

Social Private Equity South Africa (SPESA)

...making private equity work for the poor...

Overview

In the recent past, relatively small amounts of private equity (2% of GDP) rapidly and decisively transformed sectors of SA's economy, demonstrating the efficacy of PE as an impactful investment methodology. Social Private Equity (SPE) targets opportunities with high social value add and utilises the generic PE methodology to support enterprises primarily serving the poor and disadvantaged populations by:

- providing low yield mezzanine instruments and targeted non-financial assistance to investees
- lowering entry costs for social entrepreneurs to create sustainable business models
- supporting sustainable business models that provide social goods, services & infrastructure

Examples of existing SPE-type interventions include:

1. *mobile technology*, likely one of the most transformative pro-BoP industries in the past century
2. *micro-finance*, an oft replicated and hugely valuable industry in developing countries
3. *new technologies*, supporting the emergence of call centres, tele-medicine and other low overhead entities

SPESA looks to create a portfolio with investee returns ranging from that achieved by traditional PE (banking in rural areas via mobile telephony) to sub-market (water distribution infrastructure to peri-urban communities), targeting a blended return of around inflation+5%.

Context

Current orthodoxies encourage the adoption of fiscal frameworks which restrict state support, especially in developing economies, to build and maintain efficient core infrastructure, leading to low quality, higher cost social provision to the poor.

On the other hand, the prolonged global economic upswing is creating wealth at unprecedented rates. A greater proportion of which is being accumulated by individuals in a self-reinforcing cycle of wealth concentration. With weaker corporate governance structures, the intra-societal socio-economic disparities continue to widen, especially in developing societies. Since relative disparities, rather than absolute poverty levels, are the primary driver of social instability, this development benefits no one, especially the increasingly wealthy who risk catastrophic loss in probable social dislocations. In South Africa, this dysfunction is superimposed on an untested political, social and economic project - a potentially fraught enterprise.

In the last decade South Africa has had wide ranging economic reforms, themselves amplified by the global trends outlined above. The post-independence upswing in the ICT, mining and retail sectors, and the increasing role of the stock markets and private equity, have fuelled the concentration of capital primarily in a large number of mostly socially disengaged individuals. Against this, the perception of increased socio-economic inequalities, a strong leading indicator of social instability, has solidified. If anything, the recent political changes should alert us to the not-too-distant potential for traumatic outcomes. This, and the under-delivery of social goods, pose a challenge to the Rainbow Project.

Paradoxically, given its socio-political history and current robust economic outperformance, SA provides an excellent environment in which to explore innovative socio-economic formulations, such as SPESA, that:

- deliver quality social goods, services & infrastructure more affordably and reliably to the poor
- lower entry costs and broadens access to entrepreneurial participation by the disadvantaged
- encourage community-based entrepreneurial activity as a means of self-empowerment

Acknowledged under-capacity in the state system implicitly shifts more of the burden of underwriting a sustainably ordered society to the private sector, civil society and those arms of the state that can independently deploy resources – Transnet et al.

The Scale of SPE's potential

Highlighted by the Buffet-Gates arrangement, HNIs committed more than **USD60bn** in '06 in what might be broadly defined venture philanthropy, and we can assume that over the next 10-20 years, commitments level out at an average of ~USD15bn pa. Conservatively, this suggests that a potential pool of some **USD150-300bn** of philanthropic resources might be available for deployment in SPE and related formations in the next two decades. With the benefit of leveraged (**x3?**), some **USD450-900bn** of capital might be mobilised by SPE type vehicles in our lifetime. This capital represents the new asset class that is emerging – **Social Private Equity**.

The Social Private Equity paradigm

PE interventions have had some adverse consequences. But the approach has transformed global industries, addressing issues of delivery efficacy, pricing efficiency and availability of products and services to targeted markets. SPE seeks to do the same in social realm by:

- imposing a 'social value-add' (SVA) filter ahead of classic PE analysis to rank & select projects
- making the cost of capital a tactical variable (vs fixed) to preserve the entity's core SVA
- applying non-financial support to improve operational integrity and ensure a financial surplus

SPE targets both financial and social outcomes, and the measurement of the latter is problematic. Some social value measures are available on a case-by-case basis – jobs created, infant morbidity & mortality rates reduction etc – but more work is required to develop consensual and measures akin to RoI, IRR etc

In the meantime, we are investing in and reviewing attractive high SVA opportunities in South Africa, including:

1. expansion capital for a provider of incremental (microfinance) housing finance
2. an efficient employment creation business providing sanitation and public health services
3. a franchise-like provider of education and related services to kids of the peri-urban poor
4. a rural tele-medicine clinic network, with significant expansion potential
5. an entity that provides financing for peri-urbanities to create transitional accommodation