outranked Brazil in this index, and yet Brazil still manages to overtake South Africa in terms of PE inflow. The following questions attempt to derive an understanding of the reasons why Brazil is overtaking South Africa from a private equity investment perspective and in that attempt, please apply your knowledge to your applicable market accordingly.

Questions

- 1) Does your firm invest in South African and/or Brazilian funds? Please answer the following questions in accordance with the market in which you invest.
- 2) In your view or experience what are the primary reasons that your LPs have selected to invest or allocate funds into either a South African/Brazilian fund (as appropriate)?
- 3) What primary economic factor(s) do you find encouraging from a private equity investment perspective in favour of South Africa/Brazil?
- 4) Which key economic factor(s) do you find discouraging about South Africa/Brazil?
- 5) Please list the key regulatory factor(s) that you find encouraging about South Africa/Brazil?
- 6) Which key regulatory factor(s) do you find discouraging about South Africa/Brazil?
- 7) In your view how has South Africa/ Brazil (either the industry or the country) attracted capital as a destination of choice?

- 8) In your view how can South Africa/ Brazil (either the industry or the country) improve to enable better attraction for funds?
- 9) What are the key industry and structural factors that impact your choices in investee companies?
- 10) What are the five criteria's considered by your firm when making fund investment decisions?
- 11) Please rank or weight the criterion's mentioned above
- 12) Is the human capital shortage in South Africa affecting investment flow; why in your view is this component important/unimportant in the context of PE?
- 13) How does the entrepreneurial culture (or lack thereof) in South Africa and/or Brazil affect investment inflow to the respective countries? Why in your view is this entrepreneurial component important/unimportant in the context of PE?
- 14) In your view and/or experience which of the two countries has better investment transaction opportunities and why, please explain?
- 15) In your opinion which of the two countries will have better investment transaction opportunities in future and why, please explain?
- 16) What are the key elements of transaction structures in South Africa/Brazil? Please provide an explanation as to why the transactions are structured as such?
- 17) How would you explain the anomaly between the findings of the Brazil v.s SA attractiveness index and what is happening in practice?

Section 3: Questionnaire guideline for LPs

Introduction to questionnaire

The annual global venture capital and private equity country attractiveness index which is sponsored by Ernst & Young and IESE Business schools Centre for International Finance (CIF), measures the attractiveness of countries for investors in the venture capital (VC) and private equity (PE) asset classes. The index ranks the attractiveness of countries for PE & VC investors according to the following criteria: economic activity; depth of capital markets; taxation; Investor protection and corporate governance; human & social environment and entrepreneurial culture and deal opportunities. For the last four years South Africa has outranked Brazil in this index, and yet Brazil still manages to overtake South Africa in terms of PE inflow. The following questions attempt to derive an understanding of the reasons why Brazil is overtaking South Africa from a private equity investment perspective and in that attempt, please apply your knowledge to your applicable market accordingly.

Questions

- 1) Do you/ or have you invested in a South African and/or Brazilian fund(s)? Please provide some detail/ explanation?
- 2) Please list the reasons you elected to invest in a South African and/or a Brazilian fund(s) (in each case as appropriate)?
- 3) Why have you chosen/would you choose to invest in a South African/Brazilian fund over a Brazilian/South African fund (in each case)?
- 4) What strategies of the fund(s) you have invested in either in South Africa and/or Brazil attracted you to that particular fund(s) (in each case)?
- 5) As an investor, which economic factor(s) do you find encouraging for private equity investment in South Africa/Brazil (in each case)?

- 6) As an investor which economic factor(s) do you find discouraging for private equity investment in South Africa/Brazil (in each case)?

- 7) As an investor, which regulatory factor(s) do you find encouraging for private equity investment in South Africa/Brazil (in each case)?

- 8) As an investor which regulatory factor(s) do you find discouraging for private equity investment in South Africa/Brazil (in each case)?

- 9) In your view how has Brazil (either the industry or the country) set itself up to be a private equity investment destination of choice?

- 10) From the perspective of an investor, how can South Africa (either the industry or the country) improve to enable more investment flow?

- 11) As an LP, what are your important five criteria's when choosing a GP to allocate funds to?

- 12) Could you please rank/weigh the criterion's mentioned above?

- 13) Do you actively seek out GPs with funds in South Africa/Brazil?

- 14) In your view and/or experience as an investor, which of the two countries has better deal opportunities and why?

- 15) How would you explain the anomaly between the findings of the index/theory and what is happening in practice?

Appendix 2: Interview guideline

Part 1: Introduction and background

Thank you for your time and input.

I would like to confirm the confidentiality of the data I collect from you. If required, this interview can be anonymous and your name and/ or that of your organisation will not be reflected in the research report.

Please read through the interview consent form, a copy of which was also emailed to you on confirmation of this interview and complete it before we proceed with the interview.

The title of the research is “Private Equity in Emerging Markets: A comparison between South Africa’s and Brazil’s private equity industries”.

The key objectives of this research are to:

- Gain understanding of reasons as to why despite South Africa’s economic attractiveness and similarities with Brazil, investors are preferring to invest in the Brazilian private equity industry.
- Explore unknown investment criteria or known criteria weighing in the investment decisions of private equity practitioners and investors when making investment decisions that pertain to the two countries.
- Assess the potential of South Africa to catch up to or overtake the interest in terms of private equity investment flow that Brazil is currently experiencing.

The interview will be based on a conversational and exploratory basis, I therefore encourage that you speak freely and candidly and especially not be limited to only answering the proposed questions.

Do you have any questions before we proceed?

Part 2: The interview

- Ask questions as per draft questionnaire
- Ask factual before opinion questions
- Use probes when required

Part 3: Winding up of the interview

What recommendations would you give for future efforts in the private equity sector of this nature?

Is there anything further you would like to add?

Inform interviewee of next steps; which will take the form of the analysing of collected information, which will then be compiled into a draft report that could be sent to the interviewee if need be.

Thank interviewee for the generosity of their time and the information provided