Measuring the economic impact of private equity funds: the South African experience

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1. Introduction

Private equity financing is undertaken for various reasons: from increasing the working capital base to restructuring the ownership and management of a business. In line with financial globalisation over the past few decades, the private equity industry has grown significantly both in value and geographic extension. This has raised concerns about the global impact of private equity and underlined the need to understand it well. With private equity funds increasingly flowing between developed and developing economies, important questions have emerged on the measurement and impact of private equity on employment, corporate strategy, financial markets and the macroeconomy in general.

This paper seeks to analyse the international landscape of the private equity industry alongside the corresponding developments in South Africa. The ultimate aim is to outline the measurement and economic impact of private equity in financial markets and for balance of payments purposes using the South African experience.

2. Structure of the private equity market

Over the past few decades, financial investors in developed countries have increasingly diversified their portfolios with a view to broadening their exposure to different sectors and regions within an ever-changing global financial arena, while still seeking higher returns on invested capital. This phenomenon was a main driver behind the formation of alternative and innovative asset classes such as private equity.

Private equity refers to medium- to long-term shareholder capital investment in private companies as opposed to publicly listed companies. The average lifespan of a private equity investment is ten years (Fourie, 2008). In its broadest sense, private equity encompasses various activities aimed at securing funds from investors, utilising those funds in a range of investment transactions and eventually delivering a superior return on investment to the investors. The overarching idea of private equity is thus to invest in companies that are not publicly listed or to delist traded companies through a negotiated process where the buy-out can be friendly or hostile, depending on whether or not the negotiation is with the party that has the controlling interest. The private placement of new shares or the sale of pre-existing shares by the controlling interest or minority shareholders characterises most private equity deals (Chandrasekhar, 2007).

Although various private equity models can be utilised, the model for a specific transaction is determined by the particular requirements of the issuers of private equity. Chandrasekhar (2007)

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identifies the distinguishing feature of such investors as their reliance on private equity experts to assess companies and deliver on expectations with probable success, rather than on criteria such as the relative performance of a security. Given the longer-term nature of private equity investments, investors generally require a higher return. Therefore, in most cases investors have the intention of acquiring a controlling stake in a company in order to influence the operational activities and performance of that company.

According to Prowse (1998), the growth in private equity is a very good example of how organisational innovation coupled with regulatory and tax structures can lead to increased interest and activity in a specific market. The primary purpose of private equity was initially to fund risky start-ups and provide management support for such start-ups. The private equity market has seen significant growth since the early 1980s and has become an important mechanism for channelling capital through national and international markets, and funding business activities at various stages of development. In general, however, the private equity market has received relatively little attention in academic literature compared with other financial innovations. This may partly be due to the nature of private equity transactions; information about which is not always easily accessible.

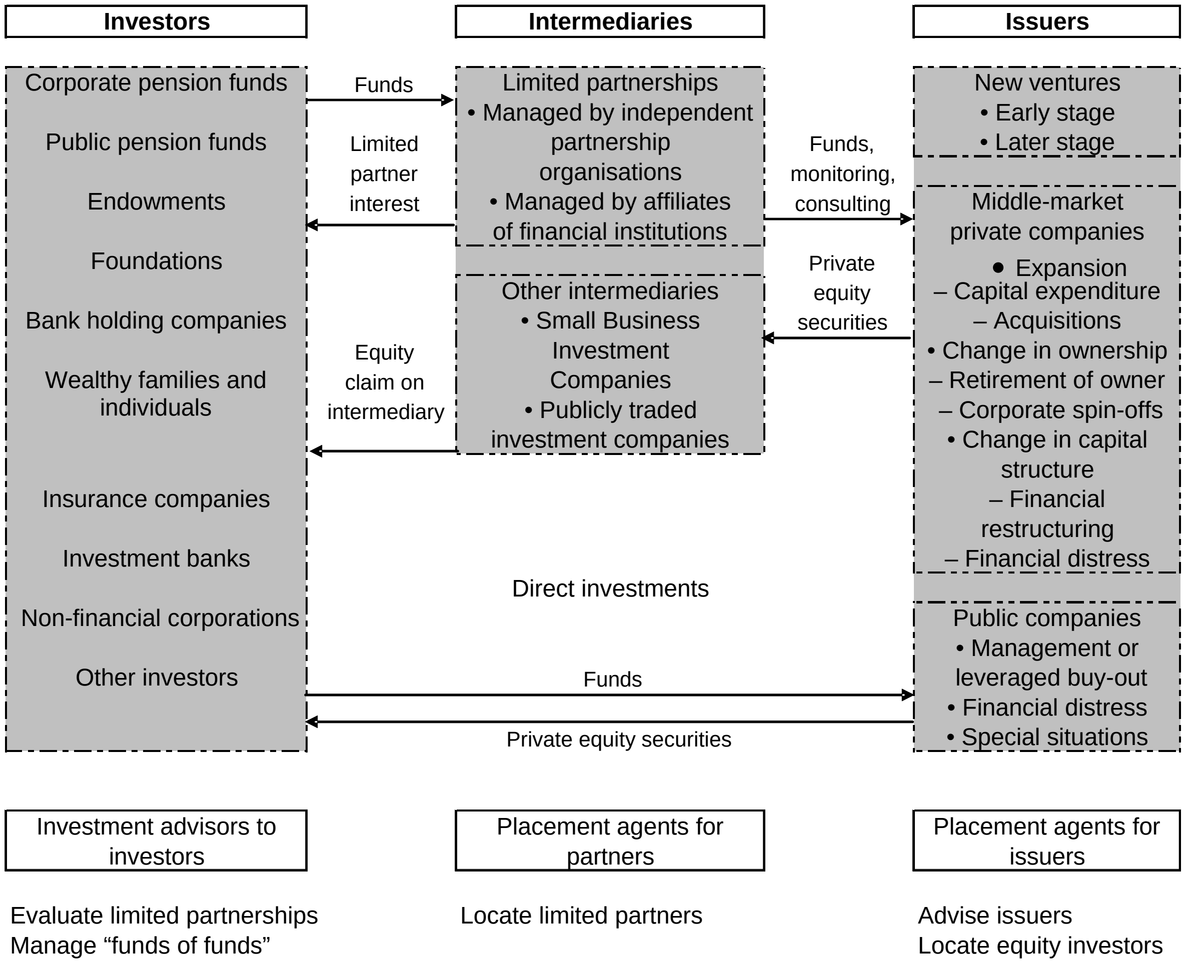
The basic structure of the private equity market is explained in Figure 1. The organised private equity market has three main role-players, namely (1) investors, (2) intermediaries and (3) issuers of private equity. The arrows in Figure 1 indicate the activity and the flow of that activity between the role-players. Pension funds, insurers and other investment companies are the main contributors on the investment side. The main reasons institutional investors may choose to invest via a private equity model is the expectation that risk-adjusted returns[3] will be higher than on other investments, as well as the implied benefits that diversification into private equity brings into their overall portfolio. The relationship between the investors and intermediaries often takes the form of a partnership.

Partnerships generally consist of limited partners, who provide funding, and a team of professional general partners, who are actively involved in the sourcing of funds, investments and eventual management of the private equity investment. General partners or fund managers have a direct interest in developing and growing the business model, because they derive a return that is directly proportional to the growth of the business. Private equity companies that are affiliated to larger holding companies are known as "captives" and can be divided into various sub-categories, such as government and non-government captives. Intermediaries in developed nations are mainly made up of limited partners who manage approximately 80 per cent of private equity investments, while the developing nations utilise various other mechanisms for fund structuring due to a lack of legal structures that allow the establishment of limited partnerships (Lerner and Schoar, 2004).

[3] This may be subjectively modelled from fund of fund.

Figure 1

Structure of private equity market



Source: Adapted from Prowse (1998).

The issuers (targeted investments) of private equity vary considerably in their size and motivation for raising funds through this channel. One of the common characteristics shared by smaller issuers is the difficulty they have in raising financing from debt or public equity markets, and they thus opt for the more expensive private equity market (Prowse, 1998). The last set of role-players in the private equity industry is the “information producers” or agents and advisors who advise on possible target companies, identify sources of funds for private equity partnerships and evaluate partnerships for potential investors. The three main private equity investment stages, as explained in Table 1, involve venture capital, development capital and buy-out funding.

Table 1

Private equity investment stages

Equity category	Stage of business development	Application
Venture capital	Seed capital, start-up and early stage	Funding for developing a concept, new or young businesses (one to three years old)
Development capital	Expansion and development	Funding for growth and expansion of a sound business
Buy-out	Leveraged buy-out and replacement capital	Purchasing business from owners or purchasing existing shares

Source: Adapted from KPMG and the South African Venture Capital and Private Equity Association (2008).

The final phase in a private equity investment transaction is the exit strategy in which, if things worked out as planned, the investors liquidate their private equity investment profitably. Exit strategies can take various forms, including, but not limited to, the following:

- direct sale to new investors
- listing on stock exchanges
- dividend payments to investors through debt recapitalisation
- secondary buy-out by another private equity firm.

3. Global private equity industry

The globalisation of industries has become the norm across the world, and the private equity industry is no exception. The global value of transactions related to private equity funds has increased dramatically over the past few decades. Figure 2 provides a breakdown of the investment and fund-raising trends on an annual basis for the period 1998 to 2007. Since 2004 the private equity industry fund-raising has experienced exceptional growth that has not been matched in the history of this equity sub-class. The private equity industry registered record fund-raising activities in 2006 and 2007. The ratio of funds invested to funds raised is illustrated in Figure 3.

Figure 2

Funds raised and invested[1]

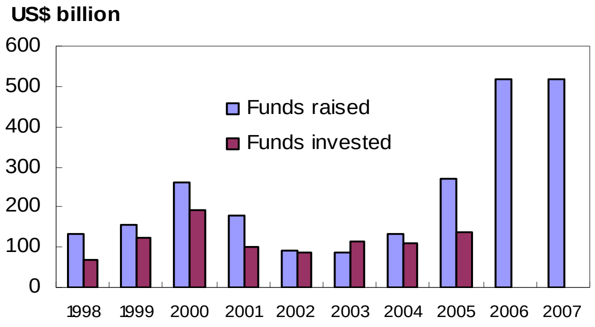
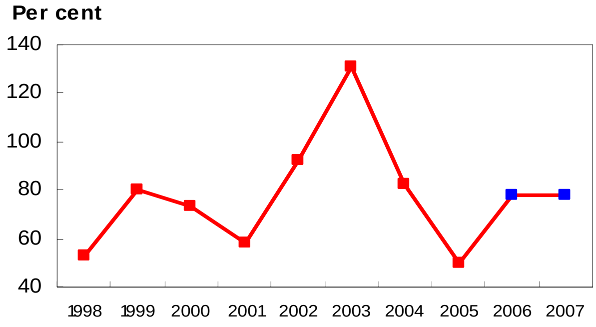


Figure 3

Ratio of funds invested[1]



[1] Data on funds invested for 2006/07 not available. Ratio based on average investment ratio for 1998 to 2005.

Source: PricewaterhouseCoopers, Emerging Markets Private Equity Association.

The main developed countries remain the most active in private equity by a large margin. The most recent global private equity survey released by Pricewaterhouse Coopers (PWC) in 2006 confirms that the United States of America (US) is still the most active investment country, with the United Kingdom (UK) in second place.

Table 2 provides a breakdown of the top 20 investment countries in 2005. North America, comprising the US and Canada, was the largest private equity market, with total funds raised during 2005 amounting to US$160,5 billion. Of these funds, almost US$48 billion were invested during 2005, which was only marginally up from the US$46,1 billion in 2004. During 2005 Europe, consisting of the UK, France, Germany, Sweden, Spain, the Netherlands, Italy and Denmark, continued its vibrant private equity activity, with funds amounting to US$84,1 billion being raised and US$55,1 billion invested.

Table2

Top 20 countries based on private equity funds raised and invested in 2005

US$ billions

Country	Funds raised	Funds invested	Percentage change in funds invested from 2004 to 2005
1. United States of America	159.00	46.41	6
2. United Kingdom	53.48	27.92	25
3. China	2.14	8.81	328
4. France	13.42	8.55	40
5. Japan	4.42	7.95	13
6. Singapore	0.74	4.41	241
7. Sweden	2.25	3.52	85
8. Germany	3.37	3.16	–28
9. Spain	1.20	3.12	35

Table2 (cont)

Top 20 countries based on private equity funds raised and invested in 2005

US$ billions

Country	Funds raised	Funds invested	Percentage change in funds invested from 2004 to 2005
10. Netherlands	2.86	2.74	41
11. Italy	1.58	2.56	48
12. Australia	2.08	2.32	7
13. Korea	2.52	2.10	35
14. India	2.48	1.94	45
15. Denmark	1.17	1.24	167
16. Canada	1.49	1.24	4
17. Israel	1.34	1.08	–11
18. South Africa	0.40	0.89	–29
19. New Zealand	0.22	0.75	200
20. Indonesia	–	0.56	694

Source: PricewaterhouseCoopers.

The evolution in size and influence of the private equity industry has led to increased transparency and awareness with regard to good corporate governance practices, particularly in respect of early stage investments. Owing to the unique nature of private equity investments, private equity managers have a high degree of involvement in the companies in which they invest and therefore play a leading role in promoting good corporate governance in these companies (Sullivan and Lim, 2004). Another emerging characteristic of the global private equity landscape is the increase in private equity activity in developing nations. Lerner and Schoar (2004) attribute this to two main reasons. The first reason is the accelerated integration of emerging nations into the world economy. Many of these nations have undertaken radical reforms in various areas, such as the reduction in trade and financial barriers (eg exchange control relaxations), the improvement of financial and regulatory systems, and overall commitment to technological innovations and improvements. These economic and structural reforms have increased emerging nations' attractiveness as private equity destinations.

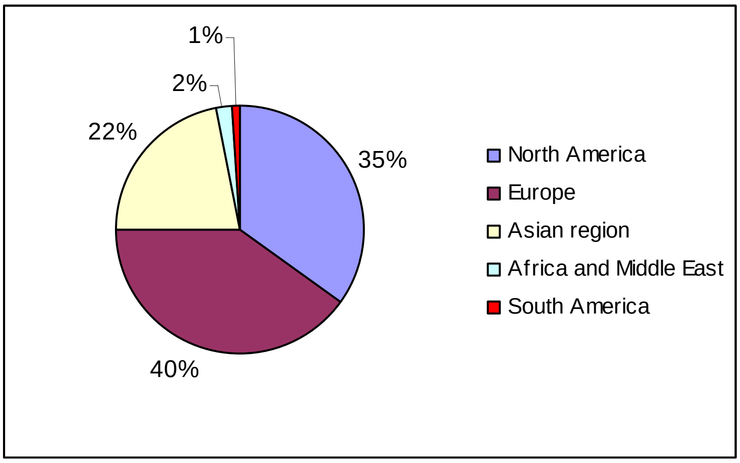
The second reason revolves around the changing views of, and conditions in, developed nations. Owing to the maturity of private equity in these countries and smaller returns on investments resulting from increased competition, these nations have embarked on reassessing the returns obtainable from, and risk associated with, developing country investments, and have generally found them favourable. For example, in 2007 many South African private equity funds reported gross internal rates of return above 40 per cent, while net internal rates of return in the US and Europe remained below 20 per cent (KPMG and SAVCA, 2008). In a study conducted by Deloitte (2007), it was found that of the sample respondents, 40 per cent indicated they had been attracted to emerging markets private equity partly due to tax incentives, free trade zones or other incentive structures, while 69 per cent indicated that more than half of their investments in emerging markets was meeting or exceeding their revenue expectations.

It is thus not surprising that one of the main trends, as seen in Table 2, is the rise of funds invested in the Asian region, thereby making it a significant player in the global private equity market. The combined value of investments in the Asian region amounted to US$25,8 billion in 2005. Of the Asian region countries, China and Indonesia showed exceptional growth over this period, with funds invested in China increasing by 328 per cent and in Indonesia by 694 per cent. Although the amounts invested are relatively small compared with other regions, the increase between 2004 and 2005 shows a significant shift to developing markets. Figure 4 illustrates the geographical breakdown of funds invested in 2005.

A further characteristic of the evolving private equity landscape is that for many of the emerging countries the investments made exceeded the funds raised in these countries, indicating that capital was transferred from North America and Europe into these economies. From a macroeconomic perspective, this may have a material impact on balance of payments positions. This point is discussed further in the section dealing with the analysis of South African private equity (refer to section 4).

Figure 4

Geographical breakdown of funds invested during 2005



Source: PricewaterhouseCoopers.

The Emerging Markets Private Equity Association (EMPEA) (2007) listed the following highlights in its survey of limited partner interest in emerging markets:

- Emerging markets will deliver superior returns for the foreseeable future
- Limited partners expect to increase their commitments to emerging market private equity over the next five years
- Governance of, and communication by, emerging market private equity funds have improved
- Asia, Central and Eastern Europe will continue to dominate activity in emerging markets.

Table 3

Emerging market private equity fund-raising by region

US$ billions

Year	Emerging Asia	Central and Eastern Europe / Russia	Latin America and Caribbean	Sub-Saharan Africa[1]	Middle East and North Africa[1]	Pan – Emerging Market	Total
2003	2,2	0,4	0,4	0,4		0,1	3,5
2004	2,8	1,8	0,7	0,5		0,6	6,4
2005	15,4	2,7	1,3	0,8	1,9	3,6	25,7
2006	19,4	3,3	2,7	2,4	2,9	2,6	33,3
2007	28,7	14,6	4,4	2,3	5,0	4,1	59,1

[1] Individual data for 2003 and 2004 not available.

Source: Adapted from Emerging Markets Private Equity Association.

Table 3 depicts the most recent fund-raising data released by EMPEA, which indicate that 204 funds collectively raised US$59,1 billion in capital in 2007; an increase of 78 per cent over the US$33,3 billion raised in 2006.

Although Africa and the Middle East have also benefited from the expansion of private equity into emerging markets, the private equity industry in these areas remains small in comparison to the North American, European and Asian regions. However, according to the African Venture Capital Association, there are a number of reasons for private equity investment activity in Africa to accelerate in the coming years, including (Financial Mail, 2008a)

- high economic growth in sub-Saharan Africa, which has averaged between 5 and 7 per cent in recent years, coupled with relatively low inflation and interest rates
- high commodity prices
- a significant improvement in governance and policy formulation
- reduction in foreign public debt levels resulting from the global economic initiative to aid heavily indebted poor countries.

4. South African private equity industry

South Africa has one of the most sophisticated private equity industries among the emerging economies, with funds invested at various business development stages. The Southern African Venture Capital and Private Equity Association (SAVCA) currently has 62 full members and 28 associate members. Together with the traditional uses of private equity, a more recent application in South Africa is the facilitation of black economic empowerment (BEE) investment as discussed later in this paper.

4.1 Structure of private equity in South Africa

Alongside global developments, the South African private equity industry was further boosted by leveraged and management buy-outs of multinationals disinvesting from South Africa in the 1980s. Private equity in South Africa has since distinguished itself as a separate subasset class of equities and, as a result, benefited from foreign investment. The domestic private equity firms are divided between independents – who manage funds on behalf of third parties – and captives – who manage on-balance sheet investments that are funded by a parent company or a group. Captives include the funds of governments, financial companies and other corporates (KPMG and SAVCA, 2008). In South Africa, there are no specific laws aimed at regulating the private equity industry, but institutional-sector legislation and regulations are fully applicable to participants.

4.2 Investment activity in the South African private equity industry

As at the end of 2007, total funds under management amounted to R86,6 billion; an increase of 46 per cent from 2006. Independents accounted for 49 per cent and financial captives for 31 per cent of total funds under management. Funds are mostly sourced from major banks, institutional investors and independent private equity houses in the US and Europe (Ewing and Butler, 2007). Funds are mainly invested in buy-outs, and expansion and development ventures. In 2007, funds invested amounted to 3 per cent of gross domestic product and of the total funds under management, more than R30 billion (an increase of 25 per cent from 2006) were still undrawn at 31 December 2007.

Figure 5

Funds under management

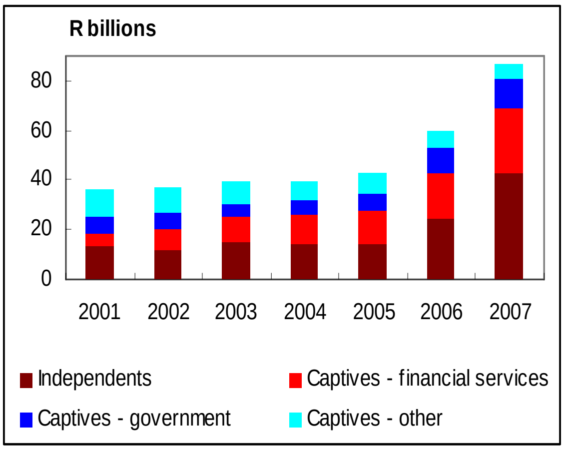
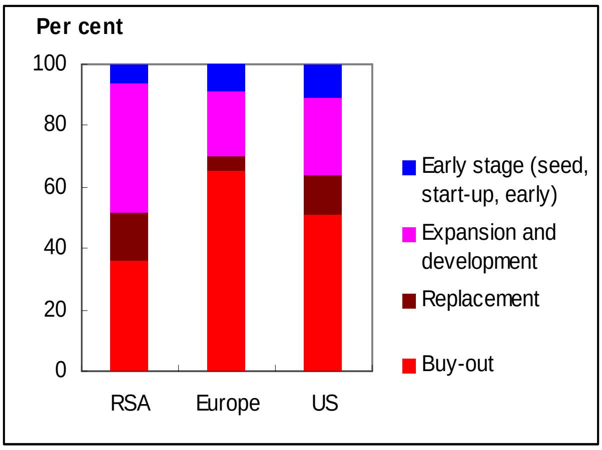


Figure 6

Investment by stage, 2007



Source: KPMG and South African Venture Capital and Private Equity Association (2008).

In 2007, South Africa was ranked 11th as a private equity investment destination and 18th in terms of fund-raising activity on a global scale (PWC, 2007). Expansion and development investment were the biggest investment types in terms of volume (47 per cent), while buy-outs constituted the largest investment type in terms of value (65 per cent). In most cases, South African private equity investment takes place in established businesses (later-stage investment) rather than start-up or early stage (Ewing and Butler, 2007). Table 4 details the ten largest private equity transactions per funds raised in 2007, with a combined value of approximately US$8,1 billion. Of this amount, the four largest transactions made up 88 per cent. Compared with listed equity, private equity investments yielded double in terms of their internal rates of return.

Table 4

Ten largest private equity transactions based on total funding raised, 2007

Name of investment	Equity provider/s	Debt provider/s	Total funding raised (R millions)	Type of investment	Private equity fund's equity interest	BEE ownership (post-deal)
Edcon	Bain Capital Barclays Private Equity Absa Capital Private Equity	Barclays Capital Absa Capital	27 132	LBO	Controlling	Not empowered
Alexander Forbes	Actis Africa Ethos Harbourvest Capital International OTPP CdpQ	RMB Investec bank Nedbank JP Morgan Goldman Sachs	8 982	LBO	50,1 per cent	Black-influenced
Primedia	BRAIT	RMB OMIGSA Vantage Capital	7 300	LBO	18,3 per cent	38,8 per cent
Consol	BRAIT OMIGSA Sanlam Private Equity Harbourvest Capital International	Citibank JP Morgan	6 600	LBO	61,5 per cent	26,0 per cent
Steinfurn	Absa Capital Private Equity	Absa Capital	1 580	LBO	49,9 per cent	Black-empowered
Premier Foods	BRAIT	NA	1 500	MBO	NA	NA
Tsebo Outsourcing Group	Absa Capital Private Equity	Investec bank Vantage Capital	1 435	LBO	45,0 per cent	Black-empowered
Brandcorp	Ethos Sphere	Absa Capital Nedbank	1 420	LBO	Controlling	Black-influenced
Vox Telecom	Lereko Metier Capital Growth Fund	Investec bank	490	Later Stage Expansion Capital	23,3 per cent	Black-empowered
Mvelaphanda Holdings	Absa Capital Private Equity	NA	450	Later Stage Expansion Capital	NA	Black company

Source: Adapted from KPMG and South African Venture Capital and Private Equity Association (2008).

4.3 The role of private equity in South Africa

A unique aspect of the South African private equity industry is its facilitation of BEE. The Broad-Based Economic Empowerment Act, 2003 (Act No. 53 of 2003) (The BBEE Act) and other industry-specific empowerment agreements between government and economic sectors (charters) have placed pressure on businesses to provide employment and give business to black people, and to allow them to own assets in South Africa in an attempt to redress the skewed economic distribution of resources. Accordingly, private equity has played a major role in broadening the scope for black people to participate in business activities. Most private equity deals concluded in recent years have a significant BEE component.

The BEE codes, as issued by government (Department of Trade and Industry), stipulate the conditions under which ownership arising from a private equity fund may be treated as held by black people. The conditions stipulate that a private equity firm must ensure that

- more than 50 per cent of the exercisable voting rights associated with the equity instruments through which the private equity fund manager holds rights of ownership is held by black people
- more than 50 per cent of the profits made by the private equity fund manager after realising any investment made accrues to black people
- the private equity fund manager is a BEE-owned company
- over a ten-year period, the private equity fund must have more than 50 per cent of its investments made in black-owned enterprises that have at least 25 per cent direct black ownership.

As at 31 December 2007, 69 per cent of total funds under management were classified as black-influenced, that is, had at least 5 per cent black ownership. The number of BEE investments increased by 15 per cent from 2006 to 2007 – reflecting the growing importance of BEE-related transactions in the South African private equity industry. In 2007, the average BEE transaction amounted to R30 million – up from R14 million in 2006.

In an unpublished SAVCA-commissioned private equity economic impact study (2005) it was found that private equity generally boosted economic growth in South Africa and was superior when compared with other forms of funding because, among other things, it

- enabled higher gearing
- was sometimes the only source of funding for companies facing unit closure
- enabled product development
- offered added value by sharing expertise, identifying investment opportunities, creating brand value and strategy development
- facilitated BEE (as discussed earlier).

Improved corporate governance as a result of improved compliance with existing legislation, such as the BBEE Act, and improved management effectiveness as a result of implementing management buy-outs were noted as important private equity benefits. According to KPMG and SAVCA (2008), private equity does not only transfer capital, but also has an impact in terms of productivity, skills development (competitiveness) and job creation (transfer of know-how).

4.4 Measurement of private equity in South Africa

This part of the paper investigates the measurement and economic impact of private equity in financial markets and on the balance of payments.

4.4.1 Private equity in financial market statistics

A major reason for analysing private equity and its impact on financial markets is to establish the extent to which the delisting and subsequent relisting of companies affect the stock exchange configuration. The initial delisting of a listed company targeted for private equity investment has the effect, albeit small, of reducing both the market capitalisation of the stock exchange and portfolio diversification options for investors, particularly if the delisted companies are industry leaders. Since the South African share market (JSE Limited (JSE)) is used as an exit mechanism for private equity, the possible subsequent initial public offerings have the potential to boost the JSE and particularly the Alternative Exchange (Altx) for medium-sized entities further by ensuring that good-quality entities are listed on the Altx (Ewing and Butler, 2007).

In 2007, the total capital value of the four largest companies that delisted for private equity reasons amounted to approximately 1 per cent of the JSE market capitalisation which was R5,7 trillion ($839 billion). This was deemed too small to affect the JSE materially. Thus far in South Africa, the largest private equity deals have involved industry leaders and may have impacted negatively on portfolio diversification. Continuous monitoring of the private equity asset class on the JSE is undertaken by several parties, including the South African Reserve Bank.

4.4.2 Private equity in balance of payments statistics

Initially, most private equity funds were raised and invested domestically and thus had limited or no balance of payments impact. However, since 2005 this has changed with some of the largest and most recent fund-raising exercises by South African-based general partners being largely foreign funded (75 per cent and more). For example, in September 2007 Pamodzi Investment Holdings announced the launch of Pamodzi Resources Fund I, a US$1,3 billion (R9,8 billion) resources fund that was completely funded from foreign sources. This has led to the US overtaking South Africa as the main source of funds raised in 2006 and 2007. South African-based funds have also started investing outside South Africa, which may have additional balance of payments implications.

The South African Reserve Bank compiles South Africa's balance of payments position and includes private equity data in the official balance of payments statistics. The data on the private equity industry in South Africa are obtained and used at three levels, as illustrated in Table 5. SAVCA provides an overall profile of the industry in South Africa to the central bank. This includes aggregated private equity industry data, industry participants and individual contact details of private equity fund managers. Regular meetings are scheduled with the leading private equity funds where all aspects of their private equity transactions are discussed and the necessary data obtained by the central bank. The private equity funds are housed in a survey database that is used to obtain quarterly data on fund raising, drawdown and investment activities.

Table 5

Private equity data sources

Data collection level	Institution	Interaction	Frequency
Level 1	SAVCA	Meets periodically Provides data on the overall South African private equity industry	Annually
Level 2	Private equity funds (general partners)	Meets periodically with main private equity funds Provides data on fund-raising activity, targeted investments and disinvestments	Quarterly
Level 3	Targeted investment companies	Meets regularly to discuss the impact on the balance of payments Included in the South African Reserve Bank survey database and provides all relevant balance of payments data through this channel	Quarterly

Further data are obtained at targeted company level. After a private equity transaction, meetings are arranged with the targeted company where the new post-private equity group structure is discussed. It is determined which companies in the group should report on a regular basis and these companies are included in the normal SARB B-survey database.

During the life cycle of a typical private equity investment, balance of payments statistics are influenced in the following phases:

- *Fund-raising and drawdown:* Initial sourcing of funds and drawdown into South Africa if foreign sourced.
- *Value creation and monitoring of investment targets:* During the life of the investment the main balance of payments impact will result from flows due to interest, dividends and fees.
- *Exit from investment and repatriation or reinvestment of funds by investors:* At the disinvestment stage of the private equity transaction there could also be a balance of payments impact. This depends on the initial investors' decision to retain their funds in the domestic economy, either by reinvesting in a new private equity fund or in another type of asset in the economy; or to liquidate their investment and repatriate the funds to their countries. At present the bulk of South African foreign-sourced investments has not reached the exit stage yet; there are roughly seven years left before this starts happening.

Although the exact structuring of a private equity transaction may have various permutations with varying degrees of influence on balance of payments statistics, there are certain standard characteristics. Table 6 illustrates a typical private equity transaction where a foreign-based private equity fund acquired a listed South African company, and its treatment in the balance of payments and related accounts.

Table 6

Recording of private equity transactions in balance of payments and related accounts: Foreign-based private equity fund acquisition

Balance of payments	Item	Frequency	Impact
Current account	Interest payments	Quarterly	Outflow
	Fees	One-off / Quarterly	Outflow
	Dividend payment	Annually / Biannually	Outflow
Financial account: liabilities			
Direct investment	Equity	One-off	Inflow
	Debt	One-off	Inflow
Portfolio investment	Payment to non-resident shareholders	One-off	Outflow
	Foreign bond issue	One-off	Inflow
Other investment	Bridging finance[1]	One-off	Inflow
Foreign debt	Bonds or negotiated loans	One-off	Inflow
International investment position	Liability position	One-off	Increase

[1] Should this type of finance and the bond issue be within the same measurement period, then the bridging finance will not be entered into the balance of payments.

4.4.2.1 Private equity treatment in the current account

The most common private equity transaction entries in the current account are transaction fees, interest payments and dividend flows. Fees can be broken down into advisory fees resulting from the structuring of the initial buy-out and management fees that accrue to the general partners throughout the period of the investment. Whereas advisory fees are generally a one-off entry, management fees accruing to non-resident general partners may be recorded for several periods during the life of the investment. Interest payments on foreign-issued debt are also recorded quarterly or biannually in the current account. Owing to the substantial leveraging of private equity transactions, the payment of dividends has thus far not been a regular feature for most of the South African transactions. The normal treatment would be to record such payments in the current account if they occur.

4.4.2.2 Private equity treatment in the financial account

The bulk of the entries into the financial account is recorded on the liability side, because most of the limited partners in the large South African private equity funds are non-residents and hence funding is sourced from international markets. Under direct investment there are typically two entries. The first represents the pure equity injection made by the private equity fund and is usually a one-off transaction. A further entry in this category represents debt, where the remainder of the capital injection is done as a shareholder loan with an indefinite period.

There are also two entries in the portfolio investment category. The first entry represents a one-off outflow of funds as payments to non-resident shareholders. This is normally the case where the targeted investment is a listed entity, with a percentage of the listed equity held by non-residents. The second entry occurs where international debt markets are accessed with the issue of debt instruments. This is recorded as an increase in portfolio liabilities within the period that the debt instrument is issued and the funds introduced into the country. In several of the large South African private equity transactions these debt issues have been utilised to substitute intermediate bridging finance that was initially used to acquire the shares from the existing shareholders. Assuming that bridging finance is obtained from a foreign third party such as a bank, and the utilisation of this debt and the substitution with long-term debt does not take place in the same measurement period, it will be recorded in the other investment category of the balance of payments. Otherwise only the long-term debt is recorded.

4.4.3 Private equity treatment in foreign debt statistics

Apart from the compilation of the official balance of payments statistics, the South African Reserve Bank is also responsible for the compilation of the country's official foreign debt statistics. Given the very definite and useful link between the data used in the financial account of the balance of payments and foreign debt data, the two independent sets of data supplement each other to a large extent. As such, the long-term foreign debt (eg bonds) raised for private equity purposes is included in the official foreign debt statistics of the country when these bonds are issued. The entity in which the debt is housed is added to the foreign debt survey database in order to record principal and interest payments. This information is entered into the appropriate balance of payments accounts over the period of the investment or loan.

4.4.4 Private equity impact on the international investment position

The South African international investment position is measured annually by recording positions as at 31 December. Private equity transactions that occur throughout a year and result in changed asset and liability positions with non-residents are included in the international investment position. In the South African case the impact is mainly on the liability side of the international investment position, causing an increase in direct and other investment liabilities and both an increase and a decrease in portfolio liabilities.

5. Conclusion

This paper analyses the international landscape of the private equity industry alongside the corresponding private equity developments in South Africa. Globally the industry has expanded significantly, both in value and geographic extension over the past few decades. Developed economies have increased their utilisation of private equity across all the private equity categories, with North America and the developed European economies registering record fund raising and investment activities since the start of the twenty-first century. Together with this, one of the most prominent characteristics of the evolving private equity landscape has been the increased private equity activity in developing economies. This should be seen as part of the accelerated integration of developing economies into the world economy. The expansion of private equity in developing nations suggests that this is the preferred route for private equity investors, given that the potential for similar investments in developed nations is reaching saturation levels. An inevitable consequence of this expansion has also been the rise of foreign-owned assets in developing nations.

The impact of private equity activities in the South African financial markets was found to be quite limited. However, private equity activities may have affected portfolio diversification for specific industries from which targeted companies were delisted. The impact of private equity in financial markets will be monitored on an ongoing basis. The extension of private equity transactions across nations has also accentuated the impact these transactions have on a country's balance of payments position. In the case of South Africa, private equity transactions by both foreign and South African private equity firms that source their funding from non-residents have led to capital flows that affect the balance of payments materially. Apart from affecting balance of payments positions, these private equity transactions also influence the South African foreign debt and international investment position. Although private equity-related inflows may assist in financing a current account deficit, the longer-term nature of these investments and their impact on the balance of payments should be understood. Realising this, the South African Reserve Bank has endeavoured to understand and measure private equity and its impact as thoroughly as possible.

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Interview

Interview with J. P. Fourie, South African Venture Capital and Private Equity Association Executive Officer on private equity issues, Johannesburg, 22 May 2008.