Private equity and the post-COVID-19 economic recovery in Sub-Saharan Africa

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The true magnitude and nature of the economic consequences resulting from the COVID-19 pandemic are yet to unfold. Countries across the world have however acted swiftly, putting in place measures to “flatten the curve” and contain infections. Yet, these measures are bound to deepen the recessionary impact.

Initial signs are that investors need to brace for scenarios that have the potential to mirror, or exceed, downturns experienced following World War II and the 2008/09 financial crisis. Yet, private equity investors have proven to be agile and able to navigate volatility and could play a key role in supporting the recovery of businesses and economies.

The “Great Lockdown” and its economic consequences
The exponential growth of COVID-19 infections globally since January 2020 has pushed governments to fully or partially shut down economies to protect vulnerable groups and healthcare resources.

The unprecedented severity of the current crisis, for example, is reflected in the jobless claims figures of the United States (US), as 30 million US citizens applied for unemployment benefits by the end of April 2020.\(^1\)

A lack of healthcare resources coupled with a rise of infections in many parts of the world prompted several African leaders to act decisively, closing borders and shutting down great parts of their economies at a time when the number of confirmed COVID-19 cases were relatively low. South Africa, Nigeria and Kenya all enforced a certain degree of lockdown conditions, which are yet to be relaxed wholly.

Beyond the local shutdowns, countries are challenged by the impact on their economies and people's livelihoods from a severe drop in global demand, disrupted supply chains, and lower commodity prices. Devastating impacts in East Africa on key sectors such as tourism and hospitality, as well as agriculture are already visible.\(^2\)

Figure 1. Real GDP growth in major economies, 2019-21f

So too are the concerns for oil exporting countries, as a dramatic drop in demand has left oil prices decimated in recent weeks, with severe impacts on foreign direct investment, the balance of payments, exchange rates and government budgets.

While forecasts continue to be fluid, most agree that the response to COVID-19 will lead the global economy into a recession this year. Projections released by the International Monetary Fund on 14 April 2020\(^3\) confirm this bleak picture.

World growth is projected to contract by 3% in 2020, a downward revision of 6.3 percentage points from January 2020 estimates. Contractions in major developed economies are expected between -5.2% and -9.1%.\(^4\)
Aggregate real GDP growth for Sub-Saharan Africa (SSA) is expected to decline by 1.6% in 2020 – the first annual GDP contraction reported by the IMF for the SSA region since 1992. Even during the global financial crisis in 2009, SSA’s GDP growth merely slowed from 5.8% in 2008 to 3.8% in 2009, and did not enter negative territory.

The impact on some of SSA’s largest economies will be hard felt. South Africa, for example, is expected to be one of the biggest losers in SSA, expected to contract by 5.8% in 2020, with 4% growth forecast for 2021. Oil exporters such as Nigeria and Angola are forecast to see a drop in GDP of 3.4% and 1.4% in 2020, respectively. Similarly, commodity exporters such as Zambia and the Democratic Republic of the Congo (DRC) are projected to have contracting economies in 2020. A number of West and East Africa’s previously high-growth economies such as Ghana, Côte d’Ivoire, Senegal, Ethiopia, Kenya and Tanzania are expected to see substantially slower GDP expansion. As economies begin to ease restrictions and rebuild, GDP growth rates are expected to somewhat rebound in 2021. However, the severity of the current economic downturn means that 2019 levels of economic output cannot be expected.

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Private equity opportunities and challenges

As businesses and whole economies move from their immediate Response to the pandemic, to putting in place the levers for Recovery, ahead of preparing for the next normal (Thrive), there will be various opportunities and challenges for private equity investors.

The fundamental principles which drive private equity investment strategies such as investing into high-quality assets, partnering with strong management teams and focused exit strategies are expected to support private equity remaining a resilient asset class and supporting the post-COVID-19 economic recovery.

The asset class has a proven track record for being able to outperform other asset classes during times of weak economic growth and market volatility, as demonstrated in recent years in South Africa. In this year’s Deloitte Africa Private Equity Confidence Survey (PECS), respondents across East, Southern and West Africa had spent the majority of their time over the past 12-24 months on raising new funds and helping portfolio companies restructure. While the fundraising environment is likely to change, a continued focus on restructuring and supporting portfolio companies navigate the volatility expected over the short term, is expected to become a primary focus for private equity practitioners.

Additionally, cash flow constraints experienced by companies during a recession may see companies turn to private equity investment as a source of financing.

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Possible focus areas for private equity during the Recovery and beyond

Technology has thus far played a major role in hospitals and communities in the fight against COVID-19, largely in developed economies. Innovative technologies have assisted healthcare workers and governments to effectively trace and treat people affected by the pandemic.

In addition to the wider application of technology in the fight against COVID-19, the onset of the Fourth Industrial Revolution (4IR) provides investors with new, innovative opportunities to deploy capital effectively in Africa during the recovery.

For example, while it is not clear what the impact of COVID-19 and resulting lockdowns will be on the current school and university year, the forced shift of education stakeholders to virtual classes during this time may drive the expected disruption of the sector at a faster rate. The shift to online retail may also be accelerated by recent events. Indeed, e-commerce in many parts of the world is likely to be revolutionised and could usher in a whole new wave of innovation.

In recent survey responses from private equity practitioners across East, Southern and West Africa, participants indicated a focus on investments in manufacturing, food and beverages, agriculture and financial services over the next 12 months.  

Although the survey was conducted before the onset of COVID-19, these industries are still expected to play a major role in the continent’s economic recovery, particularly in light of disruptions of supply chains globally, and a greater emphasis on local and Africa-based production and trade.

For example, in South Africa, the required retooling and reconfiguring of existing manufacturing capacity to meet non-hospital demand of products such as cloth masks, hand sanitisers, and gloves, given new health and safety regulations at all places of work, schools and in public spaces, is expected to result in funding requirements and could present opportunities for private equity investors to consider.

In West Africa, opportunities are expected for investment into resilient sectors such as fintech (including mobile money and e-commerce), healthcare and healthcare-related support, as well as FMCG in Nigeria.

In East Africa, local food production was severely impacted prior to the pandemic, with swarms of desert locusts having devoured local crops. The current disruptions in domestic food supply chains as well as a slowdown in agricultural production have imposed an additional threat to the region’s food security.

With a renewed policy focus on regional agriculture and agri-processing production and trade, this presents an opportunity for many economies to break the reliance on food imports from outside of the continent, and to become more self-sufficient in food production at a regional level – shortening supply chains and boosting intra-regional trade.

At a global level, there continues to be increased pressure for countries to implement measures to control adverse climatic changes. Key focus areas around a sustainable environment include adoption of clean energy, reduced carbon dioxide emissions, manufacturing of biodegradable and recyclable products, and use of green building materials in construction and real estate, among others. The recent economic shock may give economies an opportunity to refocus investments towards more sustainable solutions and a low-carbon future.

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Looking ahead
The current economic challenges will require agile investors to navigate volatile and distressed environments, but are expected to present investment opportunities. Given the proven track record of private equity investors being adaptable and resilient, the asset class has a key role to play in the post COVID-19 recovery and rebuild.

In Africa, high unemployment rates and already stretched government finances are also expected to see key industries consider a sustainable recovery by working more closely with alternate investment classes, such as private equity. The need for a more inclusive and sustainable development path provides numerous opportunities to generate adequate returns in addition to making a long-lasting, meaningful impact to millions of people and the rebuilding of economies.

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Endnotes


4 This is under the best-case scenario, i.e. the assumption that the pandemic and required containment peaks in the second quarter of 2020 around the world, and drops in the second half of this year. For more information see IMF, 2020. World Economic Outlook, April 2020: The Great Lockdown. Available [Online]. https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/World-Economic-Outlook-April-2020-The-Great-Lockdown-49306


8 Based on Deloitte Africa, unpublished. Africa Private Equity Confidence Survey (PECS) 2020. The unpublished results are based on survey responses collected over the period September 2019 and February 2020. Deloitte Africa’s annual PECS focuses on three regions, surveying respondents with operations, activities and knowledge of each of these regions. These are East Africa, Southern Africa and West Africa. The survey, as in previous years, was targeted at general partners (GPs) operating in the three regions, with additional questions aimed at limited partners (LPs).


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