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EVALUATION OF PHASE 2 OF THE COMMONWEALTH PRIVATE INVESTMENT INITIATIVE

IMANI DEVELOPMENT

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CONTENTS

GLOSSARY OF ABBREVIATIONS

ADB	Asian Development Bank
AEAF	Aureos East Africa Fund
AfDB	African Development Bank
ASAF	Aureos Southern Africa Fund
ASCI	Administrative Staff College of India
ASI	Aureos Sustainability Index
AusAid	Australian Agency for International Development
AVCA	Africa Venture Capital Association
AWAF	Aureos West Africa Fund
CDC	Formerly Commonwealth Development Corporation, now CDC Group Plc
CDE	Centre for Development of Enterprise
CFM	Commonwealth Finance Ministers
CHOGM	Commonwealth Heads of Government Meeting
CIF	Caribbean Investment Fund
COMAFIN	Commonwealth Africa Investment Fund
ComSec	Commonwealth Secretariat
CPII	Commonwealth Private Investment Initiative
DMC	Developing Member Countries
EIB	European Investment Bank
ESG	Environment, Social and Governance
FMO	Netherlands Development Bank
GP	General Partner
IFC	International Finance Corporation
LP	Limited Partners
MBO	Management Buy-Out
MDP	Management Development Programme
NEPAD	New Partnership for Africa's Development
NZAid	New Zealand Agency for International Development
PEF	Private Equity Funds
PNG	Papua New Guinea
PRI	Principles for Responsible Investment
SAARC	South Asian Association for Regional Co-operation
SME	Small and Medium Sized Enterprise
SSA	Sub-Saharan Africa
VC	Venture Capital

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EXECUTIVE SUMMARY

The Commonwealth Secretariat's Strategic Plan has as one of its goals "*To support pro-poor policies for economic growth and sustainable development in member countries*". The Commonwealth Private Investment Initiative (CPII) seeks to contribute towards this goal by facilitating capital flows and increased levels of investment for private sector development in Commonwealth developing countries. The Commonwealth Secretariat's Economic Affairs Division manages the CPII.

The CPII was launched at the Commonwealth's Finance Ministers' Meeting in 1995 with the main objective of demonstrating that emerging markets and small economies could offer attractive returns for private investors. A second phase of the CPII (CPII 2) designed to focus on the SME sector and promote greater country coverage was launched in 2005, based on a mandate from the Commonwealth Finance Ministers' meeting of that year.

The overall aim of this evaluation was to determine whether CPII 2 is meeting the needs of Commonwealth developing countries as envisaged by Commonwealth Finance Ministers and Heads of Government.

The principal approach that was adopted by ComSec to deliver on the objectives was to support the development and delivery of Private Equity Funds into target markets. Under CPII 2 this was primarily done through a partnering relationship with Aureos, a private equity fund manager that specialises in the SME sector in developing countries.

The relationship with Aureos dates back to when the former Commonwealth Development Corporation (CDC) was the primary agent for delivering private equity investment under CPII 1. The CDC, which is a British government development agency, worked with the ComSec in getting the CPII up and running. CDC devolved its direct management of funds into Aureos, which over time has developed a broad portfolio of PE Funds across Asia, the Pacific, Africa and Latin America.

The relationship between ComSec and Aureos is synergistic, collaborative and facilitative. In the main it is not contractual as ComSec itself does not invest in the PE Funds. As a result, the direct delivery of impact and benefit to the final beneficiaries (being the private sector companies) is done by Aureos through its management of the Funds. The main investors in the PE Funds that have a link to CPII are Development Finance Institutions including the CDC, the European Investment Bank (EIB), the Netherlands FMO, Norfund, the International Finance Corporation (IFC), the Asian Development Bank (ADB) and the African Development Bank (AfDB).

ComSec, through the CPII 2 has supported a number of activities over the last five years, the two major ones being the Management Development Programme (MDP) and the PE Roundtables.

The MDP has been delivered by the Administrative Staff College of India (ASCI), a premier training institute for management development. The courses covered key business concepts for middle-level managers who in many cases had never had formal training in this regard. They have been delivered to over 150 managers from investee companies in Africa, the Pacific and South Asia.

The PE Roundtables (there have been four to date) provided a catalyst to:

- Educate the national pension schemes on PE Funds and how they manage risk
- Provide an opportunity for networking with PE Fund managers and other investment schemes and learn from other country experiences; and
- Expose participants to a new asset class of investments.

A third crucial element of the programme has been the implementation of Environment, Social and Governance (ESG) principles by Aureos in the investee companies. These ESG actions are measured on an annual basis by Aureos.

The focus of this evaluation has been on the Pacific region and Africa where the ComSec CPII 2 programme has been most active. From a PE Funds perspective Aureos is managing the second Pacific fund called Kula II that has invested nearly US$ 14 million to date in SMEs in Pacific Island territories. In Africa there is the Aureos Africa Fund that has invested over US$ 170 million by 2011 across a broad range of SMEs in various African countries. There is also some coverage of a number of geographic and sector specific funds in Africa managed by Aureos, including an innovative Health Fund, that are delivering investment to the types of firms envisaged under CPII 2.

The CPII 2 programme is deemed highly relevant as it has shown "proof of concept" in that investments in SMEs in emerging markets can deliver profitable and sustainable returns on investment and they can adopt good governance principles.

The effectiveness of the programme has been demonstrated through the geographic spread of the Funds which over the life of the programme have moved beyond the major markets in Africa such as South Africa, Kenya, and Nigeria and in the Pacific such as PNG into what are described as second tier countries that have smaller economies and riskier profiles. Equally important has been the broad range of sectors in which the Funds have invested – again demonstrating that sound businesses that need investment capital can be found across the economic spectrum in emerging markets.

Perhaps what has been less effective has been the visibility of the ComSec in these endeavours. While those organisations and individuals with a background in the evolution of CPII are aware of the ComSec connection, most of the beneficiary companies are not aware and even the newer staff in some of the development agencies are not knowledgeable about the ComSec role. Nevertheless there is recognition amongst a number of the intermediary institutions that ComSec is a trailblazer, and has a comparative advantage in pioneering difficult markets. It is seen to have no vested interests or hidden agendas, and despite its very limited resources it achieves access to key stakeholders through this goodwill and impartiality. Greater leverage on these attributes should be built upon in any successor programmes.

It is not easy to assess the efficiency of the CPII phase 2 using conventional evaluation techniques. Nevertheless what can be stated is that the ComSec's approach of working with and through third parties such as Aureos is a very efficient and cost-effective approach, as it does not draw on the limited resources available to the ComSec. These resources that amount to about £185,000 over the period 2007-2011 and one full time staff member have supported not only the MDP and the PE Roundtables but also enhanced dialogue between the PE Fund managers and national institutional investors, and encouraged Aureos to tackle innovative and riskier markets[1]. In the particular case of Kula II, without the intervention of ComSec, it is unlikely that Aureos would have received financial support from AusAID and NZAid that enabled the company to broaden its coverage in the Pacific region.

The overall impact of CPII 2 is best illustrated in terms of the growth and diversification of the PE industry in Africa in particular, as well as the ESG impacts achieved by the investee firms such as increases in employment (including females), taxes paid and foreign exchange earned. In 2010 Aureos had more than US$ 340 million invested in Africa, and its investees paid about US$ 215 million in taxes (US$ 183 mn. in 2009), earned US$ 104 million in foreign exchange (US$111 mn. in 2009) and employed over 32,000 people (25,000 in 2009). While on a much smaller scale, the impact in the Pacific has been equally impressive.

ComSec has leveraged its relationship with DFIs, governments and other development organisations to support the development of the CPII funds. A key question to be faced in the future is the balance between supporting Aureos and ensuring that it is not skewing the markets in favour of Aureos (i.e. ensuring there is a 'level playing field'). Development is about improving markets in sustainable ways. In this the collaboration with Aureos has been successful and has opened the way for other PE funds to follow into these emerging markets

The CPII concept has been a success in delivering on the mandate given to it by the Commonwealth Finance Ministers and by achieving results anticipated under the appropriate areas of work in the Strategic Plan. ComSec maintains a footprint within the venture capital and private equity markets in its developing member states.

The evaluation makes a number of recommendations for the ComSec to consider in going forward. Innovative interventions in facilitating private sector investment in these markets are continually needed. It is recommended that ComSec leverage their success so far by expanding the CPII model in its next four-year strategic plan. Key interventions could include continued support to the PE Roundtable concept, targeted training to investee staff, further awareness raising of the development impact of PE funds amongst developing country national financial institutions, and assessments of innovative approaches to SME financing in developing countries.

[1] For the period 2001 to 2007 which included the preparatory phase for CPII 2 the expenditure was about £225,000.

1. INTRODUCTION

1.1 Background

The Commonwealth Private Investment Initiative (CPII) was launched in Jamaica in 1995, at the Commonwealth Finance Ministers Meeting (CFMM). The main objective of the CPII was to demonstrate that small and developing economies could offer attractive returns for private investors. CPII 2 is delivering to the ComSec's second goal under the current Strategic Plan "To support pro-poor policies for economic growth and sustainable development in member countries."

The CFMM thus envisaged a series of regional venture capital-type private equity funds for developing countries in the Commonwealth focused on difficult and embryonic markets. It followed that a number of regional private equity funds were rolled out in emerging markets in Africa, Asia and the Pacific. To be precise four regional funds were launched, namely:

- **Commonwealth Africa Investment Fund (COMAFIN)** for *Sub-Saharan Africa* in 1996 – with capital of US$63 million invested in agri-business, horticulture, mobile communications, brewery, real estate, mining and private infrastructure. This fund achieved a net internal investment return of 7 percent and individual exits have achieved returns of close to 75 percent;
- **Kula Fund** for the *Pacific Islands* in 1997 – with US$17 million in capital for investments in fisheries, mining, aviation charter services, and palm oil production. Fund achieved capital return with a small premium to investors despite difficult environment;
- **South Asia Regional Fund** in 1998 – with US$106 million for investments in manufacturing, financial institutions, chemicals and pharmaceuticals, achieving an average net return of 19 percent.
- In 1999, the **Tiona Fund** was established for the *Caribbean* region and was subsequently merged with the Caribbean Investment Fund, which had a portfolio of US$44.5 million in investments in petrochemicals and services.

Reviews of these first generation funds stated that they had fulfilled their objectives, demonstrating that equity capital can offer attractive commercial returns in emerging and frontier markets and that they can have a significant development impact.

"The larger funds, i.e. Comafin and SARF have achieved impressive returns to investors while the smaller funds operating in complex environments (Kula) had the distinction of being able to repay all its original capital to its shareholders with a small net positive return in US dollar terms. In the sense of pointing the way for the private sector to engage more fully in developing economies, CPII has had a sound demonstration effect about viable opportunities in economies not otherwise on the radar screen of private investors."[2]

The successes of the first CPII persuaded the Commonwealth Finance Ministers to support a second phase, which was launched in 2005. This phase advocated:

[2] Source: CPII: A Second Phase for the SME Sector. Paper prepared for ComSec by Aureos Advisers Ltd. August 2007

Greater Country Coverage (Geographical Scope), and

- A reduction in deal size; focusing and honing in on small to medium segments of the private equity market (SMEs).

The communiqué from the CFMM of September 2005 stated the following"

"Promoting Investment

16. Ministers reviewed the Secretariat's continuing work programme to help promote private investment in member countries. They recognised the developmental need for investment in smaller businesses and for governments to create the enabling environment to attract long-term capital to this sector. They noted the continuing contribution of the Commonwealth Private Investment Initiative (CPII) in attracting investment into difficult markets. They welcomed the proposal to launch a second phase of CPII to concentrate on the SME sector and to cover a wider range of developing economies. They also welcomed the launch of Kula 2, under Aureos management, and the successful performance of the Caribbean Investment Fund under the management of Caribbean Basin Investors Ltd. They endorsed the further extension of CPII 2 to other regions of the Commonwealth.[3]"

The Commonwealth Secretariat, with CDC and subsequently Aureos Capital Ltd (Aureos) formed a strategic partnership in developing and implementing the Commonwealth Private Investment Initiative (CPII) Funds. The ComSec partnered with Aureos for CPII 2 and in this phase the ComSec was thus working to mainstream access to finance for SMEs as a key tool in economic development, wealth creation and poverty alleviation. Private equity was the route adopted to deliver the anticipated results. Similar to the first phase of CPII, a second generation of regional funds was established, covering sub-Saharan Africa, South Asia and the Pacific Islands, each offering a package consisting of equity capital and technical assistance. The Kula II (US$22 million) and South Asia Funds were launched in 2006, the Malaysia Fund in 2007 and the Brunei Fund in January 2008. Lastly, the Aureos Africa Fund (US$382 million) saw its first close in August 2008, and is now fully closed. The ComSec input was focused on the Pacific Island and Africa geographic areas. A detailed outline of all the funds is presented in Section 2.2 of this report.

In order to understand the relationship between the ComSec and Aureos it is useful to reflect on the gestation of Aureos. The first CPII was conceived through a feasibility study after the CFM had proposed that the ComSec should investigate how it could support private sector investment in Developing Member Countries (DMCs). The feasibility study recommended the establishment of private equity funds and it was decided that the CDC was the most appropriate vehicle to deliver these new financial instruments into its geographic areas of influence. However in 2001 the CDC took the decision to divest itself of its direct role in implementing investment and created two companies to manage its operations. The one was Actis that took over the larger investments usually in excess of US$20 million, and the other was Aureos that took over the SME funds that tend to be investments in the US$1-10 million range. Aureos in turn was jointly owned on a 50:50 basis between the CDC and Norfund. In 2009 there was a full Management Buy-Out (MBO) and Aureos became a wholly management-owned private company. (A similar series of actions took place with Actis).

[3] Source: Communiqué: Commonwealth Finance Ministers Meeting, Barbados, 18-20 September 2005

This legacy which stems from the CDC's role in CPII and the subsequent role of Aureos, over the last 15 years has created an informal but nevertheless strong working relationship between the initiators of the CPII being the Commonwealth Secretariat, and the current implementers and managers of the PE funds being Aureos. As of the time of this evaluation (2011) it is nevertheless important to recognise that there is no formal or contractual link between these two organisations in respect of the PE funds.

Under the strategic partnership with Aureos, the Secretariat's role involved funding feasibility and due diligence studies for these regional funds, facilitating contacts with both local and foreign investors and helping to build the capacity of the companies in which CPII2 funds were invested.

1.2 Overall Objectives of the Evaluation

The evaluation will provide decision makers in ComSec and other relevant Partners and stakeholders with sufficient information to:

- Document the results and developmental impact of the second phase of CPII in terms of funding raised and the volume of investment that resulted in member countries, particularly small and vulnerable economies; the typology of investment (deal size and size of company) and the extent of job creation in investee companies.
- Review the impact of CPII Phase 2 against expectations and relevant CHOGM and Ministerial mandates.
- Examine the effectiveness of the Secretariat's relationship with Aureos and assess the impact of the relationship on Aureos, the Secretariat and Commonwealth member countries.
- Assess the catalytic effect of CPII2 in stimulating other investment flows to member countries.
- Examine the extent to which issues of sustainable development, gender, youth and other cross cutting themes have been addressed, and
- Identify lessons learnt both from CPII2 as an initiative and the Secretariat's partnership with Aureos.

The evaluation will draw lessons from the experiences gained, which could be useful for formulating future interventions; especially in areas where reorientation or a change of approach is required, or for adoption in other programmes. In this regard an assessment of the relationships, roles and mandates of the key players has been undertaken. Observations will be made on the decision-making and consultative processes, reporting and visibility.

Also the investment and economic development landscape has changed significantly since the CPII inception, particularly in light of the Global Financial Crisis and the growth of emerging markets. These factors will influence the future direction of the relationships as well as guide the ComSec as to which directions it should take in the future with regard to investment and private sector development strategies.

The evaluation will report on both quantitative impacts (such as employment, returns on investment) and on qualitative outcomes such as the building of business networks, the enabling environment and models of engagement with the SME sector in developing countries that have been engendered by the CPII.

1.3 Scope of the Evaluation

This evaluation is somewhat different from a standard project evaluation, where the evaluation would be of the delivery agent and its impact on the beneficiaries. In this instance the focus is on the core objectives of the CPII as described above, but this is not an evaluation of Aureos, which is an independent, private company that manages a large portfolio of PE funds, some of which have conceptual links to CPII. So although the evaluation will follow the standard evaluation criteria (relevance, effectiveness, efficiency, impact and sustainability) as far as possible, some aspects will not be that easy to determine and will need to be indirectly inferred. It therefore will be evaluating the extent to which specific PE Funds (managed by Aureos) has enabled the original objectives to be met, together with the other activities undertaken by the ComSec. These other activities include undertaking feasibility studies in conjunction with Aureos, implementing training through the Management Development Programmes (MDPs) and organisation of PE Roundtables.

It will be concentrating on the activities of CPII phase 2 which have been post 2005, although inevitably there will be some reference to the earlier days of the CPII. This report will also be identifying lessons that can be learned and making recommendations on what else the Commonwealth Secretariat may be able to do to achieve the overarching objectives.

2. THE RATIONALE AND ACTIVITIES OF CPII

2.1 The Need for Equity Capital in Developing Country Markets

Many developing economies are characterised by their dependence on international donors and the major challenges they face in implementing economic reforms. Private sector led economic growth initiatives are key to decreasing this reliance on donors, and provides for a path to sustainable development

The growth of the private sector has been hampered by access to capital in an appropriate form, a lack of commercial discipline, and a lack of understanding by the authorities of the commercial risks of investments. These factors have led to marginalisation from the international capital markets thus augmenting the problem. Private equity (PE) funds that target emerging economies look to tackle this challenge by re-assessing the risk of private investment and demonstrating viable returns on their investments. The DFIs and the CPII have encouraged this approach in the hope of building confidence in these markets by other private investors (including domestic financial resources) so that over time there is sustainable expansion of the private sector, thereby contributing to economic growth.

Private investment creates jobs and promotes economic development, therefore exhibiting potential to lift people out of poverty. It should be a clear priority of all agents looking to facilitate development in Africa, particularly sub-Saharan Africa. Private investment can be highly effective when it works in the poorest and smallest countries. By trying to connect them to the international economy, at the same time as helping them to maximise the efficiency of domestic resources, countries can become more attractive destinations for foreign direct investment and develop robust indigenous capital markets.

Private investment is a catalyst for economic development, but for efficient, long-term growth to be achieved, with investment fulfilling its real potential, significant steps must be taken by governments to facilitate the process. In particular, governments must create suitable operating environments for private equity investment, help mobilise complementary funding, and encourage development agencies to assist in defraying the high cost of operating in the private sector, enable local pension funds to invest in private equity vehicles, and introduce benign tax regimes for unquoted investments.

In the 1990’s, private sector capital flows, although beginning to exhibit some tolerance for geographic and political risk, were still tending to concentrate on the major economies and larger transactions in the emerging markets. There was a huge gap in facilitating capital flows to smaller economies, and the SME sector in particular. The Commonwealth Private Investment Initiative (CPII) was therefore launched to try to fill this gap in the short to medium term and encourage effective strategies for the long term.

CPII 2 has an explicit focus on the SME sector. This focus has arisen from the observation that SMEs are generally avoided by fund managers because transaction costs are high, and risk management strategies are more complex, it is difficult to achieve exits for the investments and the appropriate managerial skills are often missing. In addition, in developing and emerging markets there tends to be an excessive dependence on expensive, short-term capital from commercial banks that stifles competiveness and growth of SMEs.

The potential impact of effective investment in SMEs is considerable as they provide widespread and sustainable employment. In emerging markets they are positioned to be the backbone for economic development; it is estimated that around 65% of the private sector is represented by SMEs. SME development can be the catalyst for pro-poor growth through supporting the development of the middle-income class; the keystone for stable, prosperous societies. Societies with a strong middle class are those that can cultivate conducive enabling environments that will then promote stable and predictable economic policies and political systems. The key strengths of successful SMEs are:

- Greater resource use efficiency
- Capacity for employment generation
- Technological innovation
- Inter-sectoral linkages
- Propensity for exports
- Ability to foster entrepreneurial skills
- Locational flexibility; reducing development imbalances across regions.

Although the first phase of the CPII showed that investment in emerging markets can be successful there are still many significant challenges to be faced when attempting to invest in the SME sector. Prominent issues include; management teams lacking a full complement of skilled managers, weaknesses in corporate governance, unsophisticated financial management, a general lack of resources due to scale issues and limited access to long-term debt finance. Of particular concern is the commercial viability of SMEs; this, and many other challenges, must be addressed though management skills training. It is clear that the SME sector needs capital and also capacity building and technical assistance at many levels. SMEs vary dramatically in size and format so meaning a different investment strategy per context is needed. The CPII 2 recognises this need and thus delivers regional funds in a strategy that encompasses capital, technical assistance and capacity building.

"Private equity funds serve as an effective vehicle for meeting the medium and long term risk capital needs of small/medium sized businesses that are not ready as yet to solicit equity through public issue of capital. Besides investment, the value addition from fund managers to the investee companies in terms of corporate advice, board and operation management support and human resource development is significant."[4]

2.2 The CPII Portfolio of Funds Timeline

In the mid-1990s the CDC created and managed a series of funds that were precursors to the current suite of PE funds managed by Aureos. These funds can be directly identified with the CPII concept. The CPII, when launched, had a broad investment focus and operated on a region specific basis through three regional funds. These funds were COMAFIN, Kula Fund and South Asia Regional Fund. The operating plan of the CPII was

[4] Source: Aureos presentation

to "*Enhance the capacity of the private sector in different regions in the Commonwealth*" by:

- Mobilising long term capital for investments
- Emphasising the creation of new assets and the application of modernised technology
- Assisting in the development of local markets
- Combining equity financing with capacity building in financial/strategic planning, marketing and accessing financing, and
- Providing technical assistance and training to develop local management expertise and technical and marketing support for small companies.

At its inception COMAFIN was described as a new and innovative tool that combined capital flows with technical assistance in order to build capacity in the enterprise sector and improve competiveness. One of COMAFIN's key features was an Investment Committee that encouraged the identification and assessment of small and medium enterprises for capital investment. This was as opposed to the prevailing practice where investment proposals were large and had emerged through the CDC pipeline. It achieved an internal return on investment of 7%. The COMAFIN was pioneering and illustrated that investments in private equity funds could work in developing markets and achieve development outcomes. It raised the standards of investment in the target countries, and added to the private sector development (PSD) strategies of the countries in which it operated. It established a Private Equity asset class that was not previously prevalent in Africa. The actual development impact in terms of Poverty Alleviation criteria was however quite limited. A significant proportion of the finance came from CDC, which also managed the Fund, with most of the rest of the capital being committed by investment agencies in Commonwealth countries. ComSec played an important catalytic role in attracting the bulk of these funds.

In 2001 the CDC began to move from being an investor and manager into a fund of funds and created two vehicles to manage its extensive worldwide portfolio. These were Actis and Aureos. Aureos was formed as a private equity fund manager focusing on SMEs. In the first five years Aureos was a joint venture between CDC and Norfund (Norwegian development finance institution). In 2005 there was a capital restructuring followed by a full management buyout in 2009. Today, Aureos is an independent private equity fund manager focussed exclusively on investing in SME companies in emerging markets. Aureos now has 20+ offices worldwide with hub offices in London, Nairobi, Singapore and San Jose. The office in Brisbane deals primarily with the Pacific Island investments. It has tended to define its niche in the SME market sector.

After its establishment, Aureos took over the management of the CDC SME private equity funds (often referred to as the Legacy funds). In nearly all cases these legacy funds have now been fully exited. With a new mandate from CDC and Norfund, Aureos successfully accessed new investment capital for what can be described as a second generation of regional and specialist funds with similar geographic and, to a degree, sector characteristics as the original CDC funds, as described above. As of 2011, Aureos manages 17 PE funds worldwide, all of them in developing country regions.

Phase 2 of the CPII was then launched in 2005. It was designed to build on the experience of the first phase CPII with greater country coverage and a reduced deal size to allow it to focus more on the small to medium segment of the private equity market.

The ComSec works with Aureos Capital to facilitate the delivery of this second phase of CPII. With its focus on SMEs, it looks to:

- Improve the business management skills of SME managers to grow their businesses.
- Broaden the involvement of developing country national financial institutions in PE
- Deepen local financial markets in the target regions.

Within the wider remit of the investment support programme under which CPII falls, the ComSec has also been working to remove the barriers to accessing finance in Commonwealth countries, for example database formulation to facilitate access to information. It also promotes the legislative and regulatory framework for investment in a range of sectors.

As mentioned, Aureos launched a range of second-generation funds covering Asia, Africa, Central and Latin America. The largest of these has been the Aureos Africa Fund that raised US$382 million. This fund also draws on funding from within Africa itself, and can be regarded as the flagship of the objectives espoused by the CPII 2. Some key aspects of this fund include:

- Structure and management: a limited liability company; incorporated in Mauritius and managed by a single Africa team divided into 3 regional hubs (Nairobi, Accra and Johannesburg) plus Aureos satellite offices.
- Average deal size: $2-10mn; 8-10 investments per annum over a 5-year investment period. No more than 25 per cent invested in any one country and 30 per cent in any one sector.
- Advisory Committee – of investors contributing at least $25mn, meeting at least bi-annually.
- Advisory Panel – of local business leaders meeting bi-annually.
- Profile of investors – a broad cross-section of DFIs, Development Banks and private equity investors.

Funds Investment Strategy

1. Building critical mass, multi-country businesses capable of competing globally
2. Pre identification of viable disinvestment options through due diligence

Managers' Value-Enhancing Strategy

1. Proactive deal sourcing
2. Industry and cross border focus
3. Proactive work with portfolio companies
4. Mobilising multiple networks

The evolution of private investment funds with a developing country agenda and which have either a direct or indirect Commonwealth footprint is summarised in Table 1 below:

Table 1: The Evolution of CPII Funds

The table below places in a historical context the CPII funds and relevant Aureos funds, both in terms of their antecedents and recent developments.

Date of Commencement	Fund Name	Observation
1988	**Commonwealth Equity Fund**	The case for encouraging portfolio equity investment in developing countries through 'emerging market' country funds was first outlined to Commonwealth finance ministers in 1988. Shorty after the Commonwealth Equity Fund was initiated.
1993	**Caribbean Investment Fund (CIF)** (I & II)	Established at the initiative of the CARICOM Heads of State with CBIL as the General Partner.
1995	**Commonwealth Private Investment Initiative (CPII) US$200 million**	Launched at the Commonwealth Finance Ministers meeting. The salient aim of the CPII was to channel capital in order to support privatisation, expanding private companies, new ventures and small/medium private sector business in developing Commonwealth countries.
THE CPII FIRST GENERATION FUNDS:		
1996	**Commonwealth Africa Investment Fund (COMAFIN) US$63.5 million**	COMAFIN aimed to promote long-term commercial investments in the development of productive sectors in Africa.
1997	**Kula Fund for the Pacific Islands (KULA) US$16.9 million**	Aimed at encouraging the flow of private capital to the island states of the Pacific region.
1998	**South Asia Regional Fund (SARF) US$106 million**	Was established to operate in the member countries of the South Asian Association for Regional Co-operation (SAARC). Focused on the three countries of India, Bangladesh and Sri Lanka.
AUREOS FIRST GENERATION FUNDS:		
Africa: Regional and Pan-Regional Funds		
Investments spread over both manufacturing and service sectors across diverse industries		
2003	**Aureos Southern Africa Fund (ASAF) US$50 million**	Invested in a number of companies predominantly in South Africa but also in Zambia, Mauritius and Angola.

2003	**Aureos East Africa Fund (AEAF) US$40 million**	AEAF invested in manufacturing, banking and services in Kenya, Uganda and Tanzania.
2003	**Aureos West Africa Fund (AWAF) US$50 million**	Invested mainly in a range of companies in Nigeria but also in Ghana and Senegal.

Asia: Regional and Pan-Regional Funds under the Aureos Portfolio:

- South-East Asia Fund
- South Asia Fund

AUREOS SECOND GENERATION FUNDS:

Asia: Regional and Pan-Regional Funds

- South-East Asia Fund II
- India Fund II
- Brunei Fund
- Malaysia Fund
- South Asia Fund I
- Kula Fund II

2006	**Kula II US$22 million (CPII2)**	Aims to cover the Pacific Islands more broadly than the first generation Kula Fund. The investment threshold has been lowered in order to be able to invest in smaller businesses in more remote locations.
2007	**Malaysia Fund US$25 million**	Focuses on investments in the US$0.5–5 million range.
2008	**Brunei Fund US$25 million**	Aureos will be pioneering private equity investment in the SME sector in Brunei though the Brunei Fund where strengthening the SME sector is seen as a priority for the economy.

Africa: Regional and Pan-Regional Funds

- Africa Fund
- Africa Heath Fund

2008	**Aureos Africa Fund (AAF) $381.3 million (CPII2)**	The second generation Africa Fund is significant in that it is also drawing on sources of finance from within Africa itself.
2009	**Africa Health Fund closed at $103 million in December 2011**	The Africa Health Fund invests in SME companies in sub-Saharan Africa, such as health clinics and diagnostic centres, with the goal of helping low-income Africans gain access to affordable, high-quality health services. The fund will be measured not only by fiscal performance but also by its ability to cultivate businesses serving the poor.

2.3 Other related activities and issues

2.3.1 Overview of ComSec Investment Projects

The ComSec has for a number of years had programmes and projects to support investment flow into developing country Member States. Under the current Strategic Plan that covers the period 2008-2012 the activities come under the Economic Development Programme which has two broad areas of work, namely finance and financial sector development, and economic development. Table 2 outlines the various projects that the ComSec has undertaken during the last ten years under its investment support programme. This programme includes CPII:

Table 2: Overview of ComSec and Partners Investment Promotion Project Support (2001-2010)

Year	Project Description	Value of Project and Budget Source*	Comment
2009-2010	Increasing Investment Flows	£116,000 of which £101,000 from ComSec and CFTC, and £15,000 from AfDB	Umbrella of Investment related projects and includes funding for first PE Roundtable in East Africa.
2008-2009	Increasing Investment Flows	£101,000 from ComSec and CFTC	Umbrella of projects including CPII, Sharing Investment Risks, Investment Promotion under NEPAD, and work on Remittances
2007-2008	Increasing Investment Flows	£267,000 of which ComSec and CFTC £90,000. Balance from TIAF	Umbrella of projects including CPII, Sharing Investment Risks, Investment Promotion under NEPAD, and work on Remittances
2003-2007	Promotion of Funds under the CPII	£93,000 of which £43,000 from ComSec and balance from TIAF	Includes support to SME MDP programme; contribution to pre-feasibility study for PE Africa Fund; and tracking CPII funds.
2005-2006	Mid-Cap Africa Fund and other CPII 2 Funds	£40,000 from TIAF	For investigation of second generation CPII funds focused on SMEs
2001-2006	Promotion of COMAFIN 2 & other CPII funds	£92,000 of which ComSec £9,000 and balance from TIAF	Includes support to establishment of Comafin 2 through technical advice; and attending CPII Board meetings
2001-2010	Total	£709,000	

- All figures rounded. Source: ComSec reports to FMM.

Under the umbrella programme of Increasing Investment Flows sits the specific CPII 2 activities and these can be summarised as follows for the period 2007-2010:

Table 3: ComSec CPII 2 funded activities

Activity	Budget		
	2007/08	2008/09	2009/10
SME Training - Pacific	0	0	£15,000
CPII Financial Services Fund (second year not undertaken due to GFC)	0	£8,000	(£12,500)
SME Training - Africa	£6,500	0	0
SME Training Programme	£18,750	0	0
Aureos Development Impact Training	£10,000	0	0
Aureos Bangladesh Feasibility Study	£15,000	0	0
PE Roundtable (East Africa)	0	0	£29,000
Total	£50,250	£8,000	£44,000

Source: ComSec 2011.
Note two other activities were budgeted but subsequently cancelled.

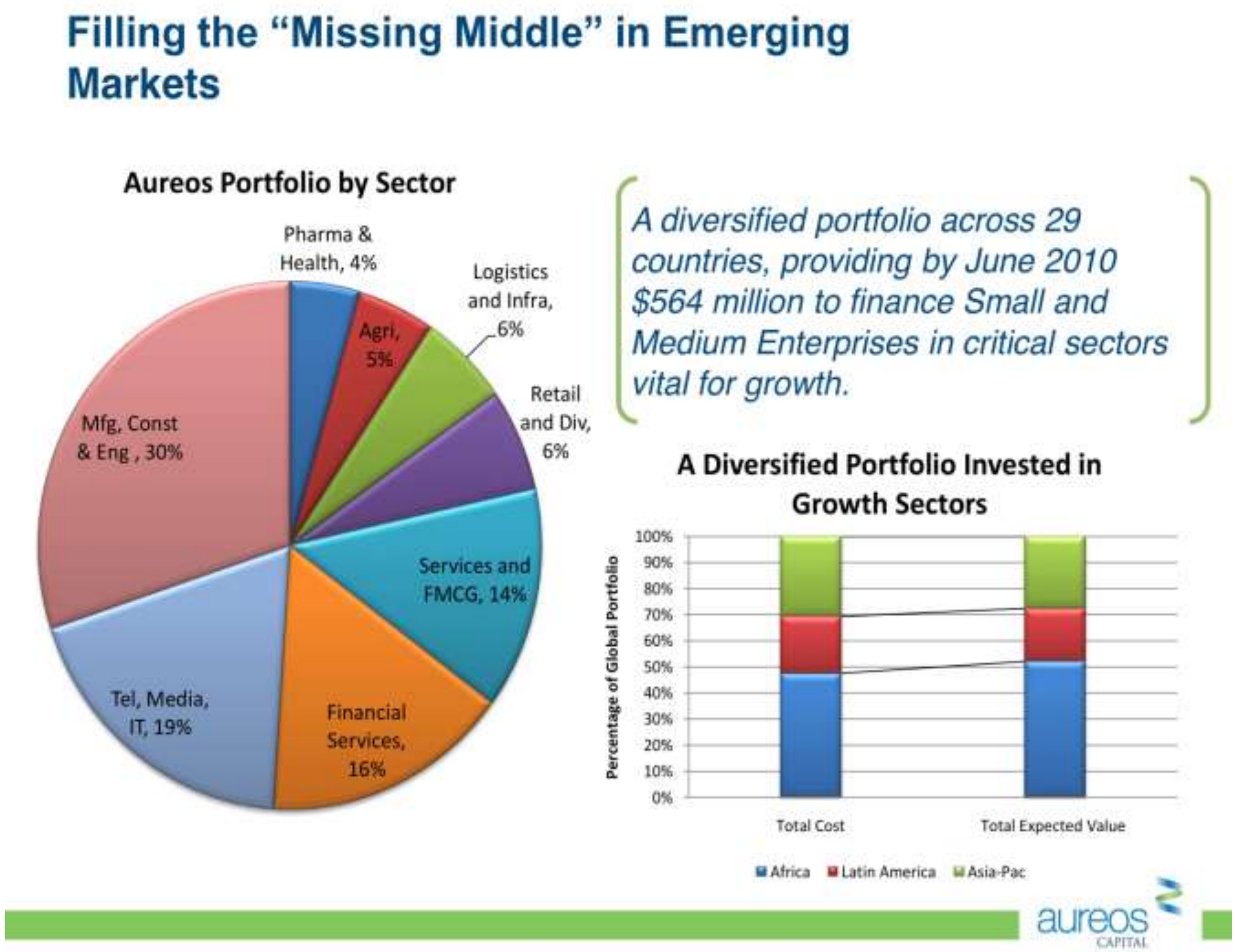
In addition there was an expenditure of £74,000 over the 2010/2011 period for the PE Roundtables in Southern Africa and West Africa and a workshop for Pension Funds in Kenya. In this financial year 2011/2012 there has been expenditure of £23,000 on the PE Roundtable in Nigeria. The AfDB contributed £15,000 that is included in the above figures. Costs have been held down through partnering with local stakeholders, and speakers prepared to give their time for gratis due to the good networking outcomes.

The cumulative expenditure for CPII 2 over the Financial Year period 2007 to 2011 (5 years) based on the figures presented above is approximately £185,000. For the period 2001 to 2007 which included the preparatory phase for CPII 2 the expenditure was about £225,000.

In total the ComSec has invested about £790,000 over ten years (2001-2011) in support of Increasing Investment in its emerging member states and the various sub-activities as presented in the project documentation.

As a measure of how the "missing middle" has been supported by PE funds during this time the growth of the PE investment category in emerging markets can be illustrated by the fact that the total turnover of companies accessing Aureos Funds was about US$130 million in 2005 and was nearly US$5 billion in 2010. This does not mean the same companies grew their turnover by this amount but rather illustrates the exponential growth of (in this case Aureos-managed) PE funds into private companies in the targeted emerging markets. While Aureos does not specifically report on

Commonwealth and non-Commonwealth investee firms, it is estimated that at least half of this turnover comes from companies resident in Commonwealth countries. The geographic and sectoral footprint of Aureos in emerging markets is illustrated by the diagram below:



2.3.2 Technical Assistance

Over the life of the CPII programme the ComSec has provided a range of technical assistance, some of which they have commissioned, others which they have directly organised. There are two main areas of such technical assistance that this review has assessed:

1. The Management Development Programme (MDP)

The MDP

Under the initiative of the ComSec a series of middle-management development programmes (MDP) for SMEs have been held in Africa, India and the Pacific for participants from companies based in Africa, South Asia (excluding India) and the Pacific Islands. The managers were from Aureos investee companies. Depending on the location, these programmes were delivered with co-funding support from the Government of India, the CDE, CS, Norfund, Aureos and the beneficiary companies. The Government of India provided a budget of US$ 300,000 for the programme that was a major contribution to bring the initiative to fruition. A training needs assessment was undertaken on the target companies in preparation for the delivery of the courses

The MDP has been delivered by the Administrative Staff College of India (ASCI), a premier training institute for management development. The course covered key business concepts for managers who in many cases had never had formal training in this regard. Topics included: team building and communications, marketing, basic accounting and business finance, quality management, supply chain management, management decision making and human resource practises.

The key objective was to build local entrepreneurial, managerial and technical skills of managers in the SME investee companies.

2. The Private Equity Roundtables

The PE Roundtables

ComSec initiated a series of Roundtable Conferences on Private Equity. To date these have been held in:

- Nairobi, Kenya 18-19 May 2010
- Gaborone, Botswana 19-20 October 2010
- Accra, Ghana 23-24 May 2011 and
- Lagos, Nigeria 12-13 September 2011.

The forums provided a catalyst to:

• Introduce participants to private equity as an asset class;

• Familiarise participants with the private equity industry in Africa and provide the opportunity to meet with fund managers, investors and other stakeholders, and

• Provide participants with an understanding of the structure of private equity funds, their operations and governance.

The forums also identify priority actions to promote private equity and to contribute to unlocking local capital for much needed private sector investment in Africa. Participants included national pension funds, financial and insurance market regulators, private asset managers, national banks, insurance companies and development finance institutions.

2.3.3 Environment, Social and Governance (ESG) issues

In looking at the impact of the CPII as delivered primarily through the PE Funds managed by Aureos, two distinguishing features emerge. The first one that is discussed in detail below under the respective Funds has been the focus on the SME sector in Commonwealth developing countries. The second is that of the Environmental, Social and Governance (ESG) issue. The application of ESG within the context of the markets and companies in which Aureos operates is highly laudable. The approach taken by Aureos is that the target investments should:

- Ensure environmental, Social and Governance (ESG) factors are integrated throughout the investment process; from deal sourcing to active management enhancing the long term value of portfolio companies and contributing to high exit valuations;
- Allow for achievement of both highly attractive returns and sustainable impact on the investee company; and
- Offer a unique market position in terms of geography, deal size, and investment approach which permits the Funds to achieve both highly attractive economic returns and have a significant positive economic and social impact.

3. EVALUATION APPROACH AND AN EXPLANATION OF PRIVATE EQUITY

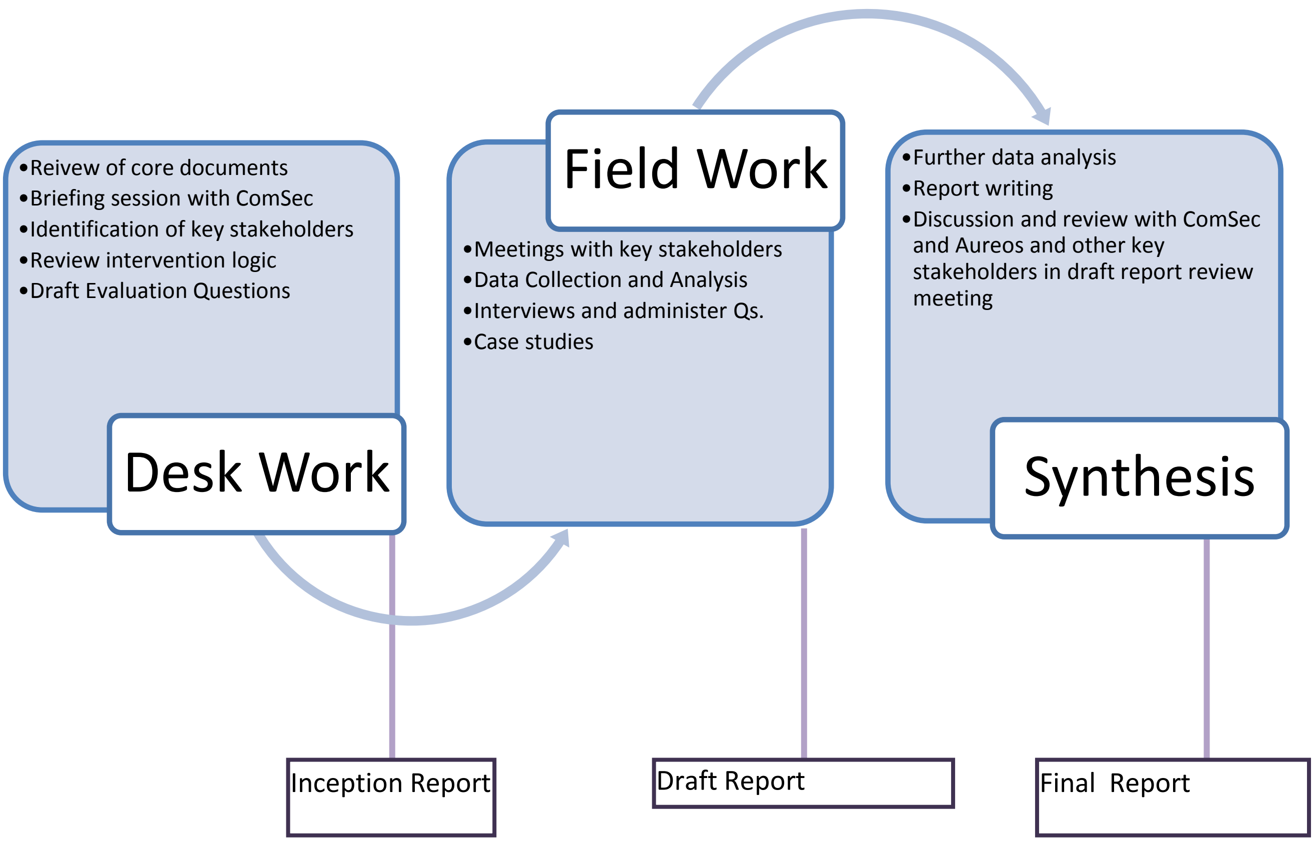
3.1 Overview

The evaluation focused on four key groups of stakeholders to access the necessary information, these being:

- Key Aureos Management Staff - in order to assess issues concerning operational relationships with investors and investees, strategic direction and tactical response, opportunities and risks.
- Investors - in order to assess their views on effectiveness, development impact and sustainability
- ComSec staff and other Development partners providing technical assistance and support - in order to assess relationships, coordination and coherence in strategic intentions, and programme deliverables
- Investee firms - in order to assess value addition of investment, impact on business objectives and social impact (employment, gender, governance etc).

The evaluation comprised of the following phases:

Figure 1 – Phasing of project



At the outset, this evaluation for the ComSec recognised a need to pay considerable attention to confidentiality of information. Information has been provided in some instances that is "commercial in confidence" particularly where it applies to the performance of individual funds as well as information on investee companies. The individual shareholder agreements between Aureos and its investors proscribe the release of such information to third parties. The authors are conscious that this document may eventually enter the public domain and therefore need to err on the side of propriety. Also, the relationship between the Funds' General Partner (Aureos) and its Limited Partners (primarily the DFIs) and the ComSec can best be described using words such as Supportive, Collaborative and Facilitative. However, it is not contractual or even strictly speaking a partnership in any formal sense, as the ComSec is not an investor in the funds. The ComSec is not a member of the Funds' Investment Committees and is not privy to the financial reports provided by Aureos to its Investors. Therefore, there is no fiduciary link between the current Aureos Fund portfolio and the ComSec. From a practical point of view, and without putting too fine a point on it, the PE funds covered by this review are Aureos Funds. This was always the intention – to demonstrate that private sector investors, working on a commercial basis could earn good returns by investing in SMEs in emerging markets. ComSec has never played or sought to play a role in the management of these funds. It should be noted that when ComSec have funded activities (e.g. the Africa Fund feasibility) contracts or grant agreements have been signed with Aureos where appropriate.

It also became apparent during the field-work that only those individuals who had a long history with any of the institutions could recall the "Commonwealth connection". Certainly none of the investee firms were aware of any such connection apart from if they had sent staff on the Management Development Programme training, and even then the ComSec visibility could be described as light. It is noted that the PE Roundtables held in Africa have certainly raised the ComSec profile and the activities undertaken by the Economic Affairs Division continue to promote the role of the ComSec in investment issues in the Commonwealth member countries, but these important actions need to be assessed separately from the performance of the PE Funds themselves.

With this perspective the review has looked in some detail at the Funds operating in the Pacific and Africa as illustrative of the key outcomes and lessons learnt over the last 5-6 years.

It has also been noted that there has been some previous in-depth analysis – primarily from an investment return perspective on some of the CPII funds by Aureos itself where it has benchmarked against international indices. There has also been analysis of Kula I by both AusAid and the ADB that looked at the fund's investment performance and the ESG aspects.

3.2 Detailed Tasks

The focus of the review was from 2005 onwards (though with some reference to impact and lessons learnt of the first phase of the CPII). The review took place from June to October 2011 and covered the following tasks:

i. The desk research phase reviewed all relevant documentation made available to the consultants including reports to the Commonwealth FMM, specific activity reports, the presentations to the three Private Equity Roundtables held in South, East and West Africa, ComSec project files, and reviews undertaken by the DFIs. There are also the quarterly and annual reports prepared by Aureos for its Investors and Cooperating Partners. Comparative research was done on the private equity and development finance market.
ii. Interviews were conducted with Aureos senior personnel. Interviews were held in London, Nairobi, Lusaka, Johannesburg and Brisbane.
iii. Dialogue with key partner investors and technical assistance supporters were undertaken by a combination of questionnaires and interviews, (face-to-face and by phone). These included CDC, IFC, EIB, ADB, AfDB, CDE, ASCI, AusAID and NZAID. Discussions were also held with key personnel in ComSec covering the CPII.
iv. Case studies on illustrative investee companies were prepared to highlight not just the financial impact but also the development impact of the investment in terms of indicators such as employment, skills, ethical practise and sustainability.
v. Country Visits were undertaken to Kenya, South Africa, Zambia, Australia, Papua New Guinea, and Vanuatu.

3.3 The Language of Private Equity

Private Equity (PE) like all investment vehicles has its own defining jargon that is worth having some knowledge of in order to understand the mechanics that drive the industry and the parameters that define what it does and does not do.

Private Equity[5] is the business of investing in unlisted companies. Investors guide the companies they finance and contribute to their development by raising quasi-equity or equity capital. Private equity investments average 5 to 10 years (In the CPII cases mostly 10 years) and boast higher yields than investments in financial markets (upwards of 15% per year) but bear greater risk. Generally speaking, private equity investors are significant but usually minority shareholders in the companies in which they invest, with a seat on the Board affording them a more influential role in their relations with company management and ensures alignment of interests.

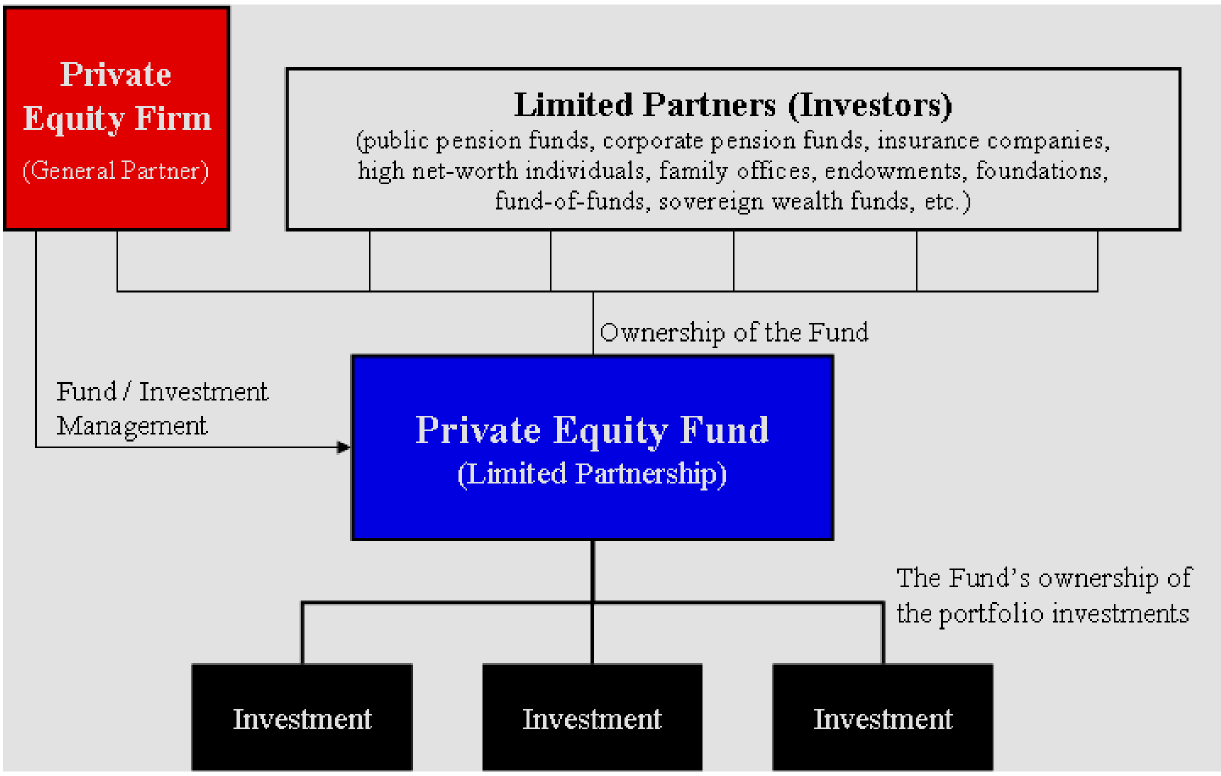
Active throughout all stages of company growth, private equity gears its strategies to the specific needs of each stage. It is broken down into four major segments: venture capital, growth capital, capital transmission and distressed capital.

- Venture capital: Investment in the capital of start-ups that bear risk but promise strong growth thanks to the innovative nature of their technologies, products or services. Venture capital is sometimes set apart from seed capital, which is invested far upstream of the company set-up. The latter is used to finance the development of new technologies, define a business model or, more generally, prepare a product or service launch. Generally not a strategy used by CPII funds.

[5] Source: Where Do Private Equity Businesses Stand on the Integration of ESG Issues? Novethic Working Paper, July 2009

- Growth capital: Entails a minority stake in a developing company with a firm foothold in its market and a high-growth outlook. The purpose of this type of investment is to guide the business directors in devising the company's development strategy in order to create value and a strong cash position in the medium term - the main strategy used by CPII funds.
- Capital transmission: Funding of the acquisition of a minority or majority stake in a company by financial investors and/or managers in exchange for a contribution in capital and debt through a holding company - a strategy used by CPII funds to a lesser degree.
- Distressed capital: Acquisition of financially stressed companies in order to turn them around. Large amounts of debt can also be used in these situations - not a strategy used by CPII funds or by PE funds operating in emerging markets.

The structure of the relationships between the actors in a PE transaction can be shown diagrammatically as follows:



PE Investment Terminology:

Term of the fund – fixed-life with a typical term of 10 years, but extendable for up to 2 years with investor consent;

Advisory fee – also known as management fee and typically 2% of the aggregate committed capital of the fund;

Hurdle rate or preferred return – normally 8% to 12% on their committed capital must be achieved before the General Partner or Trustee can receive its participation in the gains and surpluses;

Gains and surpluses – a participation in the gains and surpluses of the fund (typically up to 20%) is paid to the General Partner or Trustee as a performance return. The remaining 80% of the gains and surpluses is paid to the investors pro rata to their capital commitments;

Return of proceeds – the proceeds of fund investments are returned to the investors as and when the investments are realised and are generally not retained or reinvested by the fund;

Advisory Board: May also be known as Investment Committee, though many funds have both an Advisory Board (focusing on policy) and an Investment Committee (focusing on approving proposed investments). Resolves conflicts of interest and grants permission to the General Partner or Trustee to oversee all prudential limits. The Advisory Board also often reviews valuations of investments.

Reporting and Valuations: Quarterly reports and valuations of the fund's performance and its investments are carried out by the GP/Trustee or appointee and provided to investors. The fund is audited annually. Valuation methodologies set forth in the International Private Equity and Venture Capital Valuation Guidelines are applied.

3.4 Private Equity Key Challenges

Commentators on PE Equity have raised issues of risk (real and perceived) of this class of investment. The key issues and the response of the PE industry to these risks is described in the Table below:

Table 4: Challenges and Risk Mitigation by Private Equity

CHALLENGE	PE RESPONSE
PE is often perceived as a non-regulated sector (compared to listed investments)	Largely self-regulated by contracts with investors perform Due Diligence of fund managers prior to making an allocation. Investors require significant reporting and governance structures. Advisory Committee (composed of major investor base and GP/Trustee): Manage conflicts of interest; Adherence to management obligations; Reporting and valuation obligations
Liquidity	Institutional allocation to PE is generally small in the portfolio, and liquidity to meet capital calls is manageable. Pension funds can afford to invest in assets with a longer term liquidity profile Can be mitigated by investing across vintage years.
Concentration	A PE fund will typically invest in less than 10 companies over its life. Investors can mitigate this risk by spreading their PE allocation amongst several PE funds, or investing in a Fund of Funds (FoF). Also single country funds have higher concentration risk. Regional funds are diversified across countries and sectors as a risk mitigating strategy.
Valuation	Funds apply International PE Valuation Guidelines. Value portfolio quarterly.
Pipeline	Manager must have good sources and network to establish a deal pipeline.
Ability to exit	Proven track record of ability to exit through different methods, e.g. IPO, trade sale, sale to another financial investor, buy-back. IPOs can be very challenging in emerging markets.

The main reasons that a private company would seek Private Equity investment are as follows:

- Increasing its working capital base;
- Improving management; internal financial controls; corporate governance
- Time horizon of equity investments are more aligned to the company's needs;
- To scale up and undertake business expansion and development;
- Developing new technologies and products in order to grow and/or remain competitive;
- To finance acquisitions of other businesses; and
- To buy out an existing shareholder/s in order to restructure the ownership and management of the business.

3.5 Environment, Social and Corporate Governance (ESG) based on the UN Principles for Responsible Investment

There has been much debate and study in the international arena about building ESG principles into the delivery of investment in developing countries. This is in response to the recognition that in many of these countries national financial regulatory institutions may not have the resources or be as robust in their ability to provide oversight.

As a result, the UN-backed Principles for Responsible Investment (PRI) is a framework to help investors to build environmental, social and corporate governance (ESG) issues into their investment process, to improve long-term returns and create more sustainable markets. The Principles were developed by, and for, pension funds and investment managers.

Box 1: The Six Principles for Responsible Investment:

- We will incorporate ESG issues into investment analysis and decision-making processes.
- We will be active owners and incorporate ESG issues into our ownership policies and practices.
- We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- We will promote acceptance and implementation of the Principles within the investment industry.
- We will work together to enhance our effectiveness in implementing the Principles.
- We will each report on our activities and progress towards implementing the Principles.

Aureos is a signatory to these principles. They have also developed a proprietary set of ESG indicators – pre-dating the UNPRI -which they use in the pre-investment assessment and in their monitoring of performance of each of their investments.

The Aureos ESG Index Template is shown in Annex I.

It is noteworthy to reflect on the PRI's comment on the operations of PE's ESG in Emerging Markets:[6]

"As more Limited Partners (LP) commit to emerging market private equity funds, an LP should consider factors that may differ from developed market strategies, including:

- Private equity investments in emerging markets often do not involve the same level of ownership and control, increasing the importance of aligning interests with other investors and company management.
- A General Partner (GP) may not be able to access the same scope and volume of audited information in its due diligence process. Many legal processes may take longer in emerging markets, which often means that enforcement actions may stretch beyond the terms of the fund itself.
- There may also be differences in the regulatory regimes for a variety of ESG factors. As a result, additional legal compliance may be required, and legal compliance is not always a sufficient baseline for performance expectations.

While emerging markets may have risks not common in developed markets, GPs investing in emerging markets may also have more experience with ESG factors. Development finance institutions play an important role in the emerging market LP community. They have used detailed ESG-related performance requirements and been engaging with GPs on ESG factors for several years." ESG factors also promote sustainability of investments. Increasingly private LPs are also focusing on ESG and sustainability of investments.

This certainly seems to be the case when one reflects on the relationship between the GP (Aureos) and the LPs (DFI investors) in the CPII funds.

[6] Responsible Investment in PE; a guide for limited partners, June 2011, UNEP and UN Global Compact

4. EVALUATION RESULTS

4.1 Relevance

When the CPII was launched, it was seen to be in support of the Secretariat's second strategic goal "To support pro-poor policies for economic growth and sustainable development in member countries". The main objective of the CPII was thus to demonstrate that small and developing economies could offer attractive returns for private investors. The second phase of the CPII was refined to have a specific focus on support to SMEs. It is quite clear from the evaluators' research that the activities undertaken by the ComSec through the CPII and the overall approach initially by CDC and subsequently by Aureos have been extremely relevant to achieving this objective. This is demonstrated through the nature of the companies in which the Aureos Funds have invested. Specific reference is made to the Funds operating in Africa and the Pacific.

The Kula I Fund invested in eight companies from 1997 to 2001 in accordance with its investment objectives. Three investments were located in the Fiji Islands and five in Papua New Guinea (PNG). Three investments amounted to less than $1 million each, and five were between $1 million and $2 million each. The investee companies were in manufacturing, fishing, plantations, mining, transportation, retail, and food processing.

The ADB undertook a detailed review of Kula I in 2008 and amongst its main conclusions, clearly demonstrating the Fund's relevance, it states:

"The development impact of Kula Fund is rated as "excellent". The contribution to private sector development is rated as "excellent" overall. Kula Fund helped the private equity industry to proliferate in Pacific Developing Member Countries (DMCs)….The fund manager's headquarters focused solely on operating SME funds in developing countries, provided specialized training for its local team, supervised the collection and implementation of lessons learned, and ensured compliance. Over the life of the fund, 10 persons received both formal and on-the-job training by the fund manager's headquarters".[7]

The Kula Fund II was launched in 2006 to provide risk capital to private sector enterprises based in Papua New Guinea (PNG), Fiji, Cook Islands, Federated States of Micronesia, Kiribati, Republic of Marshall Islands, Nauru, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. The primary objective of the Fund is to provide long-term equity finance to SMEs in the Pacific islands. SMEs throughout the region need long-term financing to take advantage of broadly stable economic conditions, but struggle to meet collateral requirements for traditional debt financing. The Fund aims to fill this gap, and to actively assist investee companies to develop business plans, improve capital structures, and implement international standards of corporate governance. The Fund thus helps to (i) create sustainable private sector jobs in the Pacific islands through its investee companies; (ii) build capacity in a narrow financial sector; (iii) diversify sources of finance available for SMEs; and (iv) build sustainable private sector companies by providing management advice to SMEs.

[7] Source: Extended Annual Review Report of Kula Fund by ADB, February 2008

While a significant proportion of committed capital were expected to be invested in PNG and Fiji, the Fund's overarching objective is to build a portfolio diversified by geography, and no more than 60% of the Fund's total commitments can be invested in enterprises in these two countries. To date, the Fund has made eight investments, two in the information technology (IT) sector (PNG and Fiji), three in various segments of retail (Vanuatu, Tonga and PNG), a Security services provider in PNG, a diversified manufacturing business in PNG and a primary producer in Samoa. The fund is also hopeful of completing an investment in Kiribati and further investments in Samoa and Vanuatu. In order to ensure the Fund has sufficient time to fully test these prospects the Fund's investment period has been extended by twelve months to 1 June 2012.

The Fund works closely with the International Finance Corporation to develop co-investment opportunities. It also partners with ComSec, CDE and FMO on technical assistance and with ASCI on a management development programme that was initiated by ComSec. In addition to its core investors, the Fund Managers, through the support and facilitation of the ComSec, secured core management funding from New Zealand Aid (NZAid) and Australian Aid (AusAid). This amounted to US$150 000 from each agency, each year for three years (2007-2009). Subsequently AusAid did not renew its support but NZAid continued to do so for two more years (2010-2011). This appears to be a somewhat unique occurrence and was predicated upon the recognition of the high transaction costs incurred in operating in the small and geographically disbursed Pacific Islands. The support assisted Aureos to undertake investment missions to the smaller islands, appoint representatives in those countries as well as to provide a higher quantum of management support to the investees.

In the African context, the relevance of both the concept of CPII and the implementation through PE Funds is highlighted by the following information provided by the IFC:

- The first PE groups (e.g. Emerging Markets Partnership formed in 1992 and based in the USA with a focus on infrastructure, AIG Private Equity (part of the global AIG Group), and Zephyr formed in 1994 and focused on developing country markets) appeared in Africa in the 1990's with strong DFI-backing.

- Sub-Saharan Africa (SSA) has one of the lowest PE/GDP ratios worldwide at 0.3 (0.15 if you exclude South Africa) - compared to 1.9 in the USA. This illustrates how Africa has been under-served in attracting private equity investment.

- South Africa traditionally accounted for approx. 50% of PE dollars invested in SSA, however in the last couple of years that ratio has decreased substantially with the diversification of funds across the continent

- Interest in Africa from international investors is increasing but the percentage share of global PE fundraising is still low; there is a strong need for domestic capital to invest in this asset class.

Additional information on the dynamics of the international PE industry and how Africa is performing is available in the 2011 Global VC/PE Country Attractiveness Index. This report sees African countries moving up the rankings, increasing their position relative to counterparts in Latin America and Central and Eastern Europe. Better economic forecasts are central to this improvement, just as they are to the overall level of VC/PE activity in Africa.

Table 5: Global VC/PE Attractiveness Comparison to Peer Group

Region	2007	2011	
	Rank	Index Value	Rank
North America	1	97.4	1
Australasia	2	83.8	2
Western Europe	3	78.5	3
Asia	4	65.4	4
Middle East	5	62.9	5
Africa	7	47.3	6
Eastern Europe	6	44.4	7
Latin America	8	44.0	8

Source: The Global Venture Capital and Private Equity Country Attractiveness Index 2011 Ed. Alexander Groh, Heinrich Liechtenstein and Karsten Lieser. Detailed description of how Index is complied is given in their report.

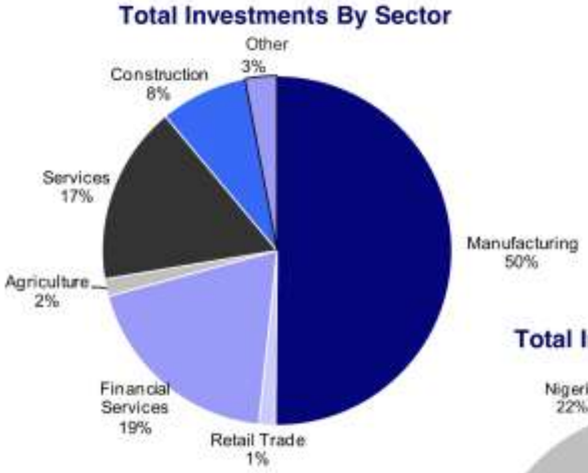
Aureos has also gone a long way to achieving the CPII goal in numerous African markets. Its approach has been very relevant to the market conditions in Africa and the process is sustainable. This has primarily been achieved through:

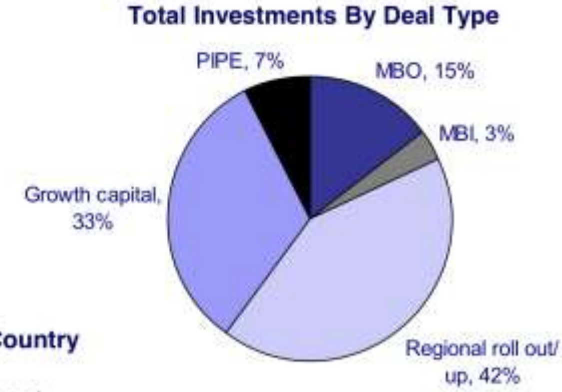
- Establishing a penetration in or being a first mover in the PE market in key locations which are then used as launch pads into a more diverse range of countries
- Leveraging the mainstreaming of PE into smaller economies through their investments.
- Aureos investments also enable the companies to establish operations in smaller countries through both:
    - Setting up of subsidiaries
    - Exports into Africa
- Increasing overall awareness of the venture capital and PE markets in African countries and providing a catalyst for future change in financial regulations and laws to improve the enabling market for the growth of private equity financial services.

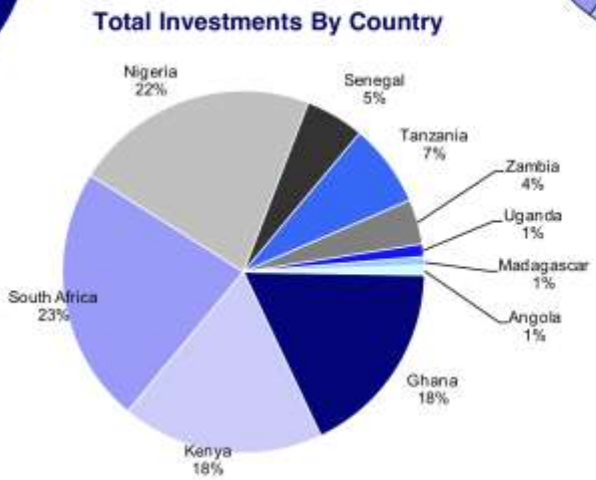
The diagram below illustrates the strategic spread of the Aureos PE Funds in Africa, from a sector, geographic and deal type perspective:

Aureos Investment Strategy (Cont'd)

Diversified portfolio across sector, deal type & geography







Note:
PIPE: Private Investment in Public Equity
MBO: Management Buy Out
MBI: Management Buy In

4.2 Effectiveness

One of the objectives within the CPII has been to have a demonstration effect and to encourage other investors to invest in this field. In this regard Aureos has been effective in attracting a range of investors. For example Kula II investors are the CDC, the EIB, the ADB, the IFC and ANZ Bank. Total committed capital is US$ 21 million and approximately US$ 13.4 million had been invested as of March 2011. All of the investments are in Commonwealth countries.

The effectiveness of the Kula Fund is clearly demonstrated in the above-mentioned ADB review that states: *"Kula Fund's economic sustainability—as well as its environment, health, social, and safety performance—is rated as 'excellent'. Its investee companies have had an important multiplier effect within their economies by generating jobs and income. Almost all investments preserved and enhanced employment opportunities in difficult environments, and they continue to operate profitably. Kula Fund complied or exceeded the standards in host country laws and regulations with regard to health and environment, and the fund manager has extensive in-house environmental and social management capabilities. In addition, its investment allowed a company to complete its research and development, as well as expansion, of an environmentally friendly technology using leftover senile coconut palms for furniture. Another investee company created a township near its PNG plantation with electricity, fresh water, education, and medical care".*[8]

Looking at the Kula II Fund, the concept of a regional PE fund in the developing countries in the Pacific is both fascinating and challenging. From an "evaluator's" perspective there are some interesting metrics:

Characteristics of Fund:

- An average of less than 2 investments per year over the life of the Fund.
- No investments to date in the tourism sector
- No investments to date in the mining or resources sector
- ICT, retail and manufacturing/processing take up the bulk of the current investments
- In most cases the companies fall into the category of medium to large by Pacific standards though would only qualify as small to medium in more developed emerging markets
- Nearly all the firms have been tightly held, family or quasi-family owned businesses.
- In half of the investments the funds have been used to buy-out an existing investor which in turn has led to growth and restructuring of the investee company.

[8] ibid.

Aureos has been very effective through the various Africa Funds in its geographic and sectoral coverage as well as in development of appropriate technology. The Funds in Africa currently have a geographic reach of 22 countries (Angola, Benin, Botswana, Burkina Faso, Congo, DRC, Egypt, Ethiopia, Gabon, Ghana, Kenya, Malawi, Mauritius, Mozambique, Nigeria, Namibia, Rwanda, Senegal, Tanzania, Togo, Uganda, Uganda, Zambia and Zimbabwe). For its Africa Fund as of March 2011, 91% of the funds invested where in Commonwealth countries. Given the size of the African funds this represents a substantial footprint. Aureos has also used its networks and contacts in China, Japan and India to provide a transfer of appropriate technology to the industries in which they have invested in Africa:

- Japan for high precision solutions
- India for innovation and appropriate technology
- China for cost effective and appropriate production techniques and machinery.

This has provided a catalyst for change in these industries as competitors have been forced to adopt similar benchmarks to be able to compete. In some cases the National Bureaux of Standards have used these industries as an example and have improved their required standards for the industry as highlighted in the example of the Kenyan steel company (see case study). Aureos has also where possible encouraged the use of appropriate technology from Africa. They have invested in the Oil and Gas industry in Nigeria that has then used technology from an investee company in South Africa.

Key areas of investment for Aureos in Africa include:

Tourism
Micro finance
Banking
Steel manufacturing
Retail
Printing and publishing
Logistics
Agro processing
Building materials

Aureos is now working with the growing domestic finance sector, and encouraging the networking between some of its investee companies to increase linkages within countries, across borders and more generally across regions in Africa.

It was noted from interviews with senior Aureos personnel that without the support from ComSec, Aureos would not have expanded their market as broadly as they have done.

For the PE market to grow in Africa, Aureos has had to focus on the key regional markets of South Africa, Kenya, Nigeria and Ghana. Here there are larger financial markets, bigger economies, larger consumer markets with opportunities for exports, and enough potential for Aureos to grow a strong, profitable portfolio. Their model of consolidating in these markets and gradually expanding into countries where there are opportunities for economic and regional integration has enabled them to create a platform for growth, and then the potential to expand into both the high risk and small economies in Africa, as illustrated by their current geographic spread of both investments and offices.

Some of the key reasons for this gradualist approach have been:

- The financial markets tend to be very restrictive and regulated in many African countries
- Low sophistication of financial instruments
- Poor competition
- Poor enabling environment for PE and for venture capital investor firms
- Restrictions on national life insurance companies' investments. In many African countries Insurance Funds may not be invested in PE firms.

It has generally been unprofitable for Aureos to invest in the smaller countries given its current structure and financial capabilities and for reasons described above. However, their model of backing companies with a regional footprint has been highly successful and a good model to increase private sector-led development. Therefore, focusing on companies with a regional and or Africa-wide strategic interest is one of the best ways for Aureos to leverage their capital. The underlining driver has been to improve access to finance in the SME sector.

Management Development Programme

The key objective was to transfer technical, financial and managerial skills to senior and middle-management employees of the Aureos investee companies. In total over 160 managers were trained from Africa, Asia and the Pacific. A training needs assessment preceded the delivery of the courses.

The Management Development Programmes have been very effective and met or exceeded expectations of the participants. In the Pacific programmes – two were held in PNG in 2009 and 2010 - of the participants in the 2009 programme, 16 rated it as excellent, 2 as good and 2 as average. For the 2010 course: 18 rated it as excellent, 1 as good and 1 as average. During the field-work for this evaluation in the Pacific, previous MDP participants were met and they re-affirmed the value of the course to their work. This was also confirmed by their senior executives.

In the Africa programmes that were held from 2007-2009 with similar objectives and course content, the participants' assessments were also extremely positive. From the two courses in 2007, 12 rated them as excellent and 10 as good for the 1st course, whilst for the 2nd course 24 rated them as excellent and 3 as good. In 2008, four courses were held - in Africa and in India that included participants from South Asia. The available results similarly indicated that participants rated the courses highly.

- Course 1: 11 excellent; 10 good; and 2 as average,
- Course 2: 19 excellent; and 6 as good,
- Course 3: 22 excellent; 4 good; and 1 as average.

4.3 Efficiency

Because of the somewhat unusual nature of what is being evaluated, as mentioned above, it is not easy to assess the efficiency of the CPII phase 2 using conventional evaluation techniques. Nevertheless what can be stated is that the ComSec's approach of working with and through third parties such as Aureos, is a very efficient and cost-effective approach as it leverages limited resources available to the ComSec. The overarching objectives of the CPII are ambitious and to implement directly would normally require the resources of a major DFI such as the IFC of the ADB. Instead the ComSec has used moral suasion, networking, knowledge sharing and highly focused interventions to maximise its impact.

It is not feasible to calculate a return on investment for the ComSec expenditure as this would raise significant questions about attribution. In other words the expenditure on CPII (2) is in the order of £185,000 over the period 2007-2011 whereas the associated Aureos funds have invested about £120 million in Africa and the Pacific[9].[10] However, ComSec provided substantial influential support that opened the doors for Aureos. Many documents that were reviewed for this report refer to and show the level of influence of the ComSec in this regard. Indeed the reports to the CFMM over the years show that the ComSec's endeavours helped drive the commitment of the member countries to support this initiative.

The limited funds that the Secretariat had available were used for targeting specific interventions such as the MDP and the Investor Roundtables, both of which were relatively low cost operations and according to the participants have been implemented in an efficient manner.[11]

Another example of an efficient use of resources was the contribution by ComSec to the feasibility study for the Aureos Africa Fund. This contribution enabled ComSec to influence the design of the fund in order to pursue CPII objectives.

It would be possible also to drill down to see whether Aureos itself is being efficient in its operations. However the evaluators were naturally not in a position to request detailed information on Aureos' operating costs. It was possible to obtain information on some of its investments. Due to confidentiality of financial information precise figures are not presented in this report but given that the investors continue to support the PE funds managed by Aureos and from the interviews with selected investors the conclusion drawn was that overall the funds are achieving acceptable returns on investment.

Owing to the nature of the asset class, Aureos only has the duration of the fund to remain invested in the companies. This is both a strength and weakness of the PE fund model. It is a strength in that Aureos has to ensure tight management processes and quicker growth to build the SME into a sustainable company that can maintain the growth with an exit strategy to meet the maturity date of the fund. But it is a weakness in that Aureos often has to sell its shares at what may not be considered the best time in the growth cycle of the business. An example of this is that they are currently disinvesting from one of the Africa investees. Company management said that Aureos

[9] Refers to only Aureos Africa Fund and Kula II by end of 2010.

[10] See also Table 5 in Section 4.4 of this report

[11] As confirmed by the Participant Evaluations of the MDP and interviews of key stakeholders

were currently the best strategic partner for them and would have preferred them to run for another 2 years before Aureos sold its equity to other investors.

Aureos exits from their investments are often through trade sales, some to other PE funds, and in some cases the investee company has listed on the stock market. Their investments traditionally run over 5 years with the possibility of extension for another 5 years after which they have to divest. Their average investment is 5 to 7 years. They have in some cases reinvested in a company after a time lapse as they did in Brookside Dairies. Reinvestment is the exception not the norm owing to the complexities this brings.

4.4 Impact

The impact of the CPII Funds has been very significant. Again, drawing on the ADB review of the Kula 1 Fund it states that:

"ADB's investment helped to establish the first private equity fund in the region, and several years after its establishment, new funds targeting small or medium enterprises (SMEs) opened. Kula Fund also assumed a pioneer role and a demonstration effect for investors and local entrepreneurs. In addition, it had a catalytic impact by disseminating private equity investment skills in PNG and the Fiji Islands, where virtually none existed at the time of its establishment….In addition, Kula Fund introduced new financing structures to the region, as when it structured the first three management buyout transactions in PNG. The fund also created entrepreneurial companies that operate profitably today, assisted with the successful listing of an investee company on the South Pacific Stock Exchange, and brought liquidity to the stock exchange by introducing institutional investors into the company. As confirmed by the stock exchange's chief executive officer, Kula Fund had a demonstration effect for better reporting and corporate governance in an environment where only very few companies achieve such standards."

The ADB drew a number of lessons from their experience with Kula I. They also implemented subsequent recommendations to invest in Kula II. The main lessons drawn from Kula Fund included the necessary use of self-liquidating instruments in order to avoid dependence on a single exit event in a volatile economic and political environment, the provision of support for accounting and management practices for successful SME equity investments in the smallest Pacific markets, and a reduced minimum investment size to allow for investments in more remote locations.

Case studies from some of the investee companies illustrate the impact at the beneficiary level.

At **BBS Holdings** (US$ 2.4mn invested by Kula II Fund) which is more commonly know as Guard Dog and is a full-service private security company in PNG since the Aureos investment the company has achieved a number of key objectives:

- It is working towards an ISO 9001 accreditation.
- HR management has been strengthened and improved in quality, and a training needs analysis is underway. Occupational Health and Safety standards in the

group have also been strengthened, including running HIV awareness sessions for its staff.

- Six staff have attended the MDP training courses.
- It has increased its employment that has doubled in 5 years (now about 7000) and is trying to reduce staff turnover –which is naturally high amongst security guards.

It has also entered into innovative joint ventures with local communities to provide security and catering services to the massive Exxon led LNG project in the PNG Highlands and Central Provinces. This involves training to local youths and working with their partners on good business practises.

For **Wilco Hardware** (US$ 2.4mn invested by Kula II Fund) in Vanuatu, the company utilised Kula's investment to build new trading premises in Port Vila and to bring all the three business units in Port Vila into one location. It has been a difficult business environment but there are signs of improvement with the company winning tenders to supply construction materials to a donor-funded school building programmes. The company has a clear mission statement to improve the quality of housing in Vanuatu for Ni-Vanuatu and expatriates alike and to improve the business practices of Ni-Vanuatu in retail and construction systems by providing regular training and development.

Wilco has a policy of training and developing its staff. This is achieved via external and internal training courses as well as supplier assisted product training courses.

The company allocates funding for educational and sporting development for Ni-Vanuatu children and is an active participant in national and community events.

Aureos has strengthened the internal financial controls, and there has also been a CDE funded OH&S review facilitated by Aureos. Six staff has attended the MDP courses.

Pacific Retail (US$ 1.9 mn invested by Kula II Fund) is the holding company for OE Limited (a supplier of office equipment, stationery and printing supplies, graphic design), PTH Limited (a supplier of hardware & construction material), ACE Lionvest Timber & Hardware Limited, Leiola Group Limited and Courts Tonga Ltd. It is one of the largest private employers in Tonga with over 100 staff.

The investment by Aureos has enabled the company to expand and was most timely. It enabled the first privatization to take place with the company's purchase of Leiola Group from the Tongan government. It has also improved business management and planning.

Since the investment there has been improvement in HR processes and procedures. It also adheres to good employment practises paying above-average wages, contributions to superannuation etc. A safety committee has also been established as a result of the ESG review that was funded by the CDE, in 2010. Ten staff have attended the MDP courses. Aureos has also developed business introductions and networking opportunities for the company.

In Africa, when the CPII started with the first funds in mid-1990s there was no developed PE market on the continent. Since then, in concert with Aureos, through their groundbreaking activities and successes they have attracted strong competition and led the way in a market that has grown rapidly. This is a strong success factor of the CPII concept. Aureos are seen as a market penetrator (first mover) and the competition is now watching their expansion and following their lead. Aureos has led the way for other private equity companies to engage more fully in developing economies, and has had a positive impact by showing viable opportunities in emerging economies not otherwise on the radar screen of private investors.

The Aureos Africa Funds have had a significant positive impact on the investee companies themselves. Overall Aureos involvement has:

- Improved the calibre of management, especially middle management. The ComSec training interventions through the MDP have been very successful in this regard. They expose senior and middle management to good management practices and strengthen their understanding of good SME business practices enhancing the importance of developing a strong middle management.
- Made management more sustainable and accountable
- Introduced financial and management information systems
- Improved salaries of middle management and made the internal pay scales more equitable
- Improved the environmental impact management of the various companies and assisted them in some cases through setting a voluntary industry standard in the industry.
- Improved corporate governance
- Opened up new markets

The case studies confirm significant development impact at the micro level with the investee companies.

At **Brookside Dairies** (US$18.7 mn. invested by Africa Fund) in Kenya, the impact has been:

- Increased daily production from 200,000 to 500,000 litres. They will reach a target of one million litres per day by the end of this fiscal year
- Improved brand recognition
- Provides income and livelihoods to 200,000 farmers
- Through their extension services Brookside increased output per cow from 5 litres per day to 10 litres per day.
- Massive impact on improved livelihoods for farmers supplying milk
- Decreased wastage and loss of income especially to small holders.
- Improved supply chain efficiency and much less wastage
- New export opportunities, currently into other EAC countries and with potential further into the COMESA region.
- Introduction of standards into the dairy industry.

With **Sandbox Holdings**, (US$ 8.6 mn. invested by Africa Fund) an IT company in South Africa, the impact of the Aureos investment has been:

- Improved market growth. (They won the Goldfields and other large mining contracts.)
- Increased employment
- Improved health, safety and environments standards. Sandbox's technology has improved the standards of the safety technology in the mines and is driving the standards of safety requirements up through improved ISO certification.
- They have a whole division of green technology. These computer-driven green technology systems analyse the usage of water, lights, heating/cooling and circuitry. Generally these systems produce an average of 30% savings in power usage.
- Sandbox has developed compliance software. Blue chip companies have to be compliant to the myriad of laws and regulations in South Africa. The software manages the compliance profiles of companies, mitigates their risk and increases the good governance ratings. It also provides accurate information to lobby government and authorities for positive change.

Sandbox is rolling its investments out into Africa through well-structured joint ventures where both capability and sustainable technical capacity will be built in the target countries. The first investment in Dar es Salaam is already underway. They are also investigating investments in Botswana, Kenya and Zambia. Through the Aureos network they are being introduced into more African countries and have partnered with an Israeli green technology company.

Scientific Engineering Ltd, (US$ 3.5 mn invested by Southern Africa Fund) is a South African firm manufacturing laboratory equipment and cooking equipment, has seen the following developmental impacts subsequent to Aureos' investment:

- They have continuing adult literacy programmes.
- They train employees in electrical skills, numeracy and other skill areas where staff may be weak so as to ensure that they have a rounded education.
- Their training programmes are totally inclusive ensuring that every level of the staff has training targeted to their needs.
- They have an effective HIV/AIDS awareness scheme for all workers.

Scientific Engineering also benefits through the strong network that the other Aureos investee companies supply. The executive management recently undertook a trip to Peru where Aureos facilitated the whole trip, gave them an office and checked the credentials of the potential trading partners that established new markets for their products. Aureos also set up export contacts for them in the Philippines through their offices in Asia. They are hoping to transition into a world-class business with the support of Aureos.

ARSPL, (US$ 6.8 mn invested by East Africa Fund) a Kenyan steel works, has also seen great benefit from the Aureos investment. Beneficial impact has been seen in:

- The environment in general
- The health and safety in the factory
- Increased productivity in the smelting process and increased profitability
- Training improved calibre of staff and subsequently the wages
- Introduced new technology to the small steel industry in Kenya as a benchmark

- Improved the calibre of overall management.

Another Kenyan company, **Porini**, (US$ 0.6 mn invested by East Africa Fund) in the tourism sector also demonstrated strong developmental impacts from the Aureos investment:

- Increased employment
- Feeding local populations during droughts
- Improved use of the land
- Decreased conflict of local population with businesses as they now manage the land together
- Decreased degradation of the land
- Strong positive environmental impact
- Strong community based development model.

Management Development Programme

The Management Development Programmes, although limited in extent, have had a positive impact. An assessment of the demand for future courses is underway in the Pacific. The report will be presented to ComSec by ASCI but this review was appraised of the significant demand for such training both at the middle management and factory/shop floor supervisory level.

Anecdotal evidence from Africa also re-affirmed the increased need for such training that targets the "missing middle" of management in companies that frequently have very hierarchical and condensed corporate structures. Middle management usually has come up through the company over a number of years and has received on-the-job training, but often lacks knowledge of best practise of core management tasks and responsibilities.

A further benefit has been the networking opportunity for the attendees. This was reported to have been as important to the participants as the training itself. It must be noted that the training would not have happened without ComSec's project development and support.

Environmental, Social and Governance (ESG)

With the ambition to be the leading emerging market private equity fund manager, Aureos has not only focused on providing attractive commercial returns to investors on a risk-adjusted basis, it has also aspired to the MDG targets through much of its investment activities. Aureos' investment approach aims to achieve strong and stable financial returns. In addition, the approach integrates sound Environmental, Social and Governance (ESG) factors into the investment process. This dual mission has provided Aureos investors with attractive returns. Through the bespoke Aureos Sustainability Index (ASI), Aureos has created a proprietary interactive tool to report development impact over the lifetime of its investments. This tool includes:

  - A synthesis of qualitative and quantitative information
  - Comparability across deal types, deal sizes, sectors and regions
  - Insight into the relationship between financial performance and "intangibles"

- A framework for engaging with investee companies on key non-financial issues.

The Review System is run once a year for all Aureos investments and Quantitative data is drawn from the Management Information System. Qualitative questions are covered for each sub-category of development impact and sub-categories are aggregated for an overall development impact rating.

Aureos measures their development impact in terms of:

- Increased efficiency in both the supply and value chains.
- Increased compliance with international financial and managerial best practise
- Improved governance
- Improved value addition
- Employment creation
- Capacity building in company employees
- Improved management techniques
- Exports
- Import substitution

Some of the major results achieved by the selected Aureos Funds are as follows:

- With the critical capital and expertise provided by Aureos, in 2009, $5.6 million was spent on training by investee companies, a 3.2-fold increase per employee versus 2008. In 2009, Aureos made new investments of $142 million in companies that employed 16,000 people.
- In 2010 the investees paid $232.7 million in taxes to their respective governments in 2010.
- The investees generated $123.8 million of foreign exchange from their operations in 2010.

Table 6: Summary of Social and Economic Impact of Aureos Funds in 2010[12]

Fund	**Fund Size (US$ mn.)**	**Employment by Investee Companies**	**Increase in Employment over previous year (average %)**	**Taxes Paid**	**Foreign Exchange Generated**
Africa Fund	382	16,850	60%	$79.8 million	$48.5 million
East Africa Fund	40	7,800	-2%	$55.5 million	$34.9 million
Southern Africa Fund	50	3,737	1%	$66.4 million	$8.8 million
West Africa Fund	50	2,743	-1%	$13.9 million	$12.0 million
Kula Fund II (Pacific)	22	7,045	57%	$10.0 million	$0.5 million
South Asia Fund	123	31,691	80%	$7.1 million	$19.1 million
Total	**667**	**46,769**	**10%**	**$232.7million**	**$123.8**

[12] All of these funds have a geographical and conceptual link to the objectives of CPII 2.

					million

- Source: Aureos ASI Data for 2010. Increase in employment data is only an approximation due to slightly different year-on-year data sets.

The table above shows that there has been very positive impact in these areas. To further illustrate how the PE funds have grown in impact, the following data for the Africa and Kula II funds is presented below:

Aureos Africa Fund	**Employment by Investee Companies**	**Taxes Paid**	**Exports Generated**
Year			
2010	16850	\$79.8 million	\$148.1 million
2009	10532	\$54.8 million	\$107.5 million
2008	4729	\$12.8 million	\$21.4 million
Kula II			
2010	7045	\$10 million	-
2009	4472	\$ 8 million	-

However, while the Aureos Sustainability Index does cover all of the aspects that a review of ESG issues would target, it is not feasible to report in numerical terms on such aspects as environment, gender and other social issues. These are given qualitative measures in the ASI reports. Also for data on employment of women in the investee companies and the percentage of women that are in management positions, these are measured at the company level but not on an aggregate or year-on-year change basis. For these it is necessary to review specific case studies at the corporate level to see what the investee companies have achieved in this regard. From those companies reviewed above and from the review done by the ADB on the Kula Fund, it appears that the investee companies often have had a real positive impact in these cross-cutting areas.

It is also to be noted that Aureos adheres to the IFC and PRI requirements of ESG. Therefore environmental assessments are undertaken on all investees to ensure that no harm is being done to the environment and where necessary mitigating measures are put in place. There is also significant attention given to work place health and safety, with audits and technical support being delivered where required. By encouraging good management practises and staff development Aureos has also influenced the work place relations at investee companies.

In cooperation with some of its key investors, Aureos launched a new initiative to help small and medium sized businesses in the emerging markets improve their environmental and social performance. The SME Sustainable Opportunities Initiative provides financial support to address challenges including reducing carbon emissions, improving energy and water efficiency and reducing effluent discharges.

Another innovation for a private equity investor has been a HIV/AIDS risk mitigation programme that Aureos initiated in its portfolio companies in Eastern and Southern Africa. The implementation of this programme directly bears on MDG Goal Six, stated by the UN as: 'To combat HIV/AIDS (and other infectious diseases)'.

4.5 Sustainability

Sustainability in the context of CPII has two main elements. The first is the growth and sustainability of the companies in which investments have been made. In this regard the approach that has been taken by Aureos is as follows:

"A key element of Aureos' philosophy has been its firm belief that strong management capacity and sound corporate governance are fundamental components of successful private equity investment in emerging market SMEs. The quality of management and governance is a critical determinant of the commercial performance and sustainability of its investee companies. This view emerges from the growing body of evidence that the SMEs most likely to prosper are those with robust management, optimal organisational structures, transparent decision-making processes and accountable supervisory frameworks. SMEs must be well-managed and governed in order to thrive in opaque yet highly-competitive conditions, where access to markets, information and capital is asymmetrical, where the playing field is far from level and where the macroeconomic environment can be unfavourable."[13]

Many of the investee companies that have been reviewed demonstrate sustainability in terms of the companies' own growth and development. They are also often contributing to broader indicators of sustainability in a development context through the contribution they are making to the economies and societies in which they operate.

The second issue is with regard to the sustainability of the emerging market PE model. Aureos has successfully demonstrated its ability to attract funding from a range of DFIs on an ongoing basis each time it launches a new fund. New entrants are also moving into the PE business in developing regions and investing in similar sectors. These factors are a clear demonstration of the sustainability of the CPII concept. Furthermore Aureos is making adequate returns on its investments, allowing continuation of its activities. The recent revamping of the Africa Venture Capital Association (AVCA) is also a positive development for sustainability of the domestic PE industry in Africa.

However an ongoing challenge is that local financial resources such as institutional pension funds need to be brought into supporting the PE funds. The comment from Aureos along these lines is as follows:

"Often there are sizeable sources of institutional savings which need to be channelled into investment of this sort, both to demonstrate to external investors a strong degree of local support signalling confidence in the economy and backing for the SME sector and to create a new class of long term assets for the investment community and for pension funds in particular. A related point is that it would also provide local investors the opportunity to

[13] Source: COMMONWEALTH PRIVATE INVESTMENT INITIATIVE:A SECOND PHASE FOR THE SME SECTOR, paper prepared by Aureos fro CFMM, 2007

get exposure to private equity as an asset class, which has demonstrated high profitability globally and increasingly in Africa as well. Through participation in the Fund's Advisory Board, these institutions would also become exposed to investment opportunities in other parts of the continent for purposes of their asset diversification. Unfortunately, in many cases, existing regulations prevent local institutions from being able to invest in offshore private equity funds."[14]

The PE Roundtables have tackled these issues head-on and created a significant awareness amongst the local financial institutions of the opportunities. The increasing PE portfolio in Africa of major DFIs like the IFC and AfDB has also given confidence to the market. As indicated in Annex II there are now a broad spectrum of PE Funds operating in Africa and this asset class has matured over the last ten years.

There are still significant challenges in the Pacific region where the geographical dispersion, and small economies have not seen a similar situation develop. Aureos remains the predominant regional player. At the time of this report serious consideration is being given as to whether there will be a Kula III, and if so what will be its characteristics in terms of market and sector focus.

[14] Source: ibid.

5. CONCLUSIONS AND LESSONS LEARNED

The strategic partnership between the ComSec and Aureos has been a mutually beneficial one in enabling the objectives of the CPII to be realised.

CPII 2 has shown that PE can have an impact on private sector development in emerging markets. From the perspective of this evaluation, the ComSec and Aureos have effectively piloted this area of development in Africa, Asia and the Pacific.

It was noted that particular key challenges faced in the PE market in Africa included:

- The type of companies that Aureos targets are generally family-owned businesses that have a hands-on management style with a generally strong top-down management style with limited delegation. This often results in lower paid and ineffective middle management.
- Training middle management is a challenge. To employ the right calibre in SMEs is often too expensive so middle management capacity building becomes a key deliverable for these projects.
- Underdeveloped financial services markets provide a poor enabling environment for SMEs to access finance and stimulate growth and increase their competitiveness.

However, Africa holds good potential for a positive impact of private equity funds. Recent trends indicate that the investment environment in Africa is becoming more conducive due to:

- Economic liberalisation: Transparent legal and regulatory frameworks are being implemented and are promoting the development of the private sector led growth
- Regional and Pan-African Integration: Partnerships such as NEPAD have demonstrated the political will of African Leaders to foster regional and continent-wide economic integration and development
- Privatisation: In some regions a growing number of governments are privatising state owned enterprises in high potential sectors
- Technology and Infrastructure Development: Improved telecommunications and transport infrastructure are transforming the conduct of business in Africa.

This review has been conducted with an understanding that economic development is dynamic and presents constantly evolving opportunities and challenges. The enabling environment over the time of the CPII (1 & 2) has changed radically. It is therefore somewhat unrealistic to assess the mid-1990s or even the 2005/06 management decisions in terms of today's environment and vice-versa. The body of knowledge surrounding Private Equity as a tool in development has also grown rapidly.

In 2003 Aureos was much smaller and relying on the CDC legacy, but by 2011 they are a fully-fledged, highly competitive PE fund management company and have attracted a large increase in funds under management. ComSec's relationship with Aureos had a nadir in 2006/07 but through careful management by ComSec this has been rectified and they now enjoy a strong relationship with good synergies. ComSec will need to be more flexible in the future on how they engage with Aureos, as Aureos has grown both in scope and coverage and is having different needs.

When reviewing the overall impact of the CPII it is important to understand what we hope to achieve by private sector development. The CPII approach has been to build sustainable and competitive SMEs. However, at the strategic level of programme goals there are ongoing debates in the development community about impact on poverty, and what is meant by private sector development. This can possibly be explained by looking at the two opposite ends of the debate. On the one side the argument is that supporting Private Equity is not the role of a development aid agency. PE is all about making shareholders profits, achieving high returns of investment, competing in the commercial financial space and due to the nature of the business each Fund only directly impacts on a very small number of companies. This position says leave it to the market and international finance to provide the solutions. Such positions would suggest working in a different private sector development space such as microfinance or rural agri-business in order to get nearer to the needs of the urban and rural poor.

The alternative viewpoint is that private equity in developing or emerging markets provides a catalyst to growth and a source of finance that SMEs that are in the "missing middle" would not normally be able to access. The impact is not only in terms of providing sustainable business growth which has multiplier effects in terms of employment, taxes paid and human resource capacity building but also provides "champions" that other SMEs can emulate. The position is that many mid-size companies[15] in developing countries are trapped in a business model of being family-owned, under-capitalised and with weak corporate governance. PE helps to break them out of this logjam. In essence PSD support is about enabling the SME sector to grow. History has proven that private sector growth comes through a vibrant, enabled and adequately resourced SME sector.

But what about the economic growth and pro-poor aspects of this position? There are two issues that bear consideration in this regard. Firstly (and why PSD gives donors a challenge) is that by definition private sector growth means a growth in turnover and profits. Over-burdening companies with social obligations or excessive donor bureaucracy can defeat this main objective. However, the role of PE that incorporates ESG is to continue to place the emphasis on business success but with a manageable overlay of good governance and ethical behaviour. This in itself can help to break the cycle of transfer pricing, tax avoidance and rent seeking so prevalent in many developing countries. The ESG aspects of this review clearly point to some considerable success for which CPII can be suitably proud.

Secondly, and somewhat more controversially, many of the social problems in the Pacific countries and to a degree in Africa are actually urban-based. In extreme cases civil disobedience has tended to be driven by the unemployed, extremely dissatisfied, urban poor youth who can be easily manipulated by the politically disaffected. Providing stable formal sector employment opportunities in the urban centres is a crucial ingredient to economic growth and social cohesion. Without over-exaggerating the impact, there is no doubt that the companies supported by the PE investors under CPII continue to play an important role in providing these opportunities in the countries in which they are operating.

[15] While recognising all the contextual and definitional problems this refers to companies with capital values in the US$1-$5 million range.

There is no “correct” answer to this debate. Does one take the shotgun approach by spreading resources into for instance many microfinance institutions, or focus on running numerous training programmes for rural farmers? Or does one take the rifle approach and focus on a few precisely targeted interventions? In most cases it is not an either/or discussion and development agencies – if they have the mandate and sufficient resources - do both. For CPII it has mainly been the latter – the targeted support to “SME champions” or more precisely by supporting Aureos, itself a “first mover” in these emerging markets.

The CPII has demonstrated that you can invest profitably into an emerging market. This review also demonstrates that PE has been successful under the development criteria used in CPII 2. The key principle was to provide a catalyst to establish a PE market to promote the development of SMEs. ComSec has played an important role in this with its wide networks, facilitation and targeted interventions. They have through their relationship with the Commonwealth member countries, DFIs and other financial institutions assisted effectively in helping Aureos to access capital and development funding. Through the feasibility studies and facilitator measures Aureos has matured and as a first mover now leads the market in new directions.

Some of the targeted interventions have been highly successful. For example, the feasibility study for the fund in Bangladesh (cost £15,000) resulted in positive outcomes that generated new investments. Aureos would not have done this study if it had not been funded by ComSec. ComSec was a catalyst to identifying potential opportunities for the investment funds that brought change.

The **Private Equity Roundtables** is a very worthwhile initiative. They provide a helicopter view of the Private Equity industry and market opportunities in Africa and were instrumental in bringing all the key PE fund managers together where there was a sharing of knowledge, ideas and future strategies. They served to build a network and introduce all the African fund managers to each other. National Pension schemes in Africa do not ordinarily invest in regional PE Funds because of the perceived risks of cross-border transactions, and therefore would not have normally attended such events without the ComSec involvement and support.

The **Management Development Programme** also provided a complementary activity in support of the investee developments being undertaken by Aureos. The concept of using a training institution from another developing Commonwealth country proved very effective.

ComSec has leveraged its relationship with DFIs, governments and other development organisations to support the development of the CPII funds. The key question now facing the institution is the balance between supporting Aureos and ensuring that it is not skewing the markets in favour of Aureos (i.e. ensuring there is a ‘Level playing field’)? The counterfactual question is ‘would the PE market be where it is today in the developing countries without the support provided to Aureos’? Development is about improving markets in sustainable ways. In this the collaboration with Aureos has been successful and has opened the way for further support through other fund initiatives such as health funds, environmental funds, green bank initiatives and other such innovative instruments.

In 2001 there were low levels of funds in the private equity capital emerging markets in Africa[16]. For instance in 2001 Aureos had US$35 million in funds under management but by 2011 it had more than $500 million. The relationship with Aureos is important for ComSec as it gives ComSec credibility with both member states and in the financial markets. Therefore, it would be effective for ComSec to leverage the Aureos relationship in such a way that it mitigates any partisan behaviour, and to encourage new and innovative approaches to increasing investment flows into the developing Commonwealth countries. The success of working with Aureos could also be leveraged by sharing the best practices and lessons learnt with other development partners, national provident funds and the DFIs.

If there is one particular critical lesson that has become apparent from the review it is that of Visibility. From an institutional perspective ComSec has very limited visibility amongst the beneficiaries of the CPII, which ultimately are the investee companies. This is a common problem for an institution operating in this space as a catalyst or facilitator rather than as a capital investor. Even amongst the investor DFIs and the donor agencies there is little current knowledge of the role played by the ComSec. A few key individuals (for example in CDC) retain an understanding and knowledge of the CPII because they were involved at the outset, and through the PE Roundtables there is some awareness of ComSec's interests. In hindsight it may have been possible to increase this visibility (such as by a formal PowerPoint presentation on CPII at each of the Roundtables) and by an expanded engagement with donors such as AusAID and NZAid on the role of private investment in the Pacific economic development agenda.

ComSec is a trailblazer, and has a comparative advantage in pioneering difficult markets. It is seen to have no vested interests or hidden agendas, and despite its very limited resources it achieves access to key stakeholders through this goodwill and impartiality. Greater leverage on these attributes should be built upon in any successor programmes.

[16] See IFC and AfDB data for details.

6. RECOMMENDATIONS

6.1 Enhancing awareness of PE markets and building capacity

As with all innovative financial instruments there is a fear of the unknown and countries need to be made aware of what PE is and the tremendous opportunities and benefits a well-established PE and venture capital market brings to the development of the private sector. It reduces dependence on donor funding, increases employment, improves human capacity, increases the industrial base, brings import substitution and creates exports. The message is that the PE investments deepen the markets, and increase the professional and business skill sets of both national financial intermediaries and the investee companies.

ComSec's key role in the future can be one of:

- Promoting the concepts
- Increasing awareness
- Working with governments to create an enabling environment for the growth of the PE markets in the developing member countries
- Building the capacity of Venture Capital associations (i.e. South Africa Venture Capital Association and Africa Venture Capital Association) and other related organisations that better enable the development of the PE markets in emerging markets.

This can be done through:

- Investment Road shows
- Facilitating the bringing of funds, governments and private sector together
- Running more PE Roundtables
- Running workshops with key financial stakeholders both nationally and regionally to increase knowledge and understanding of what PE is and its advantages to SME development
- Working with strategic partners (EIB, IFC, Norfund etc) to deliver these services through partnerships and co-financing
- Facilitating the running of PE courses at key universities in developing countries. This would have two levels for:
    - Practitioners in the PE industry
    - Support organisations, government economic ministries and regulators.

Recommendation: ComSec should look to build an intervention under the auspices of CHOGM or the CFM meeting (this is essential to ensure ownership and maintain commitment at the highest level) to run a third phase of CPII where the focus is on an awareness campaign and capacity building in the emerging PE markets. ComSec should continue working with Aureos and expand its own outreach to engage other PE firms in this campaign. This could be achieved through establishing a series of forums across the targeted Commonwealth countries. The objective would be to build core capacity in key financial intermediaries to understand the process and impact of PE on enterprise development. Forums/organisations that are already established should be used where possible so as to avoid duplication, rivalry and to ensure that the participants in the market have similar objectives. The programme would also investigate the misconceptions surrounding the PE market in both the UK and the member states, and demonstrate how human capital intensive it is to manage and implement effectively, especially when required to deliver against strong development criteria.

Recommendation: One of the keys to the future in expanding the impact of PE is to effectively engage the domestic pension funds, and this could be an area where ComSec could develop a role that has been started through the PE Roundtables. It would have to be a Medium to Long Term strategy in partnership with the Breton Woods institutions and support from key DFIs. This would require the commitment of considerable resources both financial and in technical assistance from all parties involved in this initiative.

Recommendation: ComSec could fund a team that provides technical assistance into the emerging markets that will build a base of proficient fund managers in the market. This could be done in partnership with the DFIs, as the key for the intermediary finance organisations is to grow the development of core professional skills capacity.

Recommendation: ComSec should continue hosting the PE Roundtables for the next couple of years to ensure their future sustainability. It will have the impact of an independent forum where PE Funds and other investing partners can network and learn from each other. These Roundtables can add to the sustainability of the Private Equity Fund market in a way that does not advantage Aureos in the long run against other funds. The aim would be for this intervention to deliver enough value through improved market opportunities so that it would become self-sustaining.

Recommendation: ComSec could support the initiative that IFC and other DFIs are putting together for a programme to strengthen AVCA. ComSec support to this initiative would be very useful because it is an impartial organisation that represents a wide membership. AVCA is also a neutral player that, if it becomes self-sustainable, will enable a deeper understanding of the PE and venture capital approaches, raise standards and also analysis of impact. The approach could subsequently be expanded to other regions, such as West Africa where there are venture capital associations in the formative stages.

6.2 Further support to innovative funds

ComSec could support the process of investigating and then developing innovative forms of private equity investment. Some of the ideas that have emerged include the following:

- **Environment and Climate Investment –** this is high on the agenda in development and equity markets and requires catalytic support to get the processes effectively launched. This is a high policy initiative but there are few skills to implement this agenda in Africa, Asia and the Pacific. It would require a feasibility study initially to see where and how PE can be most effective. The idea is to set up an environment fund to support initiatives that are "green", support energy efficient interventions and investments and to generally support any investments in SMEs that make them more energy efficient. There are a large number of technical solutions available in China and India that have relevant technologies for SMEs in developing countries. South Africa has also recently developed a number of Africa-centric solutions in the environmental impact arena that could be explored.

- **Informal to Formal SME Linkages –** this would support the growth of informal small or microenterprises by linking them to either existing PE clients or future clients so as facilitate their growth and possible formalisation[17]. An in-depth analysis of the potential impacts and challenges is required before investors (i.e. DFIs) allocate resources to such an approach. The aim would be to fund entrepreneurs within value chains so as to formalise those small businesses, increase the impact the businesses have on livelihoods in the value chain and bring more people into the formal economy, meeting the gap between Micro and "Small" of the SMME grouping. The implementation of this would require the provision of technical assistance. ComSec could play a pivotal role in the feasibly study and in sourcing and managing the funds for technical assistance. This project could be a benchmark for other donor driven initiatives in formalising the informal sector through value chain interventions. Hopefully this can be seen as a market penetrator and will bring both PE fund managers and DFIs into the process.

- **Gender Fund** - Specific gender-driven investments could make a fundamental difference to the markets in which PE funds operate. The objective would be to develop specific targets regarding capacity building of women entrepreneurs in emerging markets. For example Goldman Sachs has a well-publicised initiative to provide training for 10,000 women entrepreneurs in China and Nigeria. This process could be further enhanced by investigating the setting up of a seed fund to finance women entrepreneurs, who have gone through a capacity building phase. There would be an opportunity to leverage funding from existing PE funds as well from new investors. It is recommended that ComSec explore in more detail the feasibility of such a programme and how it could be delivered most effectively.

6.3 Sharing Reviews on the CPII funds.

It is recommended that the stakeholders in the CPII work closer together in future. There needs to be an agreed mandate to ensure they share their information on the impact that the CPII funds have had. For example the African Development Bank did an analysis on the impact of the first generation Africa funds and sent a team to do a closing out report. The results of the report were not shared widely. A similar situation prevailed with the AusAID evaluation of Kula I. There is a need to have more visibility of project appraisals and post project audits especially where these impacts are reviewing the social impacts (ESG) of the funds. ComSec could be the coordinator of the dissemination of these reports and fund an annual conference where the outcomes and learning from these reviews is pooled and shared and best practice extracted. A synthesis of impacts per fund would also be useful information and create a pool of 'best practices' information in this development space.

[17] Many SMEs are not in the formal sector. This fund would provide the catalyst to improve the development impact of PE funds to cascade the benefits down to smaller SMEs. ComSec would be important to this initiative in their facilitation role of bring other funds and organisations into supporting this agenda.

6.4 Internal Capacity at ComSec

This review has made the following observations:

- The strategic relationship with Aureos is being well managed by ComSec.
- There was no dedicated manager for the CPII before the incumbent was appointed.
- The ComSec investment work programme had a budget of £300,000 in 2007,it is now operating with about £100,000.
- There is little direct contact between the ComSec and Aureos at the regional office level as this is mostly managed through London. Furthermore with only one manager in ComSec it is not feasible for increased communication. The partners in the various offices have met the unit manager and work with him when the occasion arises.

A key issue facing ComSec is about resources both financial and human capital. At present it has been a one-person unit with limited administrative support dealing with CPII. It is recommended that there be a strategic relationship between the Investment Unit and the SME unit. They could possibly form a combined Private Sector Development unit to cover both elements. The SME unit effectively works in what the DFIs define as the Microenterprise space. The DFI definitions on SME are sufficiently different to ComSec as to warrant different methods of intervention in the development arena especially where PE and venture capital approaches are concerned.

6.5 Way Forward

The CPII concept has been a success in delivering on the mandate given to it by the CFMs and by achieving results anticipated under the appropriate areas of work in the Strategic Plan. The return on what is a relatively small-scale investment by ComSec, in terms of being a catalyst for innovative funding to emerging markets and delivering tangible benefits to the private sector in Africa and the Pacific, has been high. ComSec also maintains a footprint and strong relationships within the venture capital and private equity markets in its developing member states. ComSec has a comparative advantage in that they are driven by fairness to all member countries and are not seen to have possible vested interests.

Going forward, innovative interventions in facilitating private sector investment in these markets are continually needed. It is recommended that ComSec leverage their success so far by expanding the CPII model in its next four-year strategic plan. There will need to be a feasibility assessment for any CPII Phase Three and this should include a donor and DFI roundtable where these issues are deliberated upon, strategic directions compared and the role of the ComSec defined. Future areas for consideration are as follows:

- Innovative ways of supporting climate and environment related investment.
- Linking public goods such as health and aged care services to private markets,
- Building a benchmark of how SMEs perform financially and on ESG metrics across a series of key target markets in the Pacific and Africa.
- Exploring mechanisms that would liberalise and then mobilise cross-border investment by developing country domestic pension funds.

- Supporting the development of new equity investment instruments (greenfield, venture and expansion) supplied by private capital Funds in to second and third tier countries in Africa and the Pacific.

ANNEXES

Annex I: Aureos ESG Index Template

Aureos ESG Template:
FINANCIAL PERFORMANCE
Turnover
Sales Growth
Gross Profit Margin
Net Profit
Interest Cover
Fixed Asset Growth
Growth in Shareholders' Funds
Current Ratio
Quick Ratio
Return on Shareholders' Funds
Gearing 1 (debt/equity)
Gearing 2 (debt/capital deployed)
Equity Yield %
PELT Yield %
PELT P/E Ratio
Internal Rate of Return (IRR)
Valuation

Debt Service Coverage Ratio
Debt / Capital Employed
ECONOMIC LINKAGES
Taxes Paid (US$)
Foreign Exchange Generated (US$)
Total Exports (US$)
Expenditure on Local Services & Utilities (USS)
SOCIO-ECONOMIC IMPACT
Number of Employees
Change in Employees (%, change year on year)
Women as % of workforce
Women as % of management
Workers in training (%)
Annual expenditure on training (US S)
Local unemployment rate (%)
Est. no. of family members dependent on 1 employee's wages
PRIVATE-SECTOR DEVELOPMENT
Expenditure on New Technology (US $)
Investment Mobilisation (US $)
Investment Mobilised from Domestic Sources (%)
Source: PCP Management

Annex II: Examples of other Africa-focused PE Equity Fund Managers

Emerging Capital Partners

ECP is an international private equity firm that focuses on investing in Africa. It was the first firm to raise over US$1.8 billion for investment specifically in African countries. In June 2010 it closed ECP Africa Fund III with total commitments of US$613 million. ECP has seen a high demand for capital in African markets, where the demand for investment far outweighs the supply. In addition, the past several years have seen positive shifts, such as government movement to open market philosophies and improved macro-economic fundamentals. ECP has found that these factors are enabling Africa to become a vibrant marketplace with a defined opportunity set for private equity investment.

The ECP Africa Fund II was established in 2005. It raised US$453 in commitments from investors. The fund invested in 18 companies in various sectors including telecommunications, natural resources, financial services, power and water, agribusiness and transportation.
ECP is an international private equity firm focused on investing across the African Continent including Francophone Africa. The firm is the first private equity group to raise over US$1.8 billion to invest exclusively in African companies. The firm's investors are uncorrelated to the U.S. and other global economies. By the third quarter of 2008, the firm had invested in approximately 50 companies, exited from about 20, and achieved an average return of three times its initial investments. In June 2010 it closed ECP Africa Fund III with total commitments of US$613 million, the largest raised for growth equity investing across the continent.

While the African continent is generally overlooked in terms of investment opportunities, ECP has seen a high demand for capital in African markets, where the demand for investment far outweighs the supply. In addition, the past several years have seen positive shifts, such as government movement to open market philosophies and improved macro-economic fundamentals. ECP has found that these factors are enabling Africa to become a vibrant marketplace with a defined opportunity set for private equity investment.

Sectors

The firm's first independent fund – a US$407 million multi-purpose fund named the AIG African Infrastructure Fund was sponsored by AIG and the International Finance Corporation (IFC). The firm's second major pan-African fund, ECP Africa Fund II, closed in May 2007 with US$523 million. At the time, it marked the largest private equity fund ever raised for investments across the African continent. Africa Fund II was established to seek majority and minority positions in companies through equity, quasi-equity and convertible debt instruments, with a focus on:

- Telecommunications,
- Natural sources,
- Financial services,
- Agribusiness,
- Transportation,
- Utility businesses

In June 2010, it announced the final close of ECP Africa Fund III at US$613 million, bringing total capital raised to US$1.8 million and more than US$1 billion invested.

Notable Investments

ECP has secured profitable investments across a variety of industries including utilities infrastructure, agribusiness, financial services, natural resources, telecommunications and transportation. These include:

- Wananchi, a leading East African media and telecommunications company specializing in pay television and high-speed Internet services in Kenya and Tanzania. In May 2011, Wananchi raised US$57.5m growth capital to extend its triple-play services.

- Continental Reinsurance Plc, Nigeria’s largest reinsurance company which completed a successful listing on the Nigerian Stock Exchange.

- Starcomms, a leading Nigerian mobile telecommunications operator.

- Société Internationale de Plantations d'Hévéas (NYSE Euronext: SIPH), Africa's leading natural rubber producer and exporter.

ECP Funds:

ECP Africa Fund I:

The ECP Africa Fund I or AIG African Infrastructure Fund was established in 2000 to invest primarily in infrastructure and related industries in Africa. It raised 364.2m USD in commitments from investors and invested in 14 companies. ECP Africa Fund I investments span across numerous sectors throughout Africa including: telecoms, natural resources, agribusiness, transportation, power and water. The fund's investments typically range in size from 10m USD to 50m USD, in companies having valuations of 25m USD to over 500m USD. ECP Africa Fund I takes significant minority positions, generally 10% to 50% of the company's equity, which typically provide strong minority rights and board representation. The fund is expected to generate a net IRR of 17.9% with the expected exit valuation of the remaining portfolio company.

ECP Africa Fund II:

ECP Africa Fund II was established in 2005 and is the successor fund to ECP Africa I. The fund has raised 453m USD in commitments from investors. The fund has invested in 18 companies in various sectors throughout the African continent including: telecoms, natural resources, financial services, power and water, agribusiness and transportation among others. 16 of these companies are still held. The fund's investments typically range in size from 15m USD to 50m USD. Target companies are generally EBITDA positive and have total valuations in the range of 40m USD to over 500m USD.70 The fund is in monitoring phase, and the net IRR was 5.2% by Q4 2009.

ECP Africa Fund III:

Established in 2008 ECP Africa III is the successor fund of ECP Africa II. The fund has raised 447.5m USD in commitments and had invested in 4 companies by year-end 2009. The fund invests in industries that have developed positively due to increased liberalization, improved world market conditions, consolidations, low market penetration and relatively high entry barriers and high growth potential, such as telecommunications, financial services, energy, natural resources, agribusiness, transport, distribution and logistics.

Acumen Fund

The Acumen Fund was founded in 2001, with initial capital from the Rockefeller Foundation, Cisco Systems Foundation and three individual philanthropists. Since then its network of investors and advisors has grown to include a wide range of individuals and organisations. The Acumen Fund is based in the principle that entrepreneurial approaches can be used to solve the problems of global poverty. Rather than having a purely 'hand out' approach or a 'market based' approach, the Acumen Fund seeks a middle ground through what it terms 'patient capital'. "We use philanthropic capital to make disciplined investments – loans or equity, not grants – that yield both financial and social returns. Any financial returns we receive are recycled into new investments"

The Acumen Fund is a global initiative with offices in four emerging economies, including East Africa. Here, investments have been made since 2001 with a total portfolio of $17.4 million in 2010. Investments have been made in sustainable, scalable enterprises that deliver affordable health, housing, sanitation, and agricultural inputs and services to low-income communities in Kenya, Tanzania, Uganda and Rwanda. Investees include a sanitation company building pay-per-use toilet facilities; a seed distribution company addressing the lack of maize productivity among smallholder farmers; and enterprises developing innovative products to combat malaria.

African Development Partners/Development Partners International

African Development Partners I (ADP I) is a pan –African private equity fund that makes privately negotiated equity and equity related investments in high growth African companies. It has a particular focus on post-conflict and recently liberalised countries. Development Partners International (DPI) is the investment adviser to ADP I. The focus is on companies operating in the environment of an emerging middle class in the targeted countries. ADP I and DPI work throughout Africa and have over 50 years' experience of investing in the continent. DPI are a process-led private equity adviser whose investment process "*combines rigorous analysis with comprehensive due diligence*". Besides capital emphasis is concentrated on value addition for the targeted companies thus facilitating a sustainable exit strategy.

Annex III: Persons Contacted during Evaluation

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Annex V

TERMS OF REFERENCE

Evaluation of Phase 2 of the Commonwealth Private Investment Initiative

1. Background

As part of the ongoing programme of in-depth evaluation studies, the Commonwealth Secretariat's Strategic Planning and Evaluation Division (SPED), in collaboration with the Economic Affairs Division (EAD), is undertaking an evaluation of Phase 2 of the Commonwealth Private Investment Initiative (CPII). The Secretariat's Strategic Plan's second strategic goal is "*To support pro-poor policies for economic growth and sustainable development in member countries*". EAD's International Finance & Capital Markets Section, which manages the CPII, seeks to contribute towards this goal by facilitating capital flows and increased levels of investment for private sector development in Commonwealth developing countries.

The CPII was launched at the Commonwealth Finance Minister's Meeting in 1995 with the main objective of demonstrating that pre-emerging markets and small economies could offer attractive returns for private investors. Four regional funds were launched in this first phase of the CPII – the Commonwealth Africa Investment Fund (COMAFIN) for Sub-Saharan Africa in 1996, the Kula Fund for the Pacific Islands in 1997 and the South Asia Regional Fund in 1998. In 1999 the Tiona fund was established for the Caribbean region and was subsequently merged with the Caribbean Investment Fund. These first generation funds are now fully divested.

A second phase of the CPII (CPII2) designed to focus on the SME sector and promote greater country coverage was launched in 2005, based on a mandate from the Commonwealth Finance Ministers' meeting of that year. The Secretariat has partnered with Aureos Capital, a private equity fund manager, to deliver this second phase of CPII. As with the first phase of CPII, a second generation of regional funds was established to cover Sub-Saharan Africa, South Asia and the Pacific Islands. Funds launched in this second phase of CPII include Kula II in the South Pacific (US$16 million, 2006), the Aureos South Asia Fund (US$85 million, 2006) and the Aureos Africa Fund (US$372 million, 2009).

Under the strategic partnership with Aureos, the Secretariat's role has involved funding feasibility and due diligence studies for these regional funds, facilitating contacts with both local and foreign investors and helping to build the capacity of the companies in which CPII2 funds are invested. Approximately 150 managers of investee companies from Africa and South Asia have been trained between 2006 and 2007. A similar programme was delivered to Kula II investee companies in 2009.

2. Purpose

The overall purpose of this evaluation is to determine whether Phase 2 of CPII is meeting the needs of Commonwealth developing member countries, as envisaged by Commonwealth Finance Ministers and Commonwealth Heads of Government. The evaluation will contribute to an overall review of EAD's investment and private sector development work. Specifically, the study will:

- Document the results and developmental impact of the second phase of CPII in terms of funding raised and the volume of investment that resulted in member countries, particularly small and vulnerable economies; the typology of investment (deal size and size of company) and the extent of job creation in investee countries.
- Review the impact of CPII2 against expectations and relevant CHOGM and Ministerial mandates.
- Examine the effectiveness of the Secretariat's relationship with Aureos and assess the impact of the relationship on Aureos, the Secretariat and Commonwealth member countries.
- Assess the catalytic effect of CPII2 in stimulating other investment flows to member countries.
- Examine the extent to which issues of sustainable development, gender, youth and other cross cutting themes have been addressed.
- Identify lessons learnt both from CPII2 as an initiative and the Secretariat's partnership with Aureos.

3. Scope and Focus

The evaluation period is 2005 onwards, though some reference would need to be made to the initial setting up of the CPII, its implementation arrangements, results and any lessons learnt that could usefully have been applied to CPII2. The study will pay particular attention to the standard evaluation criteria relating to relevance, effectiveness, efficiency, impact and sustainability. The study will also propose strategic or operational changes that would enable the Secretariat to better deliver its mandate.

4. Methodology

The Consultant will conduct the evaluation, to include:

- The study/review of pertinent CPII2- related records and data.
- Interviews of EAD personnel and others engaged in the delivery of CPII2 activities, notably Aureos Capital
- Interviews of selected CPII stakeholders (governments, investors and investee companies)
- Such additional activities as may be agreed with the Secretariat to enable information to be obtained from sources of relevant data.

5. Deliverables

The evaluation study will provide the following deliverables to the Secretariat:

1. Evaluation workplan and methodology;
2. Draft evaluation report;
3. A seminar/presentation of the findings and recommendations; and
4. Final evaluation report, incorporating feedback/ comments.

The deliverables must be submitted to SPED electronically as a Microsoft document. A draft Evaluation Report is to be submitted within two weeks of completion of the fieldwork stage. Following the presentation of the evaluation findings at a seminar at the Secretariat and receipt of feedback comments from the Secretariat and other stakeholders on the draft report, the evaluator is expected to submit a revised final Evaluation Report. The draft (and final) Evaluation Reports must be no more than 50 pages, excluding all annexes.

6. Schedule and Level of Effort

The study is planned to commence in April 2011, and it is estimated that up to 50 consultant days will be appropriate to complete the study, including agreed fieldwork visits. The consultants will work in close collaboration with the Secretariat (SPED / EAD).