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PRIVATE EQUITY: LESSON FOR NAMIBIA

by

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ABSTRACT

The primary objective of this study was to draw experiences from other countries as to what is required for the private equity industry to flourish. The study also attempted to establish whether there is a scope for the establishment of private equity market in Namibia. In this regard, a review of different forms of private equity was conducted and the findings confirmed that there is a scope for private equity activities in Namibia in terms of both venture capital and non-venture capital components. However, the study suggests that the venture capital component could be the most appropriate vehicle for Namibia. This is so as venture capital is ordinarily known to be critical in the promotion of start-up companies, which seems to be more important in the case of Namibia. Furthermore, the paper also established that there is a scope for private equity in non-venture capital activities.

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GLOSSARY OF TERMS AND ACRONYMS

ADB	African Development Bank
AFMINCO	African Mining Development Company
Angel investors	Wealthy individuals providing venture capitalists with funds.
BEE	Black Economic Empowerment
Captive Funds	Funds that make use of capital from their own balance sheet or from the balance sheets of their parent companies.
CGA	Central Governance Agency
Committed capital	Capital committed to a specific fund, but not necessarily invested yet.
CSIB	City Savings and Investment Bank
DCP	Development Capital Portfolio
DFI	Development Finance Institutes
Expansion	Capital provided for the growth and expansion of an established company. Capital provided for rescue / turnaround situations is also included in this category.
GIPF	Government Institutions Pension Fund
High growth companies	Companies that are not lifestyle companies, but instead provide investors with opportunities for high capital growth.
Independent Funds	Independent funds raise cash commitments from third party investors[1]
Initial Public Offering	Is the sale of equity in a company, generally in the form of shares of common stock. These shares trade on a recognized stock market.
IRR	Internal Rate of Return
JSE	Johannesburg Securities Exchange
Lifestyle companies	Is a low-growth but low-risk enterprises with the capacity to provide an individual entrepreneur or a small group of partners with a comfortable and financially secure lifestyle.
Management buy-in (MBI)	Funds provided to enable an external manager or group of managers to buy into an established company.
Management buy-out (MBO)	Funds provided to enable current operating management to acquire an existing product line or business. Institutional buy-outs (IBOs), Public to Private and similar financings are included under MBO.

1 Referred to as limited partners in the US.

GLOSSARY OF TERMS AND ACRONYMS (CONT)

MTC	Mobile Telecommunications Limited
NASDAQ	National Association of Securities Dealers Automated Quotations System
NDP2	National Development Plan 2
NHI	Namibia Harvest Investment
NSX	Namibia Stock Exchange
Other early stage	Financing provided to companies that have completed the product development stage and require further funds to start commercial sales. They may not yet be generating profits.
Private Equity	all sources of finance to entities that are not quoted on the stock exchange. Equity investments in the unregistered securities of private and public companies.
SESDAQ	Stock Exchange of Singapore Dealing and Automated Quotation System
Small Business Investment Companies (SBICs)	Venture capital arms that specializes in first-stage financing for businesses in fragmented local markets.
SME	Small Medium Enterprises
Start-up Capital	Financing provided to companies for use in product development and initial marketing. Companies have not yet sold their product commercially.
USAID	United States Agency for International Development
Venture Capital	Money that is made available by risk capital companies or individuals in order to finance new business. Cilliers and Stapelberg (2000) define venture capital as investments for launching, early development or expansion of a business.

CHAPTER 1

1. INTRODUCTION

There is an increasing public awareness and interest all over the world on the roles of private equity and entrepreneurship in contributing to economic growth through the development of successful business. The international evidence has demonstrated that private sector development is the key to economic growth and development in any country. However, for the private sector to grow, it needs to have access to finance which is accompanied by a strong mentoring and management support system.

The type of finance required in this case, can be found in the private equity arrangement. In its most basic form, private equity, and more specifically venture capital, combines the provision of finance with active support of governance and mentoring of the start-up companies. It is for this reason that entrepreneurs turn to venture capitalist, a sub-set of private equity, to finance the development of their new ideas, technologies and at the same time gaining access to professional management skills.

Recognising the importance of the private equity industry in the growth process, many countries, including developing economies, have initiated the development of this industry in their countries. For example, Singapore has implemented regulatory and fiscal changes to attract top-tier international venture capital firms to establish a regional base in its territory. Besides that the government, through various agencies and government related companies, has also funded a number of new local and foreign venture capital based firms in Singapore (Francis, et.al 2002).

More recently, various players in Namibia have also realised the importance of the private equity industry to finance companies with high growth potential, particularly in the SME sector. Previous research have shown that small medium enterprises (SMEs) employ a large number of people[2]. However, these enterprises are faced with a lack of access to credit, and thus undermine their growth and employment creation potential. This is attributed to the fact that these borrowers (entrepreneurs) do not have sufficient collateral. This situation coupled with the risk-averse behaviour of commercial banks makes the undertaking of investment by these entrepreneurs extremely difficult. As a result economic growth has been hampered, and this is largely attributed to a conspicuous lack of risk capital to enable SMEs to realise their full potential.

In the case of Namibia, private equity financing needs serious attention. However, recently some new initiatives to cultivate this market have been witnessed. While the market remains minuscule compared to other corporate financing sources such as bank lending, it is believed that it could have a role to play in improving the overall efficiency of business financing, by not only providing a source of funding for smaller and riskier companies with a great potential to grow and which may face difficulty in raising funds in public markets, but also mentoring and management support.

The objectives of the study are therefore, to examine whether there is a scope for successful private equity activities in Namibia, especially in the under financed SME sector. Furthermore, the study will extract some lessons from other countries pertaining to the operation of private equity activities. This will in turn help in formulating economic strategies, which will create a conducive environment in which long-term risk is rewarded.

[2] According to the Small Business Impact Assessment study conducted by NEPRU during 2003, 19.8 percent of Namibia s labour force is employed full time in the SME sector. This translates into 132,187 thousand employees of the estimated Namibian labour force of 667,609 thousand in 2003.

The study is organised as follows; the introduction serves as chapter one, while Chapter 2 reviews the private equity literature. Chapter 3 discusses the status and scope for private equity in Namibia. Chapter 4 reviews international experience on private equity, while Chapter 5 draws some lessons for the establishment and operation of a private equity market in Namibia. Chapter 6 concludes and offers some policy implications.

CHAPTER 2 RELATED LITERATURE OF PRIVATE EQUITY

The purpose of this chapter is to provide a brief overview of the literature on private equity industry.

2.1 PRIVATE EQUITY FUNDS

In their modern form, private equity funds are basically pools of capital that invest in projects with an expectation of significant returns for the investment risk involved. Private equity is a high risk, but a high reward business. It is also neither a short term nor a liquid investment. Due to its high risk characteristic, it has long investment duration (up to 10 years and more). Furthermore, the illiquidity of its investments and high minimum investment commitment makes private equity investment generally out of reach of the average individuals investors.

The investors in private equity firms include private and public pension funds, endowment funds, foundations, insurance companies, banks, corporations and wealthy individuals. For example, in the US, institutional investors such as pension funds or university endowment funds will typically allocate between 2 percent and 10 percent of their institutional investment portfolios to venture capital/private equity as part of their portfolio s diversification.

Private equity firms come in a variety of organisational forms. There are private equity funds which invest before there is a real product to be commercialised (seed investing), or provide capital to start a company in its first or second stages of development (early stage investing). Furthermore, private equity may also invest in later stages (expansion stage financing), when the company needs additional financing to expand the business as it plans for an initial public offering.

The literature shows that private equity funds specialise in various stages of companies development. Some private equity firms specialise only in late-stage investing, while others are broadly diversified across the different stages of development. Similarly, there is a trend towards specialisation among private equity firms in terms of the sectors in which they invest.

2.2 MODELS OF PRIVATE EQUITY FUND

Generally private equity is classified into broadly two sub-classes, namely venture capital and non-venture capital (which includes development capital and buy-out). Table 2.1 below provides a summary of the two broad models of private equity.

Table 2.1 Various types of private equity

Venture Capital	Seed Capital	Funding for 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 or for the development of those which have been in business for a short time.
Non-venture Capital	Expansion and Development	Funding for the growth and expansion of a company which is breaking even or trading profitably.
	Management buy-out (MBO) or buy-in (MBI)	Funding to enable a management team and their backers to acquire a business from existing owners.
	Replacement Capital	Funding for the purchase of existing shares in a company from other shareholders.

Source: KPMG, 2001

Venture capital specialises in providing finance to companies for use in product development and initial marketing. At this stage companies have not yet sold their product commercially. The venture capitalists may also continue to provide finance to companies that have completed product development and which require funds to start commercial sales. It also plays a role in the expansion stage, refinancing of bank debt and secondary purchase (purchase of existing shares in a company from another venture capital firm or from other shareholders).

Non-venture capital specialises in the provision of funds to enable management buy-outs (MBOs), management buy-ins (MBIs) and public to private transformation. In the case of management buy-outs, the funds, which are provided by this component of private equity, enable the current operating management to acquire an existing product line or business. Whereas, with management buy-ins, the funds are used to enable an external manager or group of managers to acquire a stake in the existing company. Finally, the non-venture form of private equity plays a role in the purchase of equity of public listed companies, which are then de-listed to become private companies. Some empirical evidence suggests that the performance of non-venture backed (MBO/MBI) companies is partly attributed to the incentives structure provided to the management team and the employees. Therefore, it is argued that the provision of incentives to all the stakeholders, more particularly the employees and management, is crucial for the future success of a company. The management and the employees must also become owners. The better the company performs the better the reward.

2.3 ECONOMIC IMPORTANCE

Private equity can provide the crucial combination of capital, business mentoring and financial discipline to help and encourage enterprises to realize their growth potential. This financing and business development process supports wider economic growth by enabling structural change and redeploying capital rapidly to new businesses in new sectors. The transformational impact of private equity, applied over decades in various parts of the world, has been well documented. For instance, whole new industries have been fostered and their growth accelerated by the injection of risk capital seeking high absolute returns for both investors and entrepreneurs.

This industry plays an important role of mending the financial gap which can not be addressed by other form of financing such as commercial banks. The literature suggests that banks all over the world are perceived to be risk averse to finance unsecured long term projects. The reason for this is attributed to their balance sheets that consist mainly of short term liabilities. In addition, the firms seeking funding do not necessarily have sufficient collateral or a track record of profits to obtain bank financing. Therefore, such firms have difficulty raising capital from the commercial banks. In this regard, this problem is solved by the private equity arrangement.

However, entrepreneurs have raised a concern about some loss of control of their companies as well as a high cost of finance with respect to funds raised through private equity. A survey in the UK concludes that the main concerns about private equity voiced by SMEs are the following: dilution and loss of control; loss of management freedom; target pressure from third parties; and financing costs (Poutziouris et al 1999). This concern could be addressed by raising awareness among the SME entrepreneurs to understand that, although they may loose control or management freedom, the overall growth of the company will bear much fruit and benefit for all the parties.

2.4 WHY COMPANIES USE PRIVATE EQUITY FUNDING

The private equity market mainly attracts companies with limited access to internal funds or bank loans. As mentioned earlier these companies normally do not have a sufficient collateral or track record of profits to support bank borrowings or debt raisings. In instances, were debt financing is available, it may be relatively expensive.

Access to the stock market funding is partly hindered by tedious listing requirements, according to these businesses. For these companies, the cost associated with listing as a public company, such as the legal and accounting costs involved in the provision of semi-annual public financial statements, annual auditing, and other disclosure requirements, can be substantial. The literature also suggests that the liquidity of the stocks of large listed companies tends to be considerably higher than that of smaller listed companies, which may make capital raisings for small businesses more expensive. This may discourage small firms from seeking listings, and encourages some small listed companies to de-list and seek private equity funding instead. The advantage of private equity funding for companies, is that it also provides expertise to the management and restructuring of poorly performing companies.

The flow of venture capital from investor to starts-up companies and back can be thought of as a cycle that runs through several phases. Following is a schematic overview of these different phases:

(i) Raising the fund

The venture capital firms raise money for investment from a variety of sources such as institutional investors (public and private pension funds, insurance companies, and banks), wealthy individuals, corporate investors and government agencies. Venture capitalists raise funds into a blind pool . This means that investors do not know for which purpose their money will be used when they make the investment. Once the money has been raised, venture capitalists explore business plans which have the potential to grow into successful companies and which are then financed by venture capital.

Likewise, business people try to find a venture capital firm that would fund their business idea. Ordinarily very few proposals out of several hundred submitted for considerations are selected.

(ii) Invest and oversee

The venture capital firm invest money in a newly created firm. The goal of the venture capitalists with such an investment is to develop this start-up business into a stable, growing and profitable company. Constant monitoring and overseeing the developmental stage of the company is one of the key roles of the venture capital firm. Very often, the venture capitalist sits on the board of the company and is involved in strategic decision making.

(iii) Managing exit

Assuming the venture capitalist hits gold and the company turns into a success; it is time for him to cash in gains. There are three principal methods of exiting an investment. One key popular option for exit is floating the company on the stock market (initial public offerings). Other possible options include selling the portfolio company directly to another company (merger & acquisition), or selling it back to the entrepreneur /founders of the company (the redemption option).

CHAPTER 3 PRIVATE EQUITY IN NAMIBIA

The purpose of this chapter is to discuss the importance of private equity for Namibia and analyse whether there is a scope for private equity activities with regard to venture capital as a means of financing the Small and Medium Enterprise (SME)[3] sector. However, the chapter also looks at other areas (i.e. non-venture capital financing forms of private equity) in which private equity financing can play a role, such as buy out (black economic empowerment), privatisation of public enterprises, formation of infrastructure funds, among others. The chapter will also briefly review initiatives that relates to private equity or venture capital taking place in Namibia and will outline some of the potential areas in which private equity can play a role in the Namibian economy.

3.1 THE SCOPE FOR PRIVATE EQUITY IN NAMIBIA

The assessment will analyse the scope for private equity from two perspectives, namely venture capital and non-venture capital financing (i.e. buyout and development capital). The reason for disentangling private equity financing in the above subsets, is to help in assessing which form of financing (i.e. venture capital and non-venture capital) is much more important for Namibia.

3.1.1 Venture Capital for SME sector[4]

The role of private equity is to assist in transforming ideas into real world businesses, which cannot be financed by commercial banks. It is argued that big businesses can raise money from commercial banks and NSX, while the micro and small businesses[5] get loans through the Small Business Credit Guarantee Trust (SBCGT). However, the medium sized enterprises in Namibia suffer greatly as they do not fit well within the existing financial structure.

Furthermore, it is argued that the Namibian financial markets are characterised by a lack of equity capital for unlisted companies leading to debt-heavy balance sheets[6] for these businesses. Consequently, once these enterprises attain a certain level of indebtedness in relation to their assets, they are unable to obtain further financing for expansion, given the conservative nature of commercial banks lending practices in Namibia and the absence of formal equity financing outside of the NSX. The conservative lending practices of commercial banks in Namibia implies that long-term, unsecured lending for younger enterprises is extremely rare or at best non-existent.

This situation has been precipitated by the fact that, the size of institutional equity/loans required by medium-scale enterprises for their sustainable growth is relatively expensive to obtain from the NSX, while it is perceived to be large for risk-averse commercial banks to provide. This undermines the development of these enterprises in the Namibian economy. Therefore, it has been observed to be imperative that alternative sources of financing should be sought to realise the potential of these medium-scale business sector[7].

3 The SME sector is defined in the context of this paper in a conventional sense, meaning small medium enterprises as opposed to the Namibian definition which stands for small and micro enterprises. The definition was adopted because small and micro enterprises are not amenable to the form of financing (i.e. private equity) discussed in the content of this paper. This implies that the SME sector as discussed in the content of this paper refers to what is known as the medium-scale enterprise sector in the Namibian context and the concepts SME and medium-scale enterprise sector are used interchangeably.

4 This section is mainly based on Gibson and Davis (2001), Venture Capital for Medium-Scale Enterprises in Namibia , a report prepared for the Namibian Ministry of Trade and Industry in September 2001 and sponsored by the United States Agency for International Development (USAID), Namibia office.

5 Financing needs for small businesses rarely reach N$250,000 (Gibson and Davis, 2001).

6 A debt-heavy balance sheet simply means that, there is a lack of equity financing for Namibian unlisted enterprises. Namibian unlisted companies mainly raise their finances through debt.

7 The medium-scale business sector is defined in the context of this paper to include equity ranging from N$ 1 million to N$ 10 million.

This alternative source is nothing other than the venture capital initiatives. The venture capitalist provides the necessary finances required by these enterprises. In addition to providing finances, venture capitalists also assist businesses, with management expertise, which is a necessary ingredient for the success of any business.

Given the above situation, a logical question to pose is as follows: Is there a scope for private equity (venture capital) in Namibia, especially with particular focus on the financing needs of the medium-scale-enterprise sector?

The answer is provided by the study on venture capital for medium-scale enterprises in Namibia prepared for the Ministry of Trade and Industry. The paper established that, indeed there is a scope for financing the medium-scale enterprises sector in Namibia by means of venture capital. Financing the medium-scale enterprises by means of venture capital will open up opportunities for Namibian entrepreneurs to unlock their talents and entrepreneurial skills, resulting in the increase of investment and economic growth. The presence of venture capital often creates its own deal flow by encouraging talented business people to contemplate launching their own businesses.

3.1.2 Non- Venture Capital

Apart from the lack of finances for medium-scale enterprises, there are also other challenges to be addressed by private equity. These challenges range from a lack of managerial expertise in the new enterprises to lack of funds which can facilitates the transfer of ownership through Black Economic Empowerment (BEE). These challenges could be partly addressed by a non-venture capital form of private equity financing which could take the following forms: black economic empowerment (buyouts), privatisation of public enterprises (public-private partnerships), formation of infrastructure funds, and establishment of strategic alliances in investments.

In fact, a number of companies in Namibia have been seeking empowerment shareholders, but have often been faced with empowerment deals that do not provide market value, as many empowerment groupings are not in a position to finance these acquisitions at commercial rates, given their limited access to capital. This clearly underlines a void in the market that needs to be filled. The need for non-venture capital funds in Namibia is discussed below.

(i) Black Economic Empowerment (Buy-Out)[8]

One possible role for the private equity industry in Namibia is in the area of black economic empowerment and the acquisition of equity in corporate entities which were previously dominated by the previously advantaged section of the Namibian society. It is important that these corporate entities reflect the demographic realities of the Namibian society if national wealth is to be distributed in a fair, equitable and sustainable manner.

(ii) Privatization of public enterprises and private equity

One of the ways in which the private equity industry can play a role in the Namibian economy is through the privatisation of public enterprises such as Air Namibia, among others. The promotion of private equity

8 According to the Namibia National Chamber of Commerce and Industry (NNCCI) the concept of Black Economic Empowerment (BEE) in Namibia is not well understood. From the interviews they have conducted, some of the respondents viewed BEE as a synonym of affirmative action, whilst others took a much broader view of it, which encompasses affirmative action. However BEE should be viewed as broader process aimed at encouraging broader ownership of the factors/means of production by the majority of the previously disadvantaged people of Namibia. This should cover the upliftment of the ordinary citizens, including rural people in an attempt to having them play an active role in the mainstream sectors of the economy.

ownership in state owned enterprises can be used as a means of broadening public participation in the economy and hence, contribute to equity and distributional objectives of the government. In fact divesting countries around the world have used privatisation as a tool to achieve equity and distributional objectives, and in the process jump-starting capital market development. Private equity funds can play a significant role in this regard in Namibia as well, because other methods such as the simple distribution of shares to employees and other methods of financing will not necessarily solve the problem of newly privatised under capitalised enterprises. Furthermore, their access to international capital markets may also be limited.

The World Bank (1996) report noted that: Namibia s parastatals, and in particular, utilities such as NamPower and Telecom are especially amenable to such distributional techniques given their strong financial position and good operating track record . It further noted that , their privatisation (NamPower and Telecom) would offer viable investment opportunities to non-bank financial institutions (insurance companies and pension funds) to invest some of their sizeable savings in Namibia rather than in South Africa and along with smallholder participation this can effectively contribute to the development of capital markets in Namibia.

(iii) Formation of Infrastructure funds

Economic development depends critically on well-developed and organised infrastructures. Transport and communication services link people, firms, cities, and countries in the global economy. Traditionally the provision of infrastructure has been the preserve of the public sector, more especially in developing countries partly due to its perceived strategic importance to the economy and partly because of the large investment costs and long gestation periods which are usually associated with investment in infrastructure projects. However, the provision of some services by private holders in some developing countries, have shown that private financiers are able to mobilize resources necessary to finance infrastructure projects.

In general private participation offers enormous potential to improve efficiency of infrastructure services, extend their delivery to the poor, and lessen pressure on public budgets that have long been the only source of infrastructure finance. Hence, private equity financing can play a role in the private provision of public infrastructure.

Currently, there is only one specialised infrastructure development fund in Namibia which is operated by Old Mutual Namibia. The Managing Infrastructure Development in Namibia fund (MIDINA) aims to deliver investment returns by providing debt financing to local authorities and investing in social and commercial projects. The proceeds from investors will be utilised to fund capital projects like bulk water supply and telecommunication infrastructure. It must be noted that MIDINA is essentially a debt structured infrastructure fund, whereby local authorities will borrow funds from and repay back at a rate of interest below the market rate.

However, for Namibia s infrastructure to develop further there is a need to establish infrastructure funds of an equity nature which will invest in non-listed companies that develop, own or operate infrastructure facilities and projects. This type of fund may need the participation of multilateral financial institutions such as the African Development Bank (AfDB)[9].

3.2 PRIVATE EQUITY INITIATIVES IN NAMIBIA

There have been a few initiatives in Namibia which are aimed at filling the financing gap faced by medium-scale enterprises and injecting private equity capital in other areas of the economy which are experiencing

9 India has established the Infrastructure Fund of India (TIFI) during February 2004 with the participation of the Asian Development Bank (ADB) and AMP capital Investors, the funds management arm of the Australian financial services group, AMP. Namibia could learn from their experiences

financial constraints. These initiatives are the Stimulus Private Equity Fund (Pty) Ltd (Stimulus) and the African Mining Development Company (Pty) Ltd (AFMINCO). Furthermore, the Namibian Harvest and Government Institutions Pension Fund (GIPF) have also played a significant role in the provision of funds to unlisted activities. These initiatives are discussed in detail in the following sub-sections:

(i) Stimulus Investments Limited Ltd

Stimulus Investments Limited Ltd is a joint venture between PointBreak Equity (Pty) Ltd and Irwin Jacobs Greene (IJG) Corporate Finance (Pty) Ltd. PointBreak Equity (Pty) Limited is a wholly owned division of PointBreak in Namibia, whilst IJG Corporate Finance (Pty) Ltd is a subsidiary of Irwin, Jacobs, Greene (Pty) Ltd, one of Namibia's leading stock broking firms.

Stimulus has been created to fill the finance void in empowerment ventures with the capacity to do empowerment deals on commercial terms. Stimulus is majority controlled by previously disadvantaged Namibians, whilst PointBreak and IJG Corporate Finance remain minority shareholders. Stimulus will focus on investment in Namibian companies in all sectors other than mining.

This private equity initiative is expected to be actively involved in investee companies, with significant participation on audit committees, investment committees, human resources/hiring committees, and similar committees of investee companies.

(ii) The African Mining Development Company (AFMINCO)

The African Mining Development Company (Pty) Ltd (AFMINCO) is a joint initiative between Namibia Investment Bank (NIB), member of the Nedcor Group, and IJG Corporate Finance (Pty) Ltd, to establish a private equity fund to invest in junior mining projects in Namibia. The junior mining fund aims to bridge the funding gap between initial discovery of a potential mineral resource and the completion of a bankable feasibility study, which can be used to raise the money required to establish the venture.

Up to now, the emphasis in the Namibian mining sector has been on large scale projects that lend themselves to a major mining house approach. The junior mining approach has for various reasons not taken root in Namibia. Prerequisites for a junior mining approach are amongst others: an entrepreneurial culture and access to appropriate sources of capital to fund exploration and take projects from exploration through feasibility and into production. However, despite a sophisticated banking sector and a large pool of institutional savings, Namibian financial institutions are reluctant to lend to mining in general and exploration and feasibility activities in particular. This gap will be partially filled by AFMINCO.

(iii) The Government Institutions Pension Fund (GIPF)

The GIPF established a development capital portfolio (DCP) in 1995, which is made up of its investments in unlisted instruments. The philosophy guiding investments of the DCP is to invest a maximum of 5 percent of the total market value of the assets held, in crucial projects that will contribute to social upliftment and economic development within the Namibian society. The GIPF makes investments in unlisted companies at the sole discretion of its Board of trustees in terms of regulation 28[10] of the Pension Funds Act of 1956, as amended.

[10] Regulation 28 of the Pension Funds Act of 1956 as amended requires Namibian pension funds to invest 35 percent of their funds locally.

A significant portion of the DCP is made up of both the secondary and tertiary sectors of the economy, constituting over 50 percent of the portfolio. Within the secondary sector, the share of the manufacturing sub-sector is quite substantial at 28 percent of the portfolio, while hotels and leisure (a proxy for investments in the tourism sector) constitute 11 percent of the portfolio.

Since its inception in 1995, the DCP has made significant investments in unlisted companies such as Namibia Grape Company, Etosha Fisheries Holding Co. (Pty) Ltd., SWABOU Bank and Ostrich Production Namibia, among others. The performance of these investments, show mixed signals. A close analysis reveals that DCP investments fail to meet the expected performance, mainly due to a lack of sound management support for these newly established ventures. The experience shows that for these kinds of initiatives to be more successful, it requires not only funds, but also coordinated support in terms of the management of the company. From this experience, there is now a shift in GIPF investment strategy, it prefers to invest funds allowed in terms of regulation 28 via established institutions such as venture capital firms, Development Bank and the Agricultural Bank of Namibia who can on-lend to other retailers (Hango, 2004).

As a result, the GIPF and Sanlam Namibia Investment Management (SIM) are engaged in deliberations to convert the DCP into a private equity fund. SIM/GIPF is expected to inject N$50 million into the envisaged private equity fund with the rest expected from other partners (i.e. institutional investors and private individuals/companies). These initiatives, if well designed will clearly go a long way in bridging the financing gap and lack of management expertise faced by many businesses in Namibia, particularly the medium-scale enterprise sector.

(iv) Namibian Harvest Investments (NHI)

NHI is an investment holding company with a focus on financial services. The company was incorporated as a public company in Namibia, and eventually got listed on the NSX. The operating entities within the NHI group include the following as shown in the table below:

Table 3.1 NHI operating entities

Name of entity	Nature of Business	Percentage Ownership
Namibia Asset Management(Pty) Ltd	Asset management	100%
Namibia Unit Trust Managers Ltd	Unit trust management	100%
!Uri !Khubis Abattoir (Pty) Ltd[11]	Abattoir	20%
Shares of NamHarvest in FNB Namibia Holdings	Commercial Bank	7.78%

Source: Circular to Shareholders, NHI (Pty) Ltd, 12 December 2003

However, in a more recent times NHI has been realigning its activities to focus on its core business, which is asset and unit trust management. As a result the company sold its 47.5 percent stake in Edu-Loan Namibia (Pty) Ltd, a company that specialises in the micro-lending business. Furthermore, the company have disposed of its stake in Namhealth and also voted in favour of disposing of their shares in First National Bank of Namibia Holdings (FNB Namibia Holdings).

11 NHI had extended a loan of N$4 million to the !Uri! Khubis abattoir (Pty) Ltd which was written off in 2000. The reason behind writing-off the loan was based on the company s prudence policy. As a matter of company policy, NHI writes off private equity investments that cannot be valued by reference to objective factors.

NHI experience with investments in private equity has been somewhat unsatisfactory. The company experienced problems with its investment in the then City Savings and Investment Bank (CSIB) due to the fact that, the bank required substantial recapitalisation, which was achieved indirectly by purchasing the non performing loan book from CSIB. Furthermore, NHI experienced problems with regard to its investment in the !Uri! Khubis Abattoir[12] and as indicated has written off the loan it extended to the abattoir, although it is hoping to recover some of its investment. Currently NHI is owed N$7.8 million by the !Uri! Khubis abattoir. The poor performance of some of these activities could also partly be attributed to lack of managerial support, which most companies at initial stage desperately need.

3.3 INSTITUTIONS AND INCENTIVES FOR PRIVATE EQUITY IN NAMIBIA

For private equity to fully flourish in Namibia, there is a need for establishing initial conditions as well as an enabling environment under which it can fully take-off. The enabling environment entails amongst others the following features:

- Sound Macroeconomic and structural policies[13];
- Strong incentives and institutions;
- Entrepreneurial Culture.

Sound macroeconomic policies refer to a stable macroeconomic environment in terms of price stability (low inflation, low budget deficit, steady growth in GDP and a viable external payments situation) as well as structural policies such as labour market policies. Namibia has strong and sound macroeconomic and structural policies under which private equity should grow.

The country also has a strong incentive structure for the promotion of industrial development. The incentive structure is outlined in various Acts of Parliament such as the Export Processing Zone (EPZ) Act of 1995 and the Foreign Investment Act of 1990. A review of these Acts falls beyond the scope of this paper. In fact, a USAID-sponsored report on Venture Capital for Medium -Scale Enterprises in Namibia prepared for the Namibian Ministry of Trade and Industry notes that: given the favourable legal environment and the successes of the public equity market for financing larger firms, there is reason to believe that Namibia can also develop a market for private equity at the level of medium enterprises (Gibson and Davis, 2001).

Namibia also has an abundance of savings over investment as documented in various publications of the Bank of Namibia (i.e. Annual Reports and Occasional Papers). The presence of financially sound institutions in the form of pension funds and insurance companies in Namibia should facilitate the development of a viable private equity industry. However, these institutions must be ready to go out there and explore available opportunities in unlisted companies. The SME sector, parastatals and other entities also have a role to play in making the opportunities known to potential investors. There are indeed forums/platforms through which the SME sector and the state owned enterprises can make such opportunities known such as the Joint Consultative Committee (JCC)[14] and the Central Governance Agency on State Owned Enterprises (CGA)[15].

12 The !Uri !Khubis abattoir with its debt totaling about N$80 million and assets valued at between N$33,8 million and N$21,2 million is technically insolvent and unable to pay its debt and without reasonable prospect for recovery. In fact the Agricultural Bank of Namibia (AgriBank) has asked the High Court to order !Uri! Khubis to be wound up, no opposition was registered with the court against the order, consequently, the request was granted in 2004.

13 Sound macroeconomic policies are mainly monetary and fiscal policies, while structural policies are: labour market policies, trade and industrial policies, competition policies, etc.

14 For further details, please refer to the JCC website at www.jcc-smepromotion.org.na.

15 For more information on the operations of the Central Governance Agency on State Owned Enterprises in Namibia, please contact them at the following telephone number: 061-254636.

Despite the fact that Namibia possesses a conducive environment under which the private equity industry can develop, there are also some challenges. These challenges, among others, are lack of managerial and professional skills. These skills have been cited to be crucial and supportive for private equity to fully take place in any country. In other words, there is a need for competent management and professional skills. The importance of this in Namibia is attested by some projects of a private equity nature which failed due to a lack of proper and competent managerial and professional skills.

3.4 SUMMARY

The chapter established that there is a scope for private equity (venture capital) in Namibia, especially for the medium-scale enterprises (N$1 million to N$10 million). Furthermore, the chapter also established that private equity financing in its non-venture capital form (i.e. buyout and development capital) can be used to address challenges facing Namibia such as: broadening the ownership of businesses which are dominated by the previously advantaged section of the Namibian society, privatising public enterprises, establishing infrastructure funds and forming strategic alliances in businesses. As a result, existing initiatives must be encouraged to continue and government should take the lead in terms of establishing a venture capital fund for medium-scale enterprises.

However, it must be noted that for private equity financing to work appropriately in Namibia the relevant stakeholders should primarily focus on designing strategies aimed at addressing the lack of appropriate managerial and professional skills within the economy.

CHAPTER 4 EXPERIENCES FROM OTHER COUNTRIES

The purpose of this chapter is to highlight some of the critical issues that are necessary for the development of venture capital and private equity fund in an economy. The experience covered below will be drawn from diverse countries, ranging from developing to industrialised countries.

4.1 DETERMINANTS OF PRIVATE EQUITY

4.1.1 Well functioning legal system

With a longer history of private equity funds, Europe and the United States have well developed legal frameworks which promote the development of the industry. In terms of the legal structure, about 80 percent of all venture capital funds in the U.S. flows through independent limited partnerships, with most of the remaining 20 percent provided by subsidiaries.

The literature cites that an absence of a law which provides for limited partnerships or similar structures, which are the usual organisational set up used in countries with mature private equity industries, could be a constraint for the development of private equity funds. Limited partnerships are structured to address problems of asymmetric information and to align the incentives of the general partners and the limited partners.

In addition, few countries have laws that specifically define venture capital companies and their procedures. The existence of such legislation is usually associated with the existence of tax benefits, and establishes the precise requirements to access them. The ***French legislation*** for instance requires, a minimum paid in capital, and maximum ownership limit of 30 percent for any stakeholder, among others. Other countries with specific venture capital legislations are Australia, Canada, Germany, Korea, Mexico, the Netherlands and Portugal. This implies that for any country to have a successful private equity industry it should have a sound legal system, which is particularly more supportive of private equity.

4.1.2 Government Support

In most of the countries where dynamic private equity markets have developed, their development have been greatly assisted and stimulated by governments. The European governments for example in general appreciate the importance of venture capital and private equity as facilitators of company formation, employment growth and wealth creation. This awareness have shifted focus towards the promotion of an entrepreneurial environment through the creation of appropriate institutional, financial, fiscal and legal frameworks by governments. A number of public funded programmes and incentives schemes, focusing primarily on start—up businesses, have been established.

The Canadian Government has also created a federal government backed labour-sponsored venture capital corporation program which is provided for under the Income Tax Act and related provincial registration programs for labour-sponsored investment fund corporations such as the one in Ontario under the community small business investment funds Act (Ontario). The individual investors who invest in labour sponsored funds are eligible for a federal tax credit equal to 15 percent of the invested amount. However, there is a term limit to investment, that an investor cannot withdraw the investment in a period of less than 8 years. This programme is aimed at providing fiscal incentives (tax exemption) in order to promote investment in small and medium enterprises.

Similarly, the ***Government in Singapore*** has also played a significant role through the creation of appropriate institutions. The establishment of the Economic Development Board has created a favourable environment for start-ups and companies of all sizes, and hence acted as a catalyst for the development of the private equity industry in Singapore. The government was also involved in directly providing funding in venture firms in order to attract private investors funds into these types of business.

Israel is one of the successful countries in the development of a private equity industry. At least part of its success can be traced to deliberate policy decisions by the Likud government in the early 1990s, which took concrete steps to commercialise defence—related technology developed with public funding. The influx of trained engineers and scientists from the former Soviet Union also helped the development of the private equity industry. This review shows that there is a need for government support and involvement in the development of venture capital and private equity industry in any economy.

4.1.3 Sources of Funds

Private equity funds obtain their funding from various sources, the most common ones are institutional investors. Australian private equity firms, for example obtain their funding commitments primarily from domestic institutional investors. In 2001, almost half of the funding was sourced from Australian superannuation funds and life insurance companies. Government provided about 12 percent of the funding, with Federal and State governments investing in private equity through a range of programs. The Australian Government offers tax exemption for superannuation and pension funds in order to encourage them to invest in the private equity industry and the SME sector. The pension funds can invests in SMEs with total assets of less than $50 million whose primary activities are not retail operations and property development. Income derived from investment in small and medium companies is taxed at a concessional rate of 15 percent, rather than 36 percent. Improvements to the tax regime for investment funds in 2002 and 2003, including a concession which cut capital gains tax for foreign investors through venture capital limited partnership, have attracted many large international investment funds to Australia.

Unlike, Australia much of Canada s institutional investment community has been more reluctant to embrace private equity as an asset class. Rather, the pension funds and several of the largest institutional investors have employed their own professionals to conduct direct investment programs from in-house. However, institutional investors have recently supplied limited partnerships (LPs) private equity funds with resources to manage.

In Chile, institutional investors were not permitted to invest in private equity until 1985. Since then, between 1985-1995 the Chilean government relaxed its prudential regulations to 30 percent maximum investment of funds assets in equity. The measures were further liberalised to 37 percent since 1995 till to date. The relaxation of the strict prudential measures which limited the investment in equity to zero is said to have contributed to the development of equity investment and SME activities.

The South African experience shows that institutional investors had been generally reluctant to invest in private equity. A major reason for this had been the reluctance of insurance companies and the pension fund trustees to allow much investment of this type because returns are hard to measure and investments may be unsaleable for several years. Surprisingly, the largest source of funds for the private equity industry in South Africa is captive funds of larger commercial banks.

Independent funds, those funds that generally manage third party funds, are becoming an increasingly important segment of the South African private equity industry s landscape. This sector is mainly dominated by the larger buy-out focused funds. Independent funds make up 37 percent of funds under management at 31 December 2003.

The continuing challenge facing the private equity industry in South Africa is the one of convincing institutional investors trustees that private equity represents a suitable asset class for long-term sustainable growth. This is a crucial campaign as ultimately, the responsibility of investment-policy orientation lies with the pension trustees and not the professional money manager.

4.1.4 Exits and Second tier Capital Market

The two most used exit vehicles for venture capital investors are initial public offerings (IPOs) and acquisitions. It is difficult for a small firm to go public in the main stock exchanges given the numerous and stringent listing conditions. In some countries other exchanges which specialise in selling stock of smaller firms have developed, for example the Vancouver Exchange in Canada and the Denver Stock Market in the United States. Specialised brokerage firms have also emerged.

In the ***United States,*** most venture backed firms that go public first do it through NASDAQ, the over-the-counter (OTC) exchange. This has been advantageous to small firms because it has less stringent listing requirements than the New York Stock Exchange or the American Stock Exchange. A similar role has been played in the ***United Kingdom*** by the Unlisted Securities Market (USM) which was established in the early 1980s. This shows that development of stock exchanges which are receptive to small firms is crucial for investors, but even more for the firms themselves as a way to access additional equity capital to finance their future growth. In the developing world an example of an over—the —counter market is the ***Stock Exchange of Singapore Dealing and Automated Quotation System (SESDAQ),*** which was modelled along the lines of NASDAQ and established to attract small and new companies.

Recognising the need to encourage the growth of small to medium sized businesses, the JSE created the ***Development Capital Market (DCM) and Venture Capital Market (VCM).*** The listing requirements for companies on the DCM and VCM boards are significantly less onerous than for those that aspire to list on the main board. In spite of the relatively relaxed requirements for the DCM and VCM, the markets have not been successful as expected. Only 63 companies are currently listed on the VCM and DCM boards of the JSE (19 on the DCM and 44 on the VCM), representing a market capitalisation of R2 billion (DCM R0.6 billion and VCM R1.4 billion). The survey shows that migration from the DCM to the main board has been disappointing over the years. One of the inhibiting factors for the development of DCM and VCM is the low level of liquidity. This is mainly caused by long periods of no turnover on the DCM and also days of inactivity on the VCM. To address the challenges experienced by DCM and VCM, the JSE and South African Department of Trade and industry (DTI) have launched a joint venture, the so-called alternative exchange (AltX). This exchange is specifically targeting small and medium enterprises. This exchange in addition to enabling these small and medium businesses to raise capital will provide mentorship as well as capacity building and management support to these businesses.

The poor environment for new listings has no doubt contributed to the low number of exits via IPO's. There is a general consensus that indicates that one of the strongest growth factors in the private equity industry is a healthy institutional appetite for new listings. This, implies, that an absence of new listing will not promote the development of the private equity industry.

4.1.5 Skills and Expertise

The performance of the venture capital firms is considerably dependent on the ability of the venture capital managers to: (a) assess the growth potential of a new business, and (b) ensure that the new idea is transformed into a success story. This requires not only financial expertise to produce customised financial structures for the clients, but also experience in industrial management, market research, sales and the like.

4.2 THE PERFORMANCE OF THE PRIVATE EQUITY MARKET

Measuring the performance of private equity funds is always difficult. Private equity valuations are, by their very nature, highly subjective. Funds in the private equity industry judge their performances on the basis of the Internal Rate of Return (IRR) achieved by the fund. The minimum IRR is highly dependent on the risk of the investment and is often associated with the life stage of investment, but risk is also dependent on the industry and the company itself.

When assessing the performance of the private equity funds, it is also important to focus on long term returns. Initial returns over the first two or three years can be misleading if viewed in isolation. High rates of short term return can be achieved through a few attractive divestments, while low rates may result from new funds only just beginning their investment activity. Therefore, any consideration of returns over short term must be done in combination with the scrutiny of the level of investment and divestment activity.

The survey in the ***UK*** indicates that the difference between returns to funds raised at different points of the cycle can be quite pronounced. For instance UK ten year overall annual private equity returns for funds raised in 1986 were 6.1 percent per year, compared with 21.7 percent per year for funds raised in 1989. Since, 1994 funds have shown the best performance of 32.2 percent per year, while 1987 funds have shown the returns of 8.2 percent per year (BVCA, 2002).

The ***European*** private equity industry preliminary performance figures saw a slight decrease in 2003 with annualised net pooled internal rate of return (IRR) of 9.7 percent across Europe, as compared with 10.8 percent in 2002. The 5 and 10 year investment horizon returns across all stages of investment currently stand at 7.2 percent and 11.7 percent respectively. However, that of venture capital stood at 2.5 percent and 8.3 percent respectively, indicating that the non-venture capital part has shown the strongest rate of returns in this cycle, by recording growth rates of 9.3 percent and 12.5 percent respectively (BVCA, 2003).

The private equity market in ***Canada*** shows a target IRR by funds in the buy-out and venture capital domain to be in the range of 25 percent to 35 percent. Canada is one of the economies that have experienced a major growth and diversification over the course of the 1990s, which has included a steady increase in the number of national and local investor groups and funds, as well as the size of capital pools managed by them. One of the key factors behind the growth of the Canadian private equity market is the mounting demand for risk financing from established middle market firms in the case of buyout/mezzanine activity, and from emerging technology firms in the case of venture capital.

In addition, another reason for the tremendous growth in Canada s private equity market has been the proximity to the massive and highly sophisticated private equity markets in the United States of America, fuelled by an ever-expanding volume of assets from institutional investors (i.e. pension funds, insurance companies and endowments/foundations).

In ***Singapore,*** a high degree of government support and participation in the venture capital industry has been phenomenal. The country has experienced a marvellous growth in the venture capital industry. In 1985, Singapore s Economic Development Board, an institution established to act as a catalyst and facilitator to nurture a vibrant, self-sustaining enterprise eco-system, created its own venture capital fund. In 2001, EDB has managed a cumulative total of more than S$11.5 billion of the VC funds (EDB, 2001). In 2002, there were about 133 VC fund management groups/companies, both international and home grown. Currently, there are 635 VC backed companies in Singapore, with more than 500 investment professionals.

4.3 SUMMARY

A sound legal framework and specific laws that promotes the establishment of the private equity industry are crucial. Government support in the form of providing subsidies and tax incentives and taking a lead in the establishment of certain institutions seems to be more crucial than anything else. Skills and expertise in various areas of specialisation should be highly promoted as the venture capital industry s success to a greater extent relies on the availability of appropriate technology and innovations.

CHAPTER 5 LESSONS FOR NAMIBIA

This chapter will draw broad relevant experiences and lessons for Namibia, from both developed and developing economies. This will help the relevant authorities to take account of what is often required for the private equity industry to be established and operate effectively within an economy. The literature shows that other countries adopted private equity as it serves as a gap filler between self-financing and conventional capital market activity.

5.1 LEGAL FRAMEWORK [17]

Protection of investors: One of the primary policy objectives of the laws regulating the private equity industry is the protection of investors. Whether as banks or equity providers, financiers normally have little direct control over the firms in which they invest and depend heavily on the legal system to protect their rights. Since the relationship between a private equity investor and an entrepreneur is fundamentally a contractual one, the manner and ease with which property rights can be protected in the courts is a critical measure. The review shows that Namibia has a reliable legal framework, which protects the interest of investors.

Provision for the formation of venture capital entities: The review shows that a country s institutional formation structure must have sufficient provision for the formation of entities, which meet the basic legal objectives of private equity funds. In the case of Namibia, company s formation structures such as close corporations make provision for investors and fund managers to share in profits and risk. The report prepared for the Ministry of Trade and Industry on the formation of venture capital also suggested that venture capital fund could be formed as a trust under the Namibian trust law. The experience in other countries shows that ***Limited partnership*** is a superior private equity formation structure. A close analysis of the two structures the Limited partnership and Close Corporation do seem to exhibit the same fundamental tenets. This implies that Namibia has an appropriate legal formation structure for private equity industry.

Specific legislation: The review shows that a number of countries with well developed private equity industries have specific legislation geared toward promoting them. It is imperative that Namibia must consider introducing a law that specifically define venture capital companies and their procedures. Specific venture capital legislation serves as a signal for effective venture capital policies. These policies provisions include encouraging a diversity of venture investors, specific tax incentives and spell out the authority s commitment in supporting venture capital and seed firms in various growth sectors. The investors should not assume anything, it is crucial for the policies to be clear and to be on black and white.

5.2 LUCRATIVE EXIT MARKET

One of the financial landscapes which make venture capital investing attractive is the existence of well developed public equity markets, which provide appropriate exits for venture capitalists. The most attractive exit is typically through an IPO and subsequent public offerings at the stock exchange. The review has generally shown that an exit mechanism is a crucial factor for the formation of a private equity industry. It is a known fact that the primary objective of venture capitalist is to make an investment in a venture firm with a clear goal of generating enough profits and thereafter exit the business. In this regard, venture capitalist should be convinced that there will be an exit mechanism at the end of the period.

The Development Capital Board (DCB): The experience from most of the countries, particularly the industrialised, shows that alternative stock exchanges are a feasible vehicle for the exit of venture capitalists.

17 See the Report prepared for the Ministry of Trade and Industry for a detail discussion on the legal framework in Namibia.

The cases in point are; NASDAQ in the United States, Unlisted Securities Market (USM) in the United Kingdom and SESDAQ in Singapore. To cater for small companies which may not qualify under the main board of the stock exchange, the NSX has designed the DCB to encourage the listing of Small to Medium sized businesses on the NSX. Despite this relaxation on the small firms to list on the NSX, this has not even resulted in any single listing. For the company to be listed on the DCB it must have an after tax profit of N$100,000, while the main listing requires an after tax profit of N$500,000. This implies that the current DCB though may contain lenient requirements, there could be fundamental areas which need to be addressed for the listing to be successful. The new approach adopted by the JSE and the South African Department of Trade and Industry to establish an independent exchange could be something the DCB can learn from. As pointed out earlier the new initiative differs from VCM and DCM of JSE in the following aspects: the alternative exchange will provide management support and mentoring to the potential listed companies.

Lack of retail investors: many countries reviewed are characterised by a vibrant market with both wholesale and retail investors. Retail investors are perceived to be of strategic importance particularly for smaller companies in the stock market. However, in the domestic economy it is cited as one of the factors which possibly hinder the development of the stock market.

5.3 SOURCES OF FUNDS

Institutional Investors: The experience from other countries show that long-term capital sources such as pension funds and insurance companies are essential for private equity and venture capital formation. This means that a country with well developed pension funds and life insurance institutions will be better placed to make use of these resources for private equity financing. Previous research shows that the Namibian economy has well developed contractual savings institutions such as life insurance and pension funds which have long-term liabilities on their balance sheets. This situation enables Namibia to have an advantage in the process of fostering the initiatives of the private equity industry towards the promotion and the growth of the domestic economy.

Prudential regulation: Generous prudential regulation, which enables institutional investors to invest their funds in unlisted activities, does play a role in the development of private equity firms. Chile had relaxed its prudential regulation and this has enabled the institutional investors to invest generously in unlisted activities. Therefore, a country should have a generous regulation for investment in unlisted activities to promote the private equity industry. These are some of the reasons, which have played a role in the proposed revision of the current prudential regulations for institutional investors which limit them not to more than 5 percent of their portfolio in unlisted activities. The proposed amendment to Regulations 28 and 15, which require the institutional investors to invest at least 5 percent in unlisted entities is a step in the right direction. It will have a positive effect on the investment of unlisted activities, including the private equity industry.

Business Angels: Despite institutional investors community in countries with well developed private equity industries, the role of business angels has featured prominently in these economies. This is due to the fact that institutional investors at times are perceived to be rigid in their investment decisions because of historical and structural factors. To fill the gap which could be left by institutional investors there is a need to explore other sources of funds such as business angels. This is based on the assumption that a country may have wealthy individuals with surplus funds who may have the passion for investment which contributes to the overall growth and development of the economy.

5.4 SKILLS EXPERTISE

Skills formation: Israeli experience has shown that skills acquisitions and development in the crucial areas can expedite the formation of the private equity industry. In the case of Namibia, lack of skills has hampered performance of some initiatives undertaken by some institutional investors such as GIPF and Namibia Harvest. These institutions have provided funds to a number of unlisted activities. However, the funded companies did not perform well as expected due to a lack of managerial support and expertise. Skills are required to add a non-financial value to young companies in order to contribute to their capital growth.

5.5 GOVERNMENT–FINANCED PRIVATE EQUITY FUNDS

Financial Support: The research paper done for the Ministry of Trade and Industry on private equity activities, proposes three financing mechanisms. These mechanisms are direct financing, loan of a fixed amount to be repaid with interest, and equity investment. Considering the government fiscal position, the second option of providing a loan to be repaid with an interest seems to be a feasible proposition. However, further discussion and research is needed with a view to lay out the proper mechanism for government financial support, as it is beyond the scope of this paper to suggest a clear cut financing channel.

Promotion and development: One of the lessons, which cut across all the countries, with venture capital industry, is the one whereby government plays an active role in its promotion and development. Although the perceptions about venture companies, especially the SMEs remain poor in Namibia, a proper public relations exercise could enhance the profile of this sector. To address this problem, there would be a need to establish a non-profit matchmaking services for medium sized enterprises seeking equity finance. A similar institution was established in Australia and the UK just to mention but a few. The role of this institution would be to act as an intermediary between the venture capitalist and enterprises seeking equity finance. In other words, this institution would find potential businesses and match it with the venture capitalist interested in the same venture. This would address the problem of information asymmetry and reduces transactions cost.

Tax incentives for international investors and business angels: The government of Singapore have introduced generous tax incentives and since then a number of international venture capital firms had established presence in that country. Business angels in the UK obtain tax incentives from the Government through the Enterprise Investment Scheme[18]. An investor is exempted from income tax, inheritance tax after three years of holding such an investment, and also no capital gains tax is payable on disposal of shares after three years. This clearly shows that venture capital industry or private equity being a riskier industry can not develop on its own without the necessary support from the government. Therefore, the Government of Namibia must not only play a supportive role, but must take a lead in the process of the development of this industry.

5.6 SPECIALISATION OF PRIVATE EQUITY

Comparative sectors: There is a trend towards specialisation among the venture capital firms in terms of the sectors they invest in. In the 1970s and 1980s, the preferred sectors of venture capital investment were consumer related industries (leisure, hotel, retailing, food and beverage). Since the 1990s, communications and computer related, electronic related, industrial products, biotechnology, energy, financial services have become popular with venture capital firms. This could be a valuable lesson for Namibia to design its venture capital strategies along the lines of sectoral specialisation. Namibia must identify certain sectors in which it has some competitive advantages and start promoting investment in those sectors. A critical area to be

[18] For details on business angels in the UK see: www.eisa.org.uk

considered is the processing of raw materials with the purpose of adding more value to the exports of the country.

To recapture the main findings from the previous chapters, it is vital to point out that the review suggests that Namibia have a reasonable scope for the private equity industry to develop. The following key issues could be used to justify such an argument:

- The study confirmed that there is a demand for finance by medium sized enterprises which is currently not met by the existing financial institutions.
- The review also seems to suggest that Namibia has a proper legal framework which is said to be a necessary ingredient for the operation of private equity industry.
- Namibia Stock Exchange has a second tier exchange which enables smaller companies to be listed. Though there is a need to market it more aggressively and make some modification e.g. providing capacity building, management support and mentoring.
- The presence of contractual savings institutions with abundant resources could pave the way to and facilitate the establishment of the private equity industry.
- The resolution passed by the Cabinet to encourage institutional investors to put at least 5 percent in unlisted entities promote the presence of the private equity industry.

The fact that the government has demonstrated keen interest in the promotion of the industry through its pronouncement in the NDP2 and a study commissioned by the MTI give a positive signal of the commitment from the relevant authority on the establishment of the industry.

CHAPTER 6 RECOMMENDATIONS

Given the fact, that the genesis of the private equity, more particularly the venture capital industry is traced to government efforts to kick starts the process, it is recommended that the Namibian government should play a significant supportive role in this area. More specifically the relevant authorities should play a role in the following areas:

Promotion and development: The relevant authorities must assume the role of promoting and nurturing the development of the private equity industry. This industry s promotion must be tasked to one specific institution to coordinate the policies and incentives which can stimulate the development of private equity or venture capital in Namibia. A relevant institution to assume this specific role could be the Namibia Investment Centre. The investment centre could also assume the role of providing matchmaking services to the potential venture capitalists and enterprises in need of equity financing.

Private-public partnership: The initiative by the Ministry of Trade and Industry to establish a private-public partnership in the venture capital industry should be further explored and resources should be harnessed and made available. The private—public partnership backed venture capital firms must be encouraged and they should focus on investments in start ups business and early stage investment. This kind of investments are much needed in the case of Namibia, particularly for the SME financing as it will go a long way in addressing the social backlog of unemployment and poverty reduction that confronts the economy. It will also be fair to suggest that, the Bank of Namibia should assume an active role in supporting this initiative by the Ministry of Trade and industry to establish such private equity funds.

Skills import where there are shortages: Given the importance of skills in the different sectors of the economy for the formation of the private equity industry, there is a need to focus more attention to skills formation to support this industry. In other words, skills development should be accorded a high priority for the development of the private equity industry. Recognising the fact that skills formation may not be consolidated overnight, it is argued that Namibia must try to encourage and attract skills which are rare in the economy. In this regard, the Ministry of Home Affairs and Immigration should be lenient in terms of its immigration rules to allow expertise from other countries to be utilised in the domestic economy. However, the authority should adopt clear mechanism to ensure that these foreign expertises are effectively used and skills are imparted to the local people.

Stimulate the listing on the DCB: The NSX should vigorously undertake awareness campaigns and educate the investment community about the true value and risks found in venture-capital companies as this could improve investors appetite for such investments. The Development Capital Board (DCB) should provide mentorship to the potential businesses which could qualify for listing, as well as capacity building and management support. These kinds of services are not currently offered by the DCB.

CHAPTER 7 CONCLUSIONS

The primary objective of this study was to draw experiences from other countries as to what is required for the private equity industry to flourish. Furthermore, the study also attempted to establish whether there is a scope for the establishment of the private equity market in Namibia. To this end, the study reviewed different forms of private equity and established that there is scope for private equity activities in Namibia in both venture capital and non-venture capital forms. However, it is pointed out that the most appropriate vehicle for Namibia is venture capital. The venture capital industry is known to be critical in the promotion of start-up companies, which are generally more important in the case of Namibia. Furthermore, the paper also establishes that there is a scope for private equity in non-venture capital activities.

The experiences from other countries show that venture capital markets have developed, mainly because of government support and intervention to the industry. Government support was witnessed in forms such as; financial, fiscal and legal frameworks. The review also shows that for private equity to flourish there should be supply of funds (institutional investors). In addition, and more critically for the success of the industry, skills and necessary expertise are also required. The review shows that a poor environment for new listings has contributed to a low number of exits via IPOs, which is one of the essential prerequisites for the private equity market to take off and flourish. The study points out that for any venture capital market to emerge and become sustainable, it must be supported by a vibrant, self-sustaining enterprise culture and there must be a favourable environment for start-up companies and companies of all sizes. Finally the paper concludes that there is a scope for a private equity industry in Namibia.

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APPENDIX

VENTURE CAPITAL FOR MEDIUM-SCALE ENTERPRISES IN NAMIBIA[19]

Namibia has a relatively open and well-regulated economy, with mature financial institutions and one of the most successfully functioning stock markets in Africa. Largely as a result of Namibia s history and a highly risk-averse banking sector, Namibia suffers from a severely underdeveloped medium-scale business sector. In most countries, this is the sector of the economy which drives economic growth.

GOVERNMENT-SUPPORTED VENTURE CAPITAL PROGRAM

To address this issue, the authors of this Report have been asked by USAID to make recommendations with regard to ways in which the Government of Namibia can assist in the creation of venture capital resources in Namibia. The report concluded that: given the favourable legal environment and the successes of the public equity market for financing larger firms, there is reason to believe that Namibia can also develop a market for private equity at the level of medium enterprises .

OPTIONS FOR GOVERNMENT SUPPORT

The essence of the government support program proposed in the report is a public-private partnership in which the government makes a relatively passive investment in the venture capital fund (the venture fund), usually in the form of a direct investment, direct loan, or a 100 percent guarantee of a loan made by other investors. These options are discussed in greater detail below.

i) **Direct Loan:** Government provides a direct loan to the Venture Fund at a low rate of interest. However, the government s loan to the Venture Fund is senior to the investors equity in the fund. If the fund managers are not successful, then the loan and interest are paid to the government at the expense of the investors return. If the manager of the fund succeeds in producing a high rate of return, then the return to the investors increased to beyond the rate of return on the fund s portfolio of investments, due to the low rate of interest on the government s loan. In such a program, the government, by subsidizing an enhanced return to the other investors has induced the investors to take a risk they would not have otherwise taken.

ii) **Loan Guarantee:** Government provides a 100 percent guarantee to lenders who provide debt financing to the fund under essentially the same circumstances as those described above in (i). Given the full guarantee of the government, the lenders are willing to accept a relatively low interest rate on the debt, thus enhancing the expected return to the investors in the fund. In this case, the advantage to the government is that it does not need to allocate significant budgetary resources to the Program in order to capitalize Venture Funds under the Program. Normally the government simply takes a reserve against the loan guarantee.

iii) **Direct Investment:** Government invests directly into the Venture Fund as a passive equity investor. The government contributes capital in exchange for a separate class of shares. These shares have payout rights separate from those of the private and institutional investors. As in scenarios (1) and (2) above, the government s investment is structured such that, if the fund is successful, the return to the other investors is superior to that of the government and to that of the portfolio as a whole. If the fund is not successful, then the government has liquidation rights preferential to those of the investors.

FINANCIAL DYNAMICS OF A VENTURE FUND

The most typical formula for compensating fund managers calls for an annual fund management fee, plus a carried interest . The fund management fee provides for modest salaries for the fund manager s team and sufficient money to conduct the operations of the Venture Fund. In the carried interest arrangement, after the investors in the Venture Fund receive a minimum return on their investment (most typically 8 percent), the investors then share the profits of the Venture Fund with the Fund Manager, usually 80 percent going to the investors and 20 percent to the Fund Manager. Thus, if the Fund Manager performs poorly, then the Fund Manager receives only the fee and all profits go to the investors. Under a program in which the government provides a significant portion of investment to the Venture Fund, potential for extraordinary returns to the fund manager is even greater.

POTENTIAL INVESTMENTS

In considering the creation of a domestic venture capital industry in Namibia, it is important to keep in mind that smaller venture funds in the U.S. and Europe typically complete five to seven investments per year. If Namibia were to launch a program to create new funds, it would be most prudent to begin the program with either one or two funds capitalized in the range of N$75 million to N$100 million each. These funds would serve as pilot funds, requiring a combined maximum of 15 to 20 investments per year. From discussions with various business consultants and bankers in Namibia, it appears that finding this small number of Namibian medium-scale enterprises worthy of investment would not be an unreasonable task. Furthermore, once the presence of venture capital is felt within the Namibian private sector, it is likely that the number of medium-scale start-ups and business expansions in Namibia will increase significantly.

NEXT STEPS

- It is recommended that, as a first step, a committee be formed to study the Report and to decide whether or not to go forward with some variant of the type of the programs described herein.
- Proposed composition: leaders in the private and public sectors, including high-level individuals from the appropriate offices within the Ministry of Trade and Industry, the Ministry of Finance, the Bank of Namibia, and the GIPF.
- It should also include at least one representative from each of the legal, banking, and investment banking communities as well as from the NSX.
- Once agreed on the way forward, the following fundamental steps needs to taken into account to initiate the implementation of the program:
    - Drafting of the full written description of the program.
    - Approval of the final version of the program, including the drafting and promulgation of any legislation which may be necessary to implement the program.
    - Articulation of a process for review and licensing of Fund Managers of Venture Funds under the Program and appointment of a review committee.
    - Publication of the Program and call for application for licensing under the Program.
    - Approval of one or two Venture Funds to be established.