

Developing private equity and venture capital in Egypt

Assessment and recommendations

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Executive summary

Private equity (PE) and venture capital (VC) play an important role in the capital-raising and growth stages of firms. In developed financial markets, the private equity and venture capital (PEVC) model of investment is not only a source of funding for firms, but also facilitates access to other forms of capital market financing and supports the development of local capital markets.

Despite Egypt's market potential, PE penetration there remains low compared with the levels seen in peer economies. Owing to constraints in the country's tax and regulatory frameworks, Egypt has few onshore PE funds, with local PE firms tending to base their funds offshore or to establish atypical fund structures onshore. As a result, a large number of firms operate in the PE market, such as family offices and investment holding companies. While these firms undertake PE activities, they tend not to follow a typical PE funding model. They rely on their own capital, do not seek out limited partnerships (LPs) and do not have strict schedules for exits.

Although Egypt's PEVC industry remains in the early stages of development, the segmentation of the domestic PEVC market is similar to that seen in mature markets, with the primary stakeholders consisting of angel investors, venture capitalists, investors from small and medium-sized enterprises (SMEs) – including family offices, mid-cap and large-cap companies.¹ However, there is a significant disparity in terms of the scale of activities, the level of market development and the degree of sophistication.

Angel investors usually represent the smallest ticket size in the market (under US\$ 0.5 million) as their investments focus solely on early-stage companies. In recent years these investment firms have grown in size (particularly since the global financial crisis), but greater support is still needed to promote the growth of this investor class across the value chain.

Egypt has few active VC firms with ticket sizes of US\$ 0.5 million - US\$ 2 million. This can be attributed primarily to the high-risk nature of their investments, a lack of awareness of their role and the absence of well-publicised success stories about VC. The SME PEVC market in ticket sizes of US\$ 2 million - US\$ 10 million is still developing in Egypt. While the country has fund managers who work with SMEs, committing not only growth capital, but also the required capacity-building and operational support,

some managers lack the resources to undertake investments that require this level of effort, preferring to target more mature companies.

The small number of Egyptian PE firms and large regional PE firms that are active in the country occupy the mid-cap segment. They are also key players in the large-cap segment, with the bulk of their funds concentrated in so-called 'defensive sectors', such as food, education and health care. For these firms, investment ticket sizes are seldom below US\$ 10 million and often surpass US\$ 50 million. However, there have been few PE investments of this size in Egypt, hence there are few success stories that could generate investor confidence in PE.

A number of challenges affect the wider investment climate in Egypt. In tax administration, for example, various regulations are subject to inconsistent interpretation by tax collectors, leaving investors unable to make clear, long-term decisions from a tax perspective. The government has taken some measures to correct this problem, but numerous areas of tax administration still need improvement, including increased efforts to integrate the informal economy.

Minority investor rights are also lacking in Egypt, which ranks 114th in the World Bank's *Doing Business 2017* report in terms of protecting minority investors. This problem could be offset to some degree by increasing minority rights and by adjusting laws and regulations to explicitly allow for the enforcement of shareholder agreements.

The judicial system would also benefit from initiatives to increase its efficiency and ability to protect minority investors. Steps have already been taken to improve the country's investment climate in this area, such as through the introduction of the new investment and bankruptcy laws.

As in most emerging markets, corporate governance and red tape with regard to investment permits remain a concern.

The primary area for improvement is the regulatory framework governing the establishment of onshore PE funds. The current framework allows for PE funds to be set up, but the regulatory structure is insufficiently supportive, does not enable tax transparency and has unclear rules on investor protection.

¹ In this paper, the terms 'small-cap firms', 'mid-cap firms' and 'large-cap firms' refer to companies with approximate market capitalisations of less than EGP 50 million, between EGP 50 million and EGP 200 million, and above EGP 200 million, respectively.

In the past, PEVC fundraising has been a challenge, exacerbated in recent years by Egypt's foreign currency difficulties. Investors from member states of the Gulf Cooperation Council (GCC) have typically been a major source of finance for PE firms in Egypt, but have recently become more cautious, owing to fluctuations in the price of oil. Private sector institutional investors, such as pension funds and insurance companies, and public sector institutional investors, are not major investors in PEVC. Their lack of participation is usually due to poor awareness of PEVC and – in the case of public sector investors – a low appetite for risk or the absence of a mandate to invest in PEVC as an asset class.

Inadequate corporate governance among potential investees has been identified by international investors in particular as a major factor limiting PEVC investment. While some PEVC fund managers are willing to work with investee companies to improve corporate governance, many are unwilling to take on this risk or lack the resources to work with these firms. Egypt's current Code of Corporate Governance for Listed Companies reflects international best practice, but only applies to listed firms and some financial institutions. Extending the Code to cover all companies would be likely to augment investor confidence.

Exit options have also been limited, especially with regard to listing. While the Egyptian Financial Supervisory Authority (EFSA) has made listing on the Egyptian Exchange (EGX), the country's main

stock exchange, an attractive option, listing on the Nile Exchange (NILEX), the SME stock exchange market of Egypt, is seen as less attractive due to the low volume of trading and the extensive regulations for listing. NILEX will need to undergo reforms in order to encourage trading and incentivise firms to list on the exchange.

Lastly, increased awareness of PEVC is vital for the growth of the sector. Informing local public sector firms and large institutional investors about the benefits of investing in PEVC funds could increase their willingness to do so. Improving awareness among representatives of potential portfolio firms in the SME and corporate sectors would increase the overall investment pipeline.

While there are medium-term solutions to a number of the issues described above, other challenges will require structural changes. For instance, the reform of tax administration, the streamlining of permit processes and the reform of NILEX all require medium-to-longer-term solutions.

Nevertheless, the outlook for the market is promising. The relatively stable composition of the Egyptian cabinet raises the possibility that the country could launch many reform initiatives. Indeed, the government has already launched numerous measures for regulatory reform and it is increasingly receptive to constructive suggestions from the investment community.

Table: Summary of recommendations for tackling investment-climate issues in Egypt

Task	Recommendations	Complexity	Timeframe	Parties involved
Increase investor protection	Develop a clear legal and regulatory framework for the enforcement of shareholder agreements	Moderate	1-3 years	EFSA, Ministry of Investment, and Egyptian parliament
	Increase shareholder rights	Moderate	1-3 years	
	Require additional expert witnesses in legal cases	Low	1-2 years	EFSA, Ministry of Justice
	Improve the overall process of arbitration	High	2-3 years	
Improve the tax environment	Clearly outline the tax treatment of PEVC firms and integrate tax transparency into fund regulations	Moderate	1-2 years	Ministry of Finance
	Simplify the tax code	High	3-5 years	
	Integrate the informal sector	High	Continuous	
Enhance corporate governance	Extend the Code of Corporate Governance for Listed Companies to all companies	High	3-5 years	Ministry of Investment, General Authority for Investment and Free Zones (GAFI), EFSA
	Extend the Code of Corporate Governance for Listed Companies to all financial service firms, including PEVC firms and funds	Moderate	2-3 years	
	Strictly enforce accounting standards among SMEs	Low	1-2 years	Ministry of Finance
Reduce bureaucracy and improve the permit process	Fully implement the concept of a 'one-stop shop' in Egypt	High	1-2 years	Ministry of Investment, and GAFI (the two leading authorities in this area), Egyptian cabinet, various ministries and permit-granting agencies
	Increase the capacity of license-granting agencies	High	3-5 years	
	Clearly outline all necessary requirements for obtaining permits	Moderate	1-2 years	
Improve the PEVC regulatory framework	Amend the current regulatory framework to bring the current limited-partnership model in line with the European or North American model	High	2-3 years	EFSA, Ministry of Justice
	Amend the Executive Regulations of the Capital Markets Law to achieve a more accommodating onshore PEVC fund structure	Low	1-2 years	
	Extend the provisions of the Investment Law to include PE funds	Low	1-2 years	
	Increase specialisation of judges and provide them with relevant capacity building on capital markets	High	3-5 years	
	Develop a clear set of rules outlining the roles and responsibilities of fund managers and professional investors	Low	6 months-1 year	
	Increase the role of EPEA and require PEVC fund managers to register with the Association	Low	1-2 years	

Task	Recommendations	Complexity	Timeframe	Parties involved
Increase local fundraising from institutional investors	Provide PEVC funds with access to additional debt instruments	Moderate	2-3 years	EFSA, Central Bank of Egypt (CBE)
	Provide additional incentives for investing in collective investment vehicles	Moderate	2-3 years	
	Allow PEVC investee companies to gain access to the Central Bank of Egypt's (CBE's) debt financing initiatives for SMEs	Low	1-2 years	CBE
Increase the ease of use and effectiveness of exit options	Revamp the regulatory structure of NILEX and relax the requirements for listing on the exchange	Moderate	6 months-2 years	EFSA
	Increase research conducted by brokerage firms	High	Continuous	Brokerage firms
	Allow more tools on the EGX and NILEX (see Section 3.2.3)	Moderate	1-2 years	EFSA
	Market the Egyptian PEVC sector abroad	Low	Continuous	EPEA and EPEA members
Increase awareness of PEVC in Egypt and build the sector's capacity	Conduct training sessions, seminars and conferences to improve the capabilities of PEVC professionals	Low	Continuous	EPEA and EPEA members
	Conduct awareness sessions in universities, in addition to pitch sessions	Low	Continuous	EPEA, EPEA members, and universities
	Conduct conferences involving multiple PEVC stakeholders to discuss their activities, requirements and concerns	Low	Continuous	EPEA and advisory firms
	Conduct awareness sessions with government authorities and regulators	Moderate	Continuous	EPEA legal committee, Ministry of Justice
	Educate judges about PEVC legal issues	Moderate	Continuous	
	Incentivise the relevant institutional investors	Moderate	Continuous	EPEA and EPEA members
	Develop marketing documents and tools to help raise awareness of the merits of the PEVC industry in Egypt	Low	Continuous	
	Conduct awareness sessions and campaigns to educate SMEs and potential portfolio companies about the PEVC industry	Low	Continuous	

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1. Background

Egypt is currently at a crossroads, with multiple economic reforms in progress to assist the recovery of the third-largest economy in the Middle East and North Africa (MENA) region. The Egyptian economy is diverse and benefits from its geographic location, relatively high revenues from the Suez Canal, remittances from millions of Egyptian expatriates, and substantial reserves of natural gas. The economy is also bolstered by demand from the country's large and growing population, and Egypt has numerous trade agreements in place with countries in Europe, Africa and the Middle East.

The country's economy was well placed before the global financial crisis (GFC) and the Arab Spring, mainly due to being more diversified than its regional peers, having a robust banking sector and making a gradual transition to a market-oriented economy.

However, the events of 2011 caused economic hardship, with political issues leading to an economic slowdown. Most foreign governments, firms and individuals were still reeling from the effects of the GFC and the majority of investors were cautious about Egypt and emerging market economies in general.

The political turmoil that characterised the period after the uprising severely affected the Egyptian economy. The most immediate impact was a large decline in tourism, one of the country's main sources of foreign currency and a significant contributor to GDP (accounting for over 10 per cent of GDP before 2011).

Furthermore, this period saw investor uncertainty and large withdrawals of funds, leading to a net outflow of foreign direct investment (FDI) in 2011. In the months after January 2011, national debt grew. A substantial balance-of-payments deficit developed, foreign currency reserves declined, the value of the Egyptian pound (EGP) dropped, inflation rose and unemployment increased.

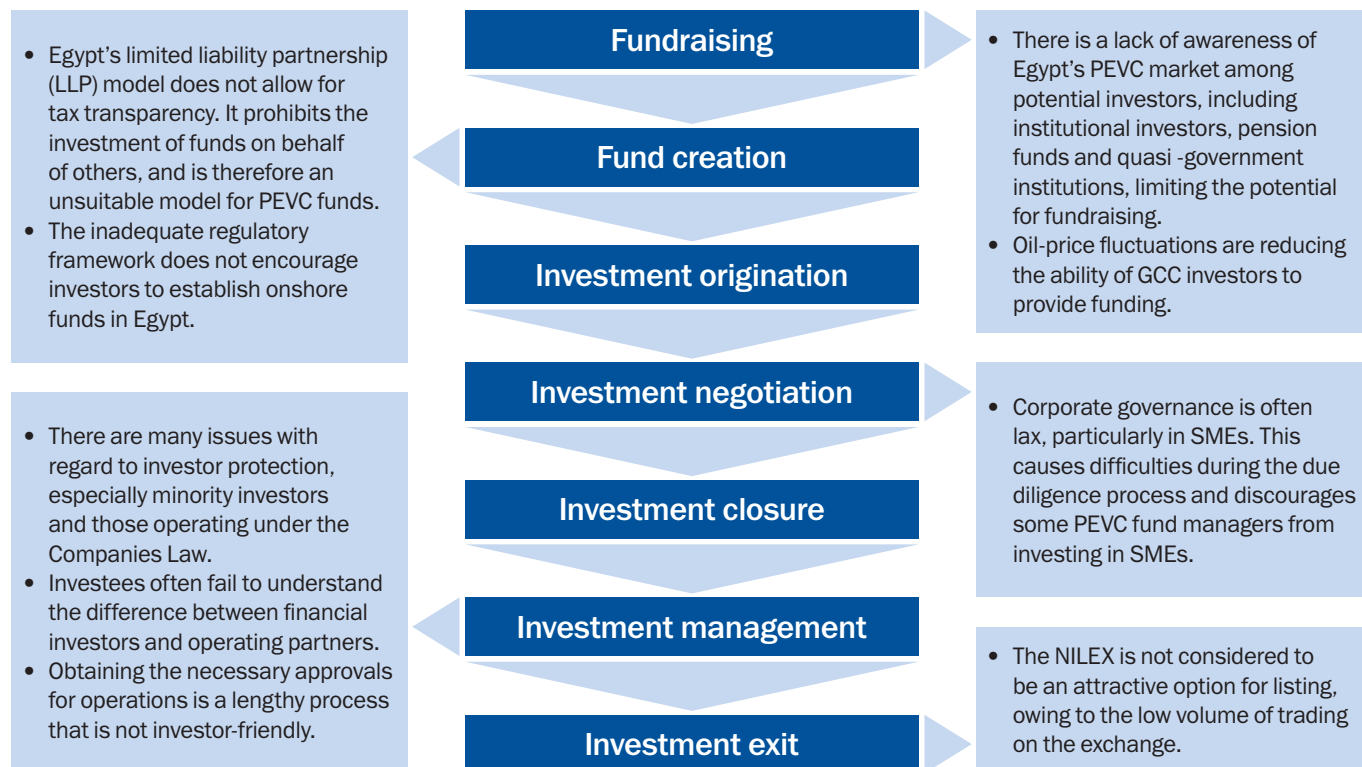
Faced with lower FDI and declining government revenues – as well as increased expenditure, primarily due to rising subsidies and public-sector pay hikes - the Egyptian government began to implement a number of policies to tackle investors' key concerns. These worries included continuous currency devaluation, shortages of foreign currency, tax difficulties and issues with profit repatriation.

Nevertheless, Egypt is now on the road to a free and growing economy. This turnaround was mainly triggered by the flotation of the EGP in November 2016, which led to a series of positive events. The most prominent of these was the International Monetary Fund's (IMF's) approval of a loan of US\$ 12 billion to Egypt, with the first tranche of US\$ 2.7 billion released eight days after the EGP flotation. The conditions of the IMF loan resulted in a larger programme of economic reform, including cuts to subsidies, new drafts of the investment and bankruptcy acts (among many other regulatory reforms now taking place), tax and non-tax incentives as well as an improved mechanism for profit repatriation. All of these measures improved investor confidence and reduced the potential hurdles that foreign investors may face. The performance of the capital market is also improving, driven by high-profile public sector IPOs, as well as Eurobond issues and currency swaps on the international front.

While numerous steps remain necessary in order to achieve long-term economic stability, these recent measures are set to improve the Egyptian economy. Increased market confidence since the EGP flotation, combined with Egypt's strong demographic base, signal the country's potential to surpass the economic levels seen before 2011.

2. PEVC opportunities and areas for development

2.1 Overview of main opportunities and areas for development



2.2 Wider business environment and macroeconomic factors

We have identified several overarching business and macroeconomic factors that impact the wider investment climate, including the PEVC industry. Given their importance, the government is expected to address them in the short to medium term. However, as these issues affect the entire economy, as well as fiscal and monetary policy, they are largely beyond the scope of this report, which will only covers them in brief.

2.2.1. Currency devaluation and shortage of foreign currency

Egypt has experienced a severe shortage of foreign currency. While this relatively recent issue was caused by tumultuous political events and the resulting decline in revenues from tourism, it has created problems for international and local investors alike.

Owing to the shortage of foreign currency, foreign PE investors have been less likely to invest in the country, fearing that it would be difficult to repatriate their profits. While no legal barriers to repatriation exist, in the past the main issue has been the availability of foreign currency. This increased currency risk has led to a need for significantly higher rates of return on investment as compensation for these foreign exchange problems, and has been further aggravated by high rates of inflation. Local investors have also been unable to exchange their funds into foreign currency. Fluctuations in the exchange rate have also increased the general level of risk.

However, following the flotation of the Egyptian pound in November 2016, a severe devaluation took place, with the currency trading at almost half of the official pre-flotation rates. Since then, the foreign currency situation has improved significantly, with unofficial parallel-market rates converging to official rates, and backlogs almost fully cleared.

Importantly, the devaluation of the EGP presents an opportunity for FDI. This is particularly relevant for export-focused firms, whose revenues are in foreign currency while a large portion of their costs remain in EGP. A number of multinational firms have looked into establishing regional hubs in Egypt owing to the country's many regional and international trade agreements (see Charts 5.5 and 5.6). These trade agreements, coupled with decreasing costs the currency flotation, make Egypt a prime investment opportunity for multinationals. If correctly leveraged, the agreements have the potential to increase FDI inflow.

The flotation has caused a high level of volatility in the value of the Egyptian pound. However, in the long term it is expected to resolve some of the issues discussed above. The main benefits of the flotation are the increased convertibility of the Egyptian pound, allowing repatriation to take place without difficulty, as well as the gradual elimination of the parallel market. These developments enable investors to plan their investments and projects effectively, based on official rates and reliable forecasts.

2.2.2. Tax administration

The tax system remains a source of discomfort to investors. Its complexity, and difficulties with tax administration, mean that companies often face uncertainty about how tax collectors will interpret the law.

Moreover, as a result of political instability and regime changes in Egypt during recent years, numerous changes have been made to the tax code. Many investors are therefore unable to make long-term decisions as they cannot plan effectively for their tax treatment. However, the increased level of stability in the Egyptian cabinet and its leaning towards reform, point to the possibility that tax administration might be clarified.

In some situations, PE funds have had to withhold profits from their LPs for a period, because tax advisers have been unable to give them firm figures for their tax obligations, but have instead provided a range of figures. Consequently, these firms have had to keep cash idle in the bank in case the tax authority indicated that the tax due was at the higher end of the range. A quicker process of tax administration would prevent similar situations from developing.

The government has introduced some corrective measures to address these problems, with the business community praising recent reforms. However, there are further areas for improvement, mainly in tax administration and the integration of the informal economy. A number of industry sectors and professions include firms operating in the informal sector and these firms are very difficult to tax as they do not keep sufficient records. In the past, tax administrators have found it simpler to pressure compliant sectors into paying additional taxes, thus ingraining the notion of 'double books'² into the Egyptian business environment. Most PEVC firms would not approach any potential investment target that uses double books. While this issue was partially solved by various reforms before 2011 that simplified tax codes and reduced the tax burden, some reforms in tax administration have since been reversed.

Furthermore, while capital gains taxes are relatively clear for listed companies, they are a large grey area for private (that is, unlisted) companies. Moreover, while the introduction of capital gains tax for unlisted companies has been postponed until 2020, a new stamp tax on the stock market has been introduced, which may complicate planning for IPOs.

PEVC funds in Egypt are taxed at the investee, general partner (GP) and limited partner (LP) level, rather than following the European and North American limited-partnership model of tax transparency³ or the tax-transparent fund model. This model is not applicable in Egypt as, from a tax perspective, limited liability partnerships are not distinguished from corporations. Thus, depending on its structure, any PE fund that is set up locally may have to pay corporate tax at multiple levels, as well as income or dividend tax, compared to just one level of taxation in developed countries.

A transparent tax structure is among the main factors that make offshore funds attractive, as each investor is responsible for their own taxes.

² A system of 'double books' is one where a company develops two sets of financial books, one for internal use and the other for external parties, such as banks or tax authorities.

³ 'Tax transparency' is a characteristic of a number of fund structures. The term refers to a situation where a PEVC fund is not subject to taxation. Instead, its owners are taxed directly as if the investors had invested in the portfolio companies directly. In this way, they are not "penalised" by investing through a fund and can avoid double taxation.

2.2.3. Corporate governance

Insufficient corporate governance at the investee level, particularly among SMEs, has been identified as one of the main elements that discourage investment in this sector despite the numerous opportunities it presents. Egypt's Code of Corporate Governance for Listed Companies is highly comprehensive and reflects international best practice. However, it applies only to listed firms and financial institutions, and enforcement of its requirements is not compulsory.

A significant percentage of private companies in Egypt are owner-managed. These firms are often characterised by insufficient reporting and lax corporate governance. Therefore, they often find it difficult to obtain additional debt or equity financing, due to the limited information that is available to potential creditors and investors.

While some PEVC fund managers are willing – and have the capability – to work with investee companies to improve corporate governance, others are either unwilling to take this risk or lack the resources needed to bring these firms to the required standards.

As in other emerging markets, some SMEs maintain double books. In many cases, PE investors can still help to restructure operations depending on the intent behind the use of double books. The system of double books has been in place for some time and thus does not necessarily raise questions about the integrity of a firm's partners. However, if firms use this system to evade taxes PE investors are unwilling to work with them. Firms need to be made aware of the importance of good governance in helping them to obtain access to equity finance.

2.2.4. Licences and permits

Egypt's current process for granting licences and permits is drawn-out and bureaucratic. This creates obstacles for investors seeking to establish a new firm or expand their operations. The prohibitively slow process affects project schedules, resulting in lower returns on new projects. The document requirements for permits are inconsistent and change frequently, potentially disrupting long-term projects midway through their lifetimes.

Egypt's General Authority for Investment and Free Zones (GAFI) has begun steps to streamline the permit and approval process, the most prominent step being the implementation of a one-stop shop for establishing a company. While this has helped to expedite the process of starting a firm, it has not solved the underlying issue, as firms still need to obtain a majority of the permits, licenses and approvals from multiple authorities and ministries in order to begin operations. The time spent obtaining these can often delay projects for months, even if only one or two licences remain outstanding.

However, some articles of the new investment law address these issues, seeking to ensure that investors receive a timely response from the authorities concerned.

In addition, the cabinet has taken steps to reduce the length of time it takes to obtain industrial permits.

2.2.5. Investor protection and minority rights

Shareholder agreements are another area where there is room to improve the investment landscape in Egypt. Under the current legal framework, shareholder agreements are valid, but the enforceability of typical PE rights, such as tag-along rights, drag-along rights, call options and put options, is untested. Hence, unless a holding company has been set up outside Egypt, it is possible that minority shareholder rights will not be enforced. This concern is reflected in Egypt's ranking in the World Bank's 2017 *Ease of Doing Business* report, where the country is in 114th place in the 'Protecting Minority Investors' category.

In Egypt, minority shareholders generally lack rights and cannot affect the day-to-day activities of a company. They are often unable to influence the strategic direction of a firm, unless they act as a voting bloc. While the relevant laws and regulations contain provisions to explicitly protect minority investors, these provisions can be difficult to enforce due to the lengthy legal process that is typically necessary to obtain a judicial decision.

Investors in organisations that have been set up under the Companies Law experience lower levels of protection than those set up under the Investment Law, owing to the special exemptions and protections that the Investment Law offers. This lack of protection may give support to a recommendation that appears later in this report, namely, to enable PE funds (in a similar manner to VC funds) to benefit from the terms of the Investment Law.

2.3. Areas for development specific to PEVC

In order to benchmark the performance of the Egyptian PEVC sector against key basic requirements for developing the sector in an emerging market, this report refers to an Emerging Markets Private Equity Association publication, titled *EMPEA Guidelines: The Key Elements of Legal and Tax Regimes Optimal for the Development of Private Equity* (2015). The main elements for development as outlined in the EMPEA report include:

1. effective, clear and flexible corporate and securities laws
2. conformity to international standards of business integrity and anti-corruption
3. clear, consistent and internationally competitive taxation
4. a reliable and consistent approach to dispute resolution and enforcement
5. non-discriminatory treatment of cross-border investment
6. an efficient, transparent and fair regulatory environment
7. transparent and reliable rules for expropriation
8. a stable and fair framework for property rights
9. flexibility in insolvency proceedings and fairness for stakeholders
10. the ability to contract freely, with minimum prescription by statute.

In the following section, this report will assess the compliance of the Egyptian PEVC sector against the above criteria and recommend areas for development, which may be necessary to enhance performance of the sector.

The following table briefly outlines this assessment.

1. Effective, clear and flexible corporate and securities laws	The EMPEA report includes recommendations for amendments to the laws on companies and on capital markets that would be likely to encourage and facilitate the establishment and subsequent operation of funds that use a typical PEVC fund structure.
2. Conformity to international standards of business integrity and anti-corruption	Egyptian regulations already require listed companies to comply with corporate governance standards. The report includes recommendations on improving corporate governance for unlisted companies, which are not currently required to comply with the same standards.
3. Clear, consistent and internationally competitive taxation	The report recommends changes to tax administration in order to take account of the special nature of the typical PEVC fund structure.
4. A reliable and consistent approach to dispute resolution and enforcement	The Egyptian judicial system is reliable and consistent. However, the report offers recommendations on the enforcement of judicial decisions and the speed of their implementation. In addition, it suggests keeping judges updated on the terms and techniques used in PEVC investments and contracts.
5. Non-discriminatory treatment of cross-border investment	Egyptian laws do not discriminate between local and foreign investors. This issue has been clarified in the new Investment Law of 2017, which explicitly gives equal rights to both types of investor.
6. An efficient, transparent and fair regulatory environment	The regulatory environment of the PEVC industry in Egypt is reasonably transparent and fair. However, it would still benefit from greater efficiency and should enable the establishment of typical PEVC fund structures.
7. Transparent and reliable rules for expropriation	The new Investment Law includes an article that clearly addresses expropriation rules.
8. A stable and fair framework for property rights	Property rights are a broader investment issue that this report does not address.
9. Flexibility in insolvency proceedings and fairness for stakeholders	Several previous studies have suggested a review of the fraud, default and insolvency regulations in Egypt. The government is currently considering a draft of the bankruptcy law.
10. The ability to contract freely, with minimum prescription by statute	The report includes recommendations on reform of the investment, companies and capital markets laws, in order to enable the establishment and operation of PEVC funds.

The rest of this section will outline areas for development that are specific to PEVC funds. These are segmented into four categories, namely (1) fundraising, (2) establishment and operation of PEVC funds, (3) exit strategies, and (4) general awareness of PEVC among stakeholders in the sector.

While deal origination and negotiation are among the main areas of activity for a PEVC fund, they are not considered to be major areas for development, due to the high number of available investment opportunities.

2.3.1. Fundraising

Owing to Egypt's tax and regulatory regimes, it is common for funds to be established offshore in order to maintain a tax-efficient structure, supported by an established regulatory environment and network of advisers, lawyers, accountants and administrators. However, some local LPs, including quasi-government bodies, can be sceptical of offshore entities and are often cautious about investing in such funds.

PE funds cannot request funding from government, quasi-government or public sector organisations unless they have their funds domiciled in Egypt, while most other LPs – such as global financial institutions – require the funding to be held offshore.

Investment managers in Egypt's larger, institutional investor bodies are often discouraged from investing in asset classes that are considered to be too risky, preferring to invest in treasuries, and thus avoid unfamiliar asset classes. This is a major hindrance to the sector because pension and insurance funds are among the world's largest investor groups in PEVC. For example, UK pension funds have over GBP 2.1 trillion of assets under management, with over 5 per cent of these assets held in PE funds in 2014. In Egypt, the largest entities are typically public-sector institutional investors, which come under intense scrutiny.

Quasi-government institutions such as government pension funds, Egypt Post (which offers a number of financial services and accepts deposits in a similar manner to banks) and insurance companies do not invest in PEVC funds, which are perceived as being risky investments. A number of public sector institutions also have a prescribed list of asset classes in which they are mandated to invest and do not venture outside that list, in order to avoid accusations that they have misused public money.

The repatriation issues discussed earlier have dissuaded many foreign investors from investing in Egypt. Initially, this did not affect high-net-worth GCC nationals, but this group became increasingly frustrated by the difficulties in repatriating their profits in 2015 and 2016, before the EGP flotation. Moreover, recent volatility in the oil price has further diminished the GCC fundraising pool, reducing the ability of these individuals to invest in PEVC.

Consequently, PEVC funds are turning more frequently to development finance institutions for fundraising. While this may be beneficial in the short term, it will not be sustainable in the long run. The market needs to shift towards a model where institutional and private investors account for the bulk of PEVC fundraising.

2.3.2. PEVC fund establishment and operations management

Most of the development areas addressed in this section relate to legislative and regulatory frameworks that enable the establishment and operation of a typical PE fund structure according to global standards. While many private equity investors invest in Egypt through alternative structures, some amendments to the regulatory framework may enhance both the setting-up and operation of a typical PE fund structure.

The three main laws relevant to this structure are the Capital Markets Law, the Companies Law and the Investment Law. This section reviews areas of development for each of these laws, with reference to other regulations that indirectly affect the PEVC sector.

Capital Markets Law

Capital markets in Egypt are regulated under the Capital Markets Law No. 95 of 1992 and its Executive Regulations. Among other areas, the Law and Regulations govern venture capital, the creation of investment funds and portfolios, and securities and brokerage activities.

According to the Law, an investment fund must take the form of a joint-stock company (JSC), which is not sufficiently enabling for the establishment and operation of a typical PE fund structure, if compared to limited liability companies (which have a similar structure to the LLCs seen in France) or limited partnerships (as seen in the United Kingdom). LLCs face fewer requirements than JSCs and establishing them requires less paperwork. Thus, it can take several weeks just to process the documents for a JSC, compared with under a week for LLCs (excluding the time needed to get other approvals, which is identical in both cases). The other main differences are the financial requirements and the levels of regulation, all of which are higher for JSCs.

While the Executive Regulations of the Capital Markets Law allow for the *creation* of onshore PEVC funds, the current regulatory framework does not facilitate and enable their *incorporation*. To a large extent, this can be attributed to how the Law deals with funds, namely, treating them all as mutual funds. This approach does not give enough consideration to the special nature of PEVC funds and to the global standards for how they are structured.

Consequently, onshore PEVC funds are rare in Egypt. The majority of PE funds are established offshore due to the enhanced flexibility this provides, the tax-efficient systems and the fact that international investors see offshore routes as well-tested and more familiar. Other local investors opt to establish investment holding firms in Egypt, thus deviating from the typical PE fund structure.

Companies Law

All corporate vehicles in Egypt are subject to the provisions of Law 159 of 1981 (known as the Companies Law), with some firms subject to Law 8 of 1997 (known as the Investment Law), based on the sector in which they operate and their ownership structure.

While limited liability partnerships do exist in Egypt, they do not provide any of the efficiencies that characterise such firms in most developed economies. The main distinctions between these models are that the Egyptian LLP model is not tax-transparent, with tax treatment identical to that of LLCs and JSCs, and that the capital requirements are more akin to those of an LLC, rather than those of a general partnership. Furthermore, LLPs in Egypt are prohibited from investing funds on behalf of others and must have a majority Egyptian shareholding, thus preventing PE funds from using this structure in Egypt.

The LLC is another form of enterprise preferred for projects that do not have major requirements for financing, but are occasionally used by corporations that have significant funding. No minimum or authorised capital is required to establish a project of this kind. However, unlike joint-stock companies, LLCs require at least one manager (an executive) to be an Egyptian citizen.

Another important issue related to the Companies Law is the enforceability of contractual and shareholder agreements, an area for improvement that is covered in the “Recommendations” section of this report. This issue is crucial as shareholder agreements are a major component of the activities of PE funds.

Changes should be introduced to the regulations that cover fund structures, to create incentives for investors to move away from the format of ‘normal’ companies and towards fund structures. The most practical solution would be to choose a successful PE model already used by another country and replicate the model in Egypt, making minor adjustments in order to comply with Egyptian regulations.

Currently, Mauritius is the only country in Africa where it makes sense to set up a PE fund, as the country offers the best regulatory framework on the continent. However, European countries such as Cyprus, Luxembourg and the Netherlands offer a superior framework for structuring PE funds.

Investment Law

Egypt’s Investment Law is the second main law under which a company can be established. The Law, which was recently replaced by Investment Law No. 72 of 2017, grants companies a number of advantages, but limits these to selected sectors, including manufacturing, mining, logistics, tourism, health care, oil services, infrastructure, and venture capital. These advantages include reduced customs rates, protection from nationalisation and the removal of foreign ownership rules in real estate, land grants or low-cost land, a reduction in bureaucracy with regard to imports and exports, government support for training and social security expenses, and reduced expenses for energy and utilities.

The Investment Law allows for the creation of public free zones, but no private free zones have been established to date. There are currently nine public free zones across the country, eight of which still have vacant spaces. These free zones offer multiple benefits, such as a very limited tax exposure and the ability to bypass a significant level of bureaucracy and red tape.

The law also regulates Special Economic Zones (SEZs), which are different from free zones and are established to provide economic independence. These areas aim to limit bureaucratic procedures, offer lower taxation rates and provide more flexible administration and labour regulations.

In addition, while venture capital funds operate under the Investment Law, and thus benefit from its investment incentives, PE funds are not covered under its mandate.

The new Investment Law No. 72 of 2017 has addressed a number of issues, including empowering a single investment authority (GAFI) to deal with companies, thus reducing the number of authorities that operate in this field. The process of establishing a firm now takes one working day, the cap on foreign employees has risen to 20 per cent, a new arbitration process has been introduced, and tax and financial incentives have received a boost thanks to the removal of stamp taxes and the introduction of a universal 2 per cent customs duty. But despite these apparent improvements, other issues have not been addressed and the government must tackle these in order to boost investor confidence.

2.3.3. Exit strategies

While an initial public offering is a common exit route for PE funds in North America and Europe, this is not generally the case in Egypt. The small number of IPOs of SMEs can be explained by the fact that NILEX, the alternative exchange in Egypt, does not provide an efficient exit function for PEVC investments.

There are various reasons for this inefficiency. NILEX previously used an auction trading method that confused potential traders; it has since been cancelled, but the negative sentiment about the trading method has endured. In addition, the exchange has extensive regulations for listing. For example, 57 regulations and 76 rules of implementation cover the maintenance of a NILEX listing. Listing requires a nominated adviser who serves only a minor role in the process, and substantial listing fees.

More importantly, trade volumes on the exchange are extremely low and the availability of exchange data is generally poor, making NILEX difficult for foreign investors to use. Consequently, only 32 firms are listed on NILEX, four of which have still not commenced trading. The result is that the current IPO exit platform does not accommodate companies operating in the US\$ 5 million to US\$ 15 million range, with most exits through IPOs in Egypt having significantly larger ticket sizes.

On the other hand, the nation's primary exchange, EGX, faces problems of its own due to non-regulatory issues, such as a low trading volumes and ambiguity regarding the implementation of capital gains and stamp taxes. Larger firms have looked abroad to list – for example, Integrated Diagnostics Holdings, which listed at US\$ 334 million on the London Stock Exchange in May 2015, allegedly due to issue with capital gains tax during the preparation for the firm's IPO. Listing on non-Egyptian exchanges is becoming a threat to the viability of EGX, with regional markets such as NASDAQ Dubai offering a feasible alternative to local listing.

The level of trading on secondary markets in Egypt is limited, partially owing to a lack of reporting by analysts. This is attributable to the country's relatively early shift to a low-brokerage-fee model, which has reduced the incentive for brokerage firms to conduct research. This has lowered the level of trading in Egypt, especially day trading, with the majority of market participants taking large long-term positions, rather than using a more short-term, high-volume approach to trading. As a result, volumes are often too low to make IPOs viable.

Another limiting factor is that 49 per cent of shares being offered to the public during an IPO must be offered through Egyptian underwriters for a one-month period. This limits the attractiveness of the Egyptian Exchange to large global firms, potentially reducing the size of the market. It also prevents the transfer of knowledge from experienced firms in developed markets to the Egyptian market.

Despite these issues, some PE firms are still looking to the EGX. Industry feedback suggests that the regulatory bodies involved in the stock market are highly accommodating and have streamlined the listing process in recent years.

Trade sales tend to be the most common exit routes in Egypt. The current trend is for strategic investors – usually large holding companies or multinationals – to purchase the investee from the PE fund, which tends to be a faster and simpler process than an IPO.

Facilitating multiple exit routes is of prime importance, due to their impact on the ability of portfolio companies to grow in future, as well as on the capacity of PEVC firms to transform local companies into regional firms. The availability and efficiency of various exit routes are also important for enhancing the operation of PEVC funds. PE funds tend to be term-defined and thus need to exit their investments towards the end of the fund's duration (as compared to the structure of a holding company, which enables PE investors to maintain their portfolio companies for longer intervals, should a suitable exit mechanism be unavailable).

2.3.4. Awareness

Government officials, the judiciary and local sources of funding

Many stakeholders in the Egyptian PEVC market are relatively unfamiliar with the PEVC investment model as an asset class and with its intricacies. This creates problems in terms of fundraising from local financial institutions, as well as the length and efficiency of dispute resolution.

Players in the sector should raise awareness among government officials about how the sector can contribute to the economy through investment, growth, job creation, and the inflow of FDI.

Institutional investors, pension funds, insurance companies and public sector banks are either unwilling to invest in PEVC funds or unable to do so due to the offshore nature of the funds. This severely limits the potential growth of the sector. While this could be solved in part by allowing for the creation of tax-transparent limited partnerships in Egypt, it is also important to raise awareness of PEVC.

Regulators and public-sector investment managers tend to be reluctant to use some of the investment tools available to them, opting instead for safer options such as treasury bills.

Furthermore, judges and government professionals in charge of settling investors' disputes often have insufficient knowledge of the industry, which hinders the operation and efficiency of the mechanism for resolving disputes.

Potential portfolio companies

Awareness of PEVC is also limited among potential portfolio companies. While some firms may be unaware of PEVC, others may be unwilling to approach a PEVC firm, or incapable of doing so. This is a problem for SMEs as they are often uninformed about the value creation that PEVC firms can potentially offer, the terms and conditions that are typical when working with a PEVC firm and how to prepare for an approach from a PEVC firm.

Many start-ups are also negatively affected by this lack of awareness, lacking the know-how to operate their business effectively or the funds to drive their growth. As PEVC offers firms both of these key factors, along with numerous other benefits, raising awareness among entrepreneurs is imperative.

2.4. Summary

In any country, the PEVC sector requires a number of enabling characteristics in order to thrive. A comprehensive ecosystem is necessary, with a number of large- and mid-cap investors, as well as small-cap players, venture capitalists and angel investors. This ecosystem needs to be supported with effective fundraising, an encouraging regulatory framework for the establishment and operation of funds, multiple exit and buyout strategies, and strong awareness among stakeholders.

The majority of these characteristics are absent from the current PEVC environment in Egypt, which has few local PEVC firms working under the typical fund structure. Instead, the dominant players are regional PEVC funds, and PEVC investors using alternative structures (for example, investment holding companies) as they are unable or unwilling to follow a traditional model and set-up.

PEVC faces a number of macroeconomic issues with regard to fiscal policy, monetary policy and the ease of doing business. Examples include tax administration, high interest rates, the issuance of permits, and the ease of profit repatriation. However, these issues are difficult to address in the short term, and lie beyond the scope of this report.

Other areas for development are PEVC-specific, and are as follows.

- **Fundraising** is a challenge due to the low appetite for risk among local funding sources. The impact of this caution has been exacerbated by the decline in funding available from GCC investors.
- The regulatory framework is not accommodating for the **establishment and operation of onshore PE funds** in line with international standards.
- The market lacks diversified, efficient and more feasible **exit options**, especially for SMEs.
- The **awareness** of PEVC among various stakeholders is low.
- Although a wider investment issue, **corporate governance** of SMEs is an area that requires major development.
- The removal of perceived obstacles to Egyptian firms investing in offshore funds.

3. Recommendations

Overview of main recommendations

PEVC investment is highly beneficial to any economy. It drives growth by promoting the creation and expansion of firms and by generating jobs. In Egypt, most firms are considered to be SMEs and can benefit significantly from the support, mentoring and investment that PEVC firms are able to provide.

PEVC investments are generally more conducive to growth than debt financing is, especially in the early stages of a company's development. PEVC investments also increase FDI and support the inflow of know-how and technology from abroad, helping the country to converge with international standards. In addition, they bring benefits to investors themselves by diversifying portfolios into multiple sectors and into longer-term investments, thus lowering the overall risk of portfolios.

In order to fully capitalise on the advantages of PEVC in Egypt, it is necessary to develop a more accommodating environment for PEVC and an improved operating environment for business in general. Accordingly, we have developed a number of recommendations to help tackle these issues. This section presents the key actions recommended, which are divided into two main areas as follows.

The first set of recommendations addresses the wider investment environment, focusing on:

- increasing investor protection
- improving the tax environment, particularly tax administration
- enhancing corporate governance
- reducing bureaucracy and facilitating the permits process.

The second set of recommendations addresses issues that are specific to PEVC and include:

- improving the regulatory framework to enable the establishment and operation of PEVC funds in line with global standards
- encouraging local fundraising from institutional investors, including quasi-government institutions and banks
- increasing the ease and effectiveness of various alternatives for exit strategies
- spreading awareness among various groups of stakeholders.

3.1. Recommendations on the investment environment

3.1.1. Increase investor protection

Egypt can improve the protection of investors by extending to local investors the same levels of protection that foreign investors enjoy. The legal and regulatory framework should also address minority rights, while the judicial system would benefit from reforms and initiatives to increase its efficiency and ability to secure minority protection.

With regard to the protection of minority shareholders, the authorities should consider making directors more accountable and increasing shareholder rights (such as additional shareholder approvals for implementing corporate actions, and the ability of holders of more than 10 per cent of shares to call an extraordinary meeting). These changes can be achieved through amendments to the executive regulations of the Companies Law and Investment Law.

The enforcement of shareholders' agreements also requires a clear legal and regulatory framework in order to protect shareholders. This can also be achieved by amending the executive regulations of the two laws mentioned above, in order to emphasise the enforceability of such agreements, or by introducing new laws to that effect.

In addition, it is imperative to improve and accelerate the settlement of disputes, the process of arbitration and of executing the outcomes of arbitration. Measures to achieve these goals would have a significant effect on investor confidence. The first step towards this goal would be to call on additional expert witnesses who are well versed in aspects of financial services. This would require some judges to become specialised in the financial sector and might even require the formation of a separate court under the auspices of the EFSA. This would greatly accelerate the judicial process, reducing costs for all parties involved. Minority shareholders would then be able to enforce their rights in a timely manner, which would enhance investor confidence.

In order to enforce contractual obligations and shareholder rights, it is also necessary to increase the efficiency of the dispute resolution system and to improve the overall process of arbitration. The most important aspect of this work would be to ensure that the outcome of arbitration, whether local or international, is recognised and enforceable. This would be an extremely complex process, requiring extensive efforts over several years. It would be likely to require the introduction of additional automation, electronic processes and increased transparency. However, the process could be initiated simply by bringing local laws in line with the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration. While the Investment Law addresses some of the issues with regard to arbitration, further measures will be necessary in order to ensure that the Egyptian system matches international standards, rather than simply relying on international arbitration.

3.1.2. Improve the tax environment

PEVC market participants should collectively initiate discussions with the Ministry of Finance, specifically the Egyptian Tax Authority, to advocate for a tax treatment that fully considers the special nature of PEVC fund structures.

Regulatory amendments are necessary to clarify how PEVC funds are taxed, and to bring their tax treatment in line with international standards. The main area of focus should be to implement clear policies that prevent the use of multiple levels of taxation, while ensuring tax transparency for PEVC funds.

A simplification of the tax code is also required in order to clarify all matters related to corporate tax, and to potential capital gains tax and stamp tax. Tax administration reform is needed in order to unify procedures for the different types of taxation and eliminate any room for interpretation by tax collectors.

The Ministry of Finance has already begun taking steps to reform both the tax code and tax administration, but the process is expected to take some time and will be implemented in phases. It would be preferable to carry out these reforms in one major step, as opposed to multiple smaller steps, thus providing firms with optimal stability and clarity. Before implementing the reforms it will be necessary to run education and awareness campaigns.

The Ministry of Finance should also take steps to integrate the informal sector into the tax base. This integration will reduce the pressure on tax-compliant firms, while enabling the government to maintain revenues at targeted rates. Although this is not, strictly speaking, the responsibility of the Ministry of Finance, there will be positive outcomes for the Ministry and taxpayers alike. While it can be beneficial to leverage the outreach and influence of PEVC investors in potential investee companies, implementing this will require a large push from the government, and PEVC firms should occupy a supportive role only.

3.1.3. Enhance corporate governance

We recommend that conformity with the current Code of Corporate Governance should be compulsory for non-listed companies (in other words, all JSCs and LLCs). Similarly, the enforcement of accounting standards among SMEs would serve to increase their readiness for PEVC firms and boost investor confidence.

EPEA, the IFC and the Egyptian Institute of Directors have already taken steps to enhance the investment-readiness of SMEs by promoting corporate governance among these firms. However, efforts are also needed to enhance corporate governance practices among PEVC investors themselves, for example by extending the Code to include shareholders and implementing stricter policies on independence. Extending the Code of Corporate Governance to cover financial services firms that are not currently under its remit (such as non-JSC and non-trading financial institutions) would also increase the confidence of institutional investors by bringing more robust transparency to the local financial sector.

These reforms should enhance fundraising capability among Egyptian PEVC firms, and enable larger deal flow as they would then be able to invest in previously unapproachable targets. This would have the added benefit of increasing investor protection, especially for minority shareholders.

3.1.4. Reduce bureaucracy and improve permit processes

It is important to develop an outline of all the requirements that firms must meet in order to obtain various types of permit. This should include all the steps and requirements that make the license-granting process as fluid as possible. Developing detailed manuals and checklists for potential investors and their staff would simplify the permit process and encourage activity among new entrants to the market and existing firms.

Developing a simplified approvals process would strengthen the investment climate for all parties, including PEVC firms at the fundraising stage, investment holding companies and potential investee firms. Looking beyond the scope of the PEVC market, a simplified process would increase entrepreneurial activity, FDI and local investment activity.

The Egyptian Ministry of Investment and GAFI have already initiated steps to simplify the process by implementing a 'one-stop shop' concept for paperwork, followed by an investor-friendly approach, in which a single authority forms the entire company once the necessary paperwork has been finished. The process is usually complete within two weeks. However, it would be more efficient for GAFI to be the main issuer of permits and to have all interactions with businesses take place through this single authority, rather than simply placing multiple authorities in a single location, which is the approach that the 'one-stop shop' uses.

Ideally, the above recommendations would be coupled with capacity-building for license-granting agencies, by increasing their headcount and training staff.

3.2. Improving the overall operating environment for PEVC

3.2.1. Improve the regulatory framework

Amending the Executive Regulations of the Capital Markets Law to permit the establishment of private equity funds in the form of limited liability companies (similar to the LLC structure in France) or limited partnerships (as in the United Kingdom), would encourage PEVC activity, allowing the formation of onshore PEVC funds. This can be achieved by adapting an existing legal structure from another country (for example, Germany, the UK or the USA) to the Egyptian regulatory framework.

Reforms to the Investment Law should include provisions for PE funds. This would enable private equity funds to benefit from the investment incentives that are included in the Law, which would encourage investment in the sector.

While the Egyptian regulatory framework makes numerous references to professional investors, it should be elaborate further. The requirements for recognition as a professional investor are not made explicit and there is no clear way to gain this classification. Furthermore, it is not necessary to achieve the classification in order to work in the financial services sector. While making it mandatory for firms to hold this classification, and stating this explicitly in the law or regulations would be burden for PEVC firms initially, it would increase transparency in the PEVC sector and the wider financial services industry, providing investors with more clarity on the roles of key industry professionals.

Obliging PEVC fund managers to register with a reputable independent entity (such as the EFA or EPEA), as is the case in some foreign jurisdictions such as France, could increase investor confidence by indicating that the fund managers have already met the necessary requirements. However, this must be undertaken as a secondary step after the rules and responsibilities of a fund manager have been clearly outlined in the legal and regulatory system.

The end result would be to encourage local investors to invest in PEVC, avoiding the foreign currency risks associated with offshore funds. This would open up PEVC investments to local high-net-worth individuals (HNWIs) as well as large institutional investors, significantly increasing the size of the PEVC investor base.

3.2.2. Increase local fundraising and capital-raising

While the regulatory amendments suggested in the Section 3.2.1 focus on how to enhance the PEVC operating environment, this section looks at the financing structure (debt-equity mix) of investee companies.

Should EFSA amend its regulations in order to allow PEVC investee companies to issue debt instruments, such as derivatives, bonds, debentures, and other debt securities, this would open new sources of short- and medium-term financing for PEVC portfolio companies, reducing any potential problems arising from cash shortages.

Another recommendation in this regard is to incentivise local investors to use collective investment vehicles (CIVs), which include all types of fund structure. This can be achieved through raising awareness of the benefits of CIVs, such as the advantages of using professional investors, reducing risk through diversification, and benefiting from economies of scale. This type of investment vehicle would typically target HNWIs through the wealth-management departments of banks and family-owned investment offices that tend to invest directly in equities, rather than doing so through a professional fund-management company.

Raising awareness among local institutional investors about PEVC as an asset class would also serve to boost local fundraising. This recommendation will be discussed in detail in Section 3.2.4.

3.2.3. Increase the ease and effectiveness of exit options

Some professionals recommend relaxing and simplifying requirements for listing on NILEX and introducing a regulatory framework that is more appropriate for SMEs. Advocates of this approach take the view that a new framework which incentivises companies planning to list on the exchange is essential for the long-term viability of the exchange as an exit option. Should this new structure be effective in encouraging companies to list, it could augment trading and pave the way for SMEs to eventually transition to the EGX, increasing the effectiveness of both exchanges. These regulations should be based on those seen in similar sub-markets of large stock exchanges, and adjusted to suit the Egyptian legal and regulatory framework. While NILEX is modelled on the London Stock Exchange's Alternative Investment Market (AIM), its listing requirements are not.

Comprehensive analyst reports covering a larger portion of listed firms, would be of great benefit. Trading on secondary exchanges in Egypt would be likely to benefit from reports of this kind, as the increased availability of information would boost investor confidence. A rise in the number of secondary market traders would draw attention to the stock and bond markets in general, making an IPO a more attractive exit option.

Allowing the use of additional mechanisms on the exchanges – such as convertibles, drag-along and tag-along rights, trade sales, and call and put options – would increase the alternatives available to investors and further encourage trading on the EGX and NILEX. This would make IPOs more effective and enhance the long-term trading potential of companies that intend to list. EGX and EFSA are currently implementing a number of these mechanisms, but should conduct an awareness campaign to inform investors about the terms and conditions of those tools and how best to use them.

3.2.4. Increase awareness of PEVC in Egypt and build the sector's capacity

For a non-traditional source of financing to flourish and grow in an emerging market, awareness and capacity-building among all industry stakeholders are necessary. These stakeholders fall into three main categories, as follows.

a) Current and potential PEVC participants

Training is needed to align industry practices with international standards, and thus enhance the ability to attract funding from abroad. Increased training and knowledge-sharing enhance the performance of PEVC firms, boosting fundraising as investors prefer to place their money with well-trained and better-qualified firms.

EPEA is already hosting training sessions, inviting leading international experts on PE to share their experiences with local professionals, educating them about the latest strategies and techniques for managing their funds and portfolio companies.

Awareness sessions among university students would attract more graduates to join the industry, based on a clear understanding of the skillsets and knowledge required. These skills and knowledge could be integrated into the educational curricula of students studying for degrees related to finance, increasing their readiness to enter the PEVC workplace after graduation. A more advanced step would be the development of a training curriculum that certifies PEVC investment specialists at three levels (junior, intermediate and senior).

Seminars and roundtables that bring together the various sub-sector groups within PEVC, as well as their stakeholders, would enhance understanding of their activities, requirements and concerns. This would smooth, for example, the flow of transactions between a VC firm that is considering an exit and a PE firm that is considering the investment opportunity. It is of critical importance to include advisory service providers in these roundtables, as they are major stakeholders in the industry. 'Matchmaking' of this kind is among the current objectives and activities of EPEA, and more is needed in order for the industry to develop.

b) Regulators, government officials and local institutional investors

Regulatory bodies can be targeted for awareness sessions and one-to-one discussions on the nature and workings of the PEVC industry. This would help to facilitate the implementation of amendments to the regulatory framework, thus increasing the prospect of achieving their desired impact.

Raising awareness among judicial professionals of the terms and conditions of PEVC investment contracts, and the precise meanings and interpretations of the terminology used in these contracts, would speed up arbitration and the settlement of disputes, enhancing investor confidence and protection.

Raising awareness of this asset class among local institutional investors, showing how the industry works, and the benefits of managing funds through professional fund-management companies, would increase local fundraising. PEVC firms should work together to conduct extensive campaigns to raise awareness, introducing institutional investors and financial institutions to the main PEVC success stories and highlighting the benefits of investment in the PEVC market. A focus on diversifying portfolios and switching to longer-term investments should be central during these sessions, coupled with showing the areas where PEVC investors can provide added value. These campaigns would be most effective after the development of an accommodating onshore structure for PEVC firms, when discussions with investors would have a higher chance of success as institutional investors would be able to invest in funds directly, using local currency.

c) General public

EPEA may develop marketing documents and these should be updated regularly (for example, annually or biannually), providing an overview of the sector, the benefits of PEVC, and related success stories. These documents should be readily available online from EPEA and its members. This endeavour would help raise awareness of PEVC in the country. Similar documents have been developed by national PEVC associations in other countries (such as *Private Equity Made Simple*, developed by the National Association of Pension Funds in association with the British Private Equity and Venture Capital Association, or the *Private Equity Guide*, published by the French Association of Private Equity and Venture Capital).

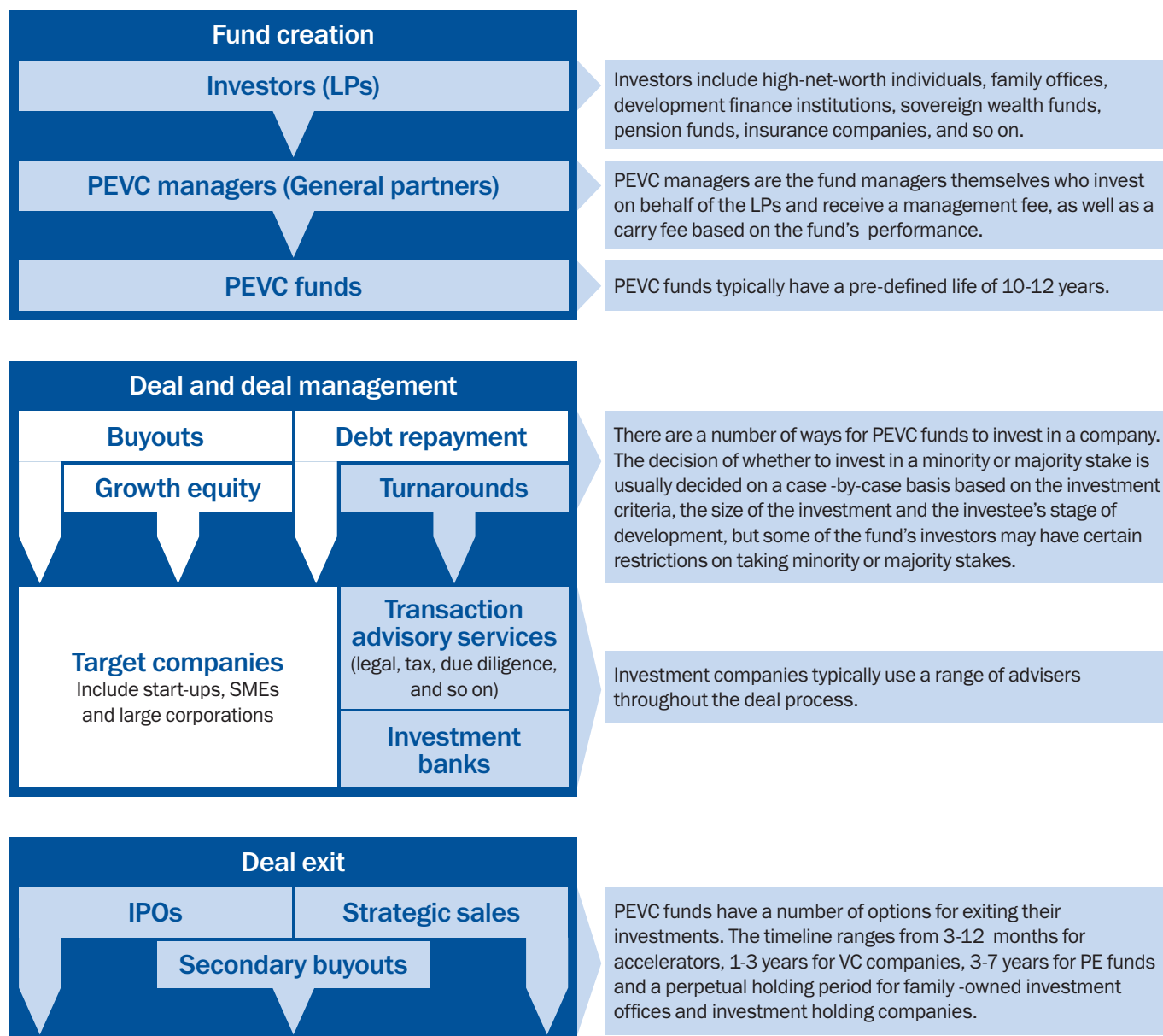
Media campaigns and awareness sessions with firms should be used to inform SMEs, entrepreneurs and potential entrepreneurs about PEVC, particularly about PEVC as a source of finance for growth, what to expect from a PEVC firm, how to prepare for and approach a PE investor, as well as major areas of negotiation, contractual terms, and expectations for exit. This should advance investment-readiness, helping to smooth PE investors' entry into, and exit from, transactions by achieving better outcomes for due diligence and faster conclusion of successful transactions. This can be achieved through conducting awareness sessions with the relevant firms and through media campaigns.

4. Annex 1:

Global and regional PEVC markets

4.1. Overview and benefits of PEVC

Chart 4.1. Traditional PEVC fund structure



Source: PwC research

Private equity is a key driver of activity in mergers and acquisitions (M&As) and involves investing in the equity of firms that are not quoted on a public exchange. Investments in private equity aim to raise the value of the target over a period that tends to be three to seven years, and take place through acquisitions, turnarounds, expansions or investment in start-ups.

Investments come in a variety of formats, such as:

- management buyouts
- venture capital
- growth capital
- turnaround funds.

PE funds exit through:

- IPOs
- trade sales
- secondary buyouts.

Increased private equity investment has had a profound effect on the economies of investee nations. Expanding target companies, whether organically or through buy-and-build strategies, raises employment levels and allows the firms to achieve economies of scale. PE involvement leads to the corporatisation of private sector firms and the introduction of corporate governance, making firms more attractive to investors and enabling them to raise additional funds once they have become publicly listed. VC funds and angel investors allow entrepreneurship to thrive, especially in high-tech industries. This continuous development bolsters the competitiveness of an economy and drives long-term growth in GDP.

In emerging market economies, most sectors are fragmented and served by family-owned firms. These sectors can benefit from consolidation, whereas SMEs can benefit from the international expertise and regional growth opportunities that PEVC firms provide. PEVC has the potential to play a major role in these transformations and contribute significantly to economic development.

Family oriented businesses represent the bulk of PE acquisitions as they have grown rapidly but missed a few crucial building blocks. This is where PE firms come into play as they help take the operations of these family-run firms to the next level of growth.

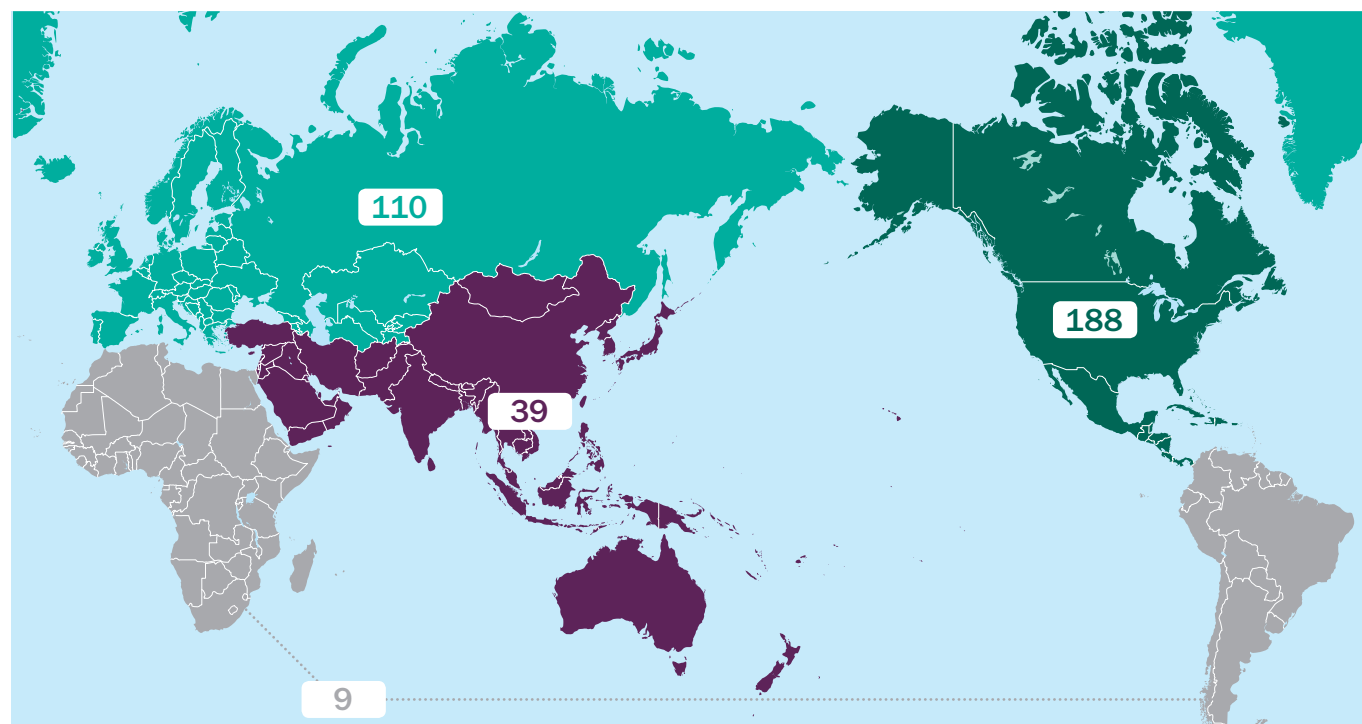
4.2. The global PEVC market

PEVC investments play a substantial role in global financial markets and, according to Preqin (2016), are expected to increase in value even further:

- private equity assets under management reached a new high of US\$ 2.49 trillion in Q1 2016
- the aggregate capital raised by 830 private equity funds that were closed in 2016 reached US\$ 346 billion
- 382 VC funds reached a final close in 2016, securing US\$ 55 billion of investment.

The two leading PE markets are the USA and Europe, with a combined US\$ 298 billion of capital raised in 2016 (see Chart 4.2). Owing to the early development of financial markets in these regions, European and North American economies tend to have sophisticated capital market structures, combined with efficient institutional and legal frameworks.

Chart 4.2. Fundraising by PE funds in 2016, by region (US\$ billion)



Source: Preqin

Globally, Asia is the third-largest PE market, where PE fundraising reached US\$ 39 billion in 2016. In this region, the spotlight is currently on China and Singapore. The sheer size of China's economy attracts investors, whereas Singapore's highly developed financial markets, supported by sustainable government initiatives, enable it to act as hub for PE funds to invest in other Asian economies. In Asia-focused PE fundraising, growth investments make up the largest percentage of the total, accounting for approximately 25 per cent of total PE fundraising. However, as these markets mature, a shift towards buyouts is expected, mirroring the trend previously seen in more developed countries.

Africa has recently become a region of focus for global investors and PE fund managers due to its attractive demographics, largely untapped PE sector and outstanding potential for growth, especially in consumer-driven sectors. The PE sector, although still in its developmental stage, is displaying signs of growth, with regional firms such as Abraaj, Helios and Actis having established Africa-focused funds and closed numerous investments over the past decade. The exit market has also advanced, experiencing its highest number of exits over the past eight years and thus generating greater investor confidence. In this area, Sub-Saharan Africa continues to receive the greatest attention and, according to EMPEA, is likely to be the third most appealing market after Latin America (excluding Brazil) and South-East Asia.

Latin America is the smallest region in terms of the value of capital raised. This regional PE market is dominated by Brazil, however, countries such as Chile, Columbia, Mexico and Peru are all gaining ground. In the region, family ownership of private and public companies is widespread. Family-owned firms are willing to leverage the expertise that PE funds can bring, but building trust is difficult and may hamper the process of due diligence. This lack of trust may give rise to difficulties while a PE fund owns a stake in a business, due to a potential misalignment of interests. As in other emerging market economies, investment exits can be challenging in Latin America. In Brazil, IPOs are difficult to set up, and the local stock market lacks depth, creating additional barriers to exit opportunities. In summary, economies in Latin America have strong potential for growth, but the challenges that investors face, limit the size of investments.

The national borders and regional boundaries shown in the map above are not necessarily the same as those recognised by the EBRD or its shareholders.

Globally, all markets experienced a period of unprecedented growth between 2004 and 2008, and the majority were subsequently severely shaken by the GFC. Each market's reaction to the crisis affected its current path of development. For example, developed PE markets are now experiencing several trends that were not present before 2008:

1. Leveraged investments are limited as credit markets are cautious about this type of investment.
2. The number of growth investments has not yet been restored to its pre-crisis levels, although economic prospects are improving.
3. Opportunities for arbitrage are limited, as increased competition in the more stable markets puts downward pressure on entry multiples.

However, as advanced economies experience a gradual weakening in growth and difficulty in raising debt, emerging economies have become progressively more attractive. Among the factors that drive investment in developing economies are higher GDP growth, higher returns over the past two decades, greater resistance to a variety of securities (such as mortgage-debt securities) owing to the effects of the GFC, and improving socioeconomic conditions. Consequently, PE markets in emerging economies are growing, but they remain relatively small.

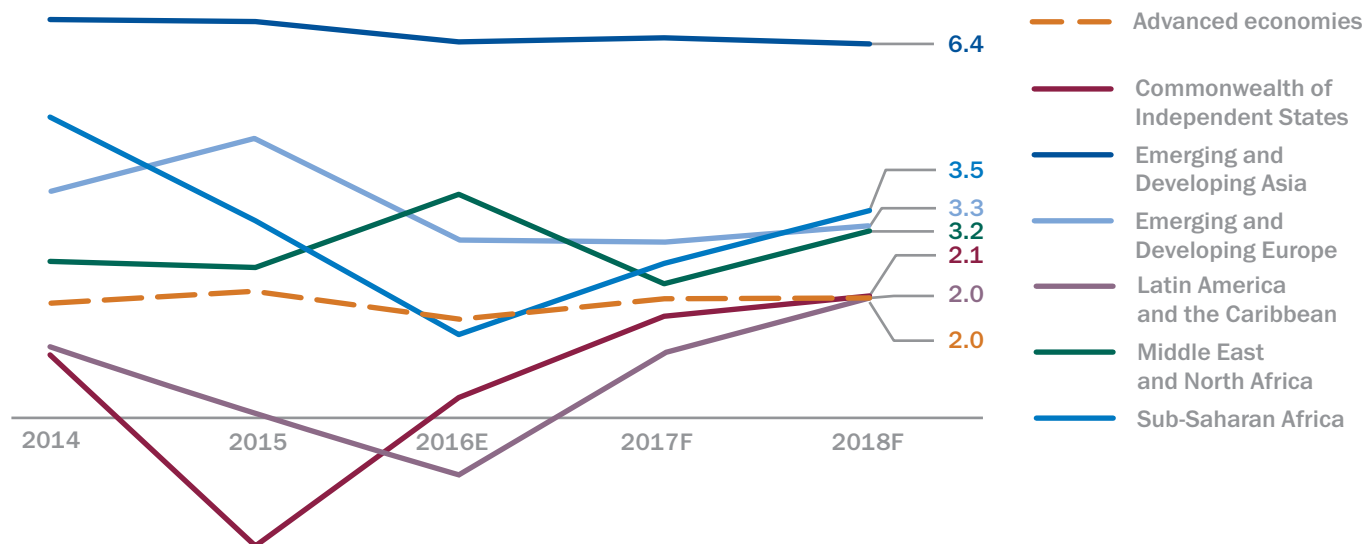
Despite the relatively small magnitude of the total capital raised, the involvement of PE investors in emerging markets is likely to continue to grow, owing to the high level of opportunity in these countries. In 2015, fundraising in emerging markets accounted for 12 per cent of global PE fundraising, with real estate and construction the primary areas of investment. However, investor focus now appears to be shifting to defensive and consumer-driven industries, such as health care and education.

4.3. The PEVC market in MENA

Within emerging markets, MENA remains a relatively untapped opportunity. Despite political conflict and oil-price volatility, the IMF projects that MENA will be the third-fastest growing region for PEVC after Emerging and Developing Asia, and Sub-Saharan Africa (see Chart 4.3). Furthermore, in comparison with other emerging markets, MENA is one of the largest economic blocks, with a combined GDP of US\$ 3.3 trillion in 2014, compared with GDP in the Commonwealth of Independent States and the ASEAN-5 of US\$ 2.7 trillion and US\$ 2.1 trillion, respectively.

An analysis of PE opportunities in MENA reveals that before the GFC the region's total fundraising value for PE peaked at approximately US\$ 6 billion (see Chart 4.4). Following the GFC and the Arab Spring, total fundraising was estimated to be approximately US\$ 1 billion, a mere fraction of its peak in 2007. The number of funds also declined, by 58 per cent, from 29 in 2007 to just 12 in the third quarter of 2015.

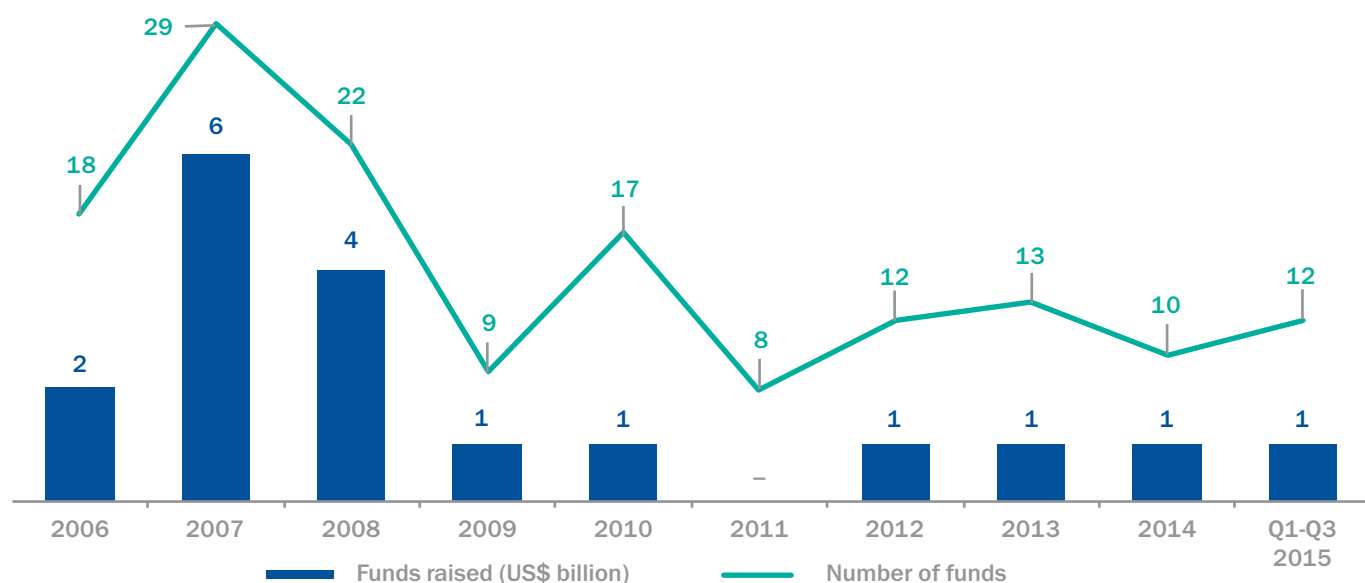
Chart 4.3. Global economic outlook – GDP growth



Source: IMF

Note: 'E' denotes 'estimate'; 'F' denotes 'forecast'.

Chart 4.4. Fundraising in the MENA region



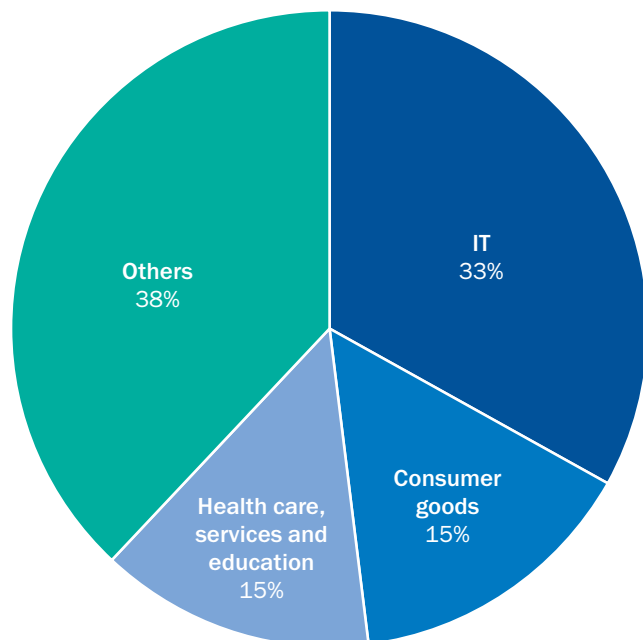
Source: EMPEA

Growth capital is the primary focus of investors in emerging markets and countries of the MENA region. This emphasis can be explained by the underdeveloped capital markets and by the fact that investments aim primarily to achieve value through a growth in profits.

LPs play a substantial role in MENA PE investments. These LPs tend to take the form of family-owned investment offices, rather than being institutional investors such as insurance companies or pension funds. As the regional PE market is still developing,

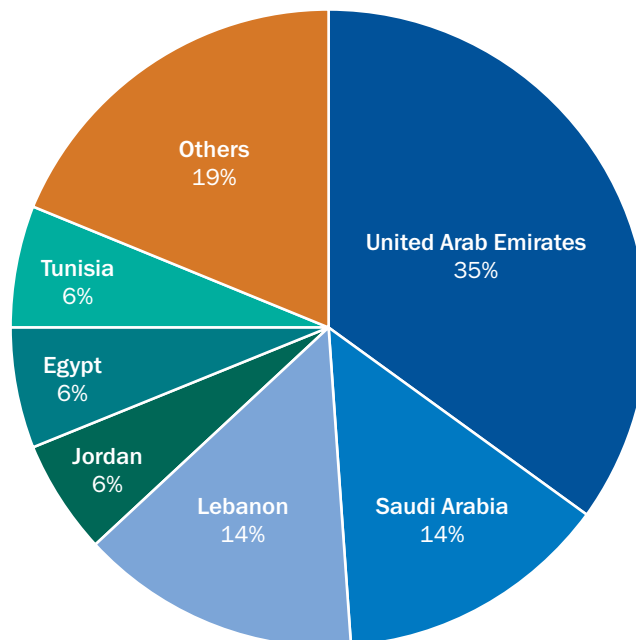
investors are seldom well informed about PEVCs and do not possess a strong understanding of the 'blind-pool' model used by PE firms. As a result, they prefer to participate on an investment-by-investment basis and will often invest less in the PE fund itself, opting instead to co-invest in the investments that they find attractive. While institutional investors in Europe and North America do co-invest, they are usually familiar with the PEVC model and comfortable investing directly into funds. This trend of rising co-investment in the MENA region presents a challenge to fund managers, who find it increasingly difficult to raise finance from local and regional sources.

Chart 4.5. PE investment volumes in MENA by industry, 2015



Source: MENA Private Equity Association

Chart 4.6. Investment volumes in MENA by country, 2015



Source: MENA Private Equity Association

The IT sector accounted for the largest percentage of PE investments in the MENA region by volume in 2015, contributing 33 per cent of the total (see Chart 4.5). This can be explained by the growth in VC activity that the region witnessed in 2015, where VC funds have focused on technology-driven firms. The United Arab Emirates and Saudi Arabia accounted for the largest percentage in terms of investment volume (see Chart 4.6).

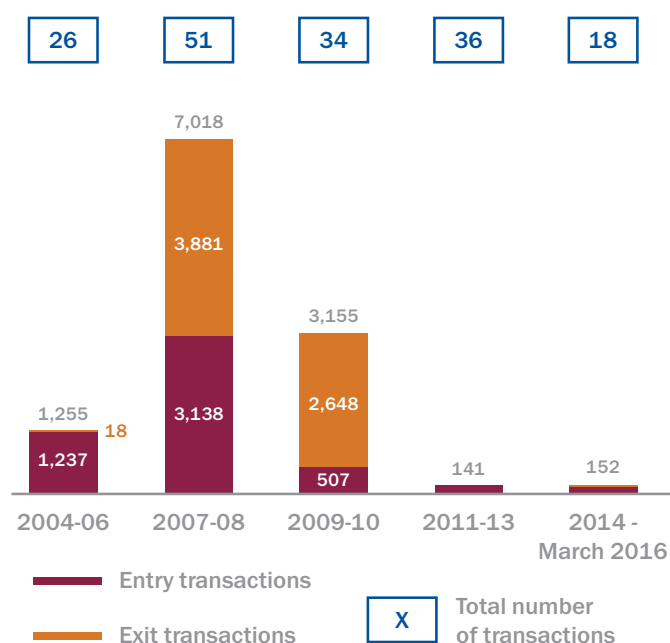
5. Annex 2:

Egypt as an investment opportunity

5.1 History of PEVC activity in Egypt

Private equity has a shorter history in Egypt than in advanced economies. For example, as Chart 5.1 shows, there was some development of the Egyptian PEVC market between 2004 and 2006, facilitated by economic liberalisation and government stimulus. With increases in regional wealth driven by rising oil prices and domestic consumption, the period from 2007-08 was clearly the peak of PE activity in Egypt, with the total value of 51 transactions reaching an unprecedented level of more than US\$ 7 billion.

Chart 5.1. PE transaction values in Egypt, US\$ million

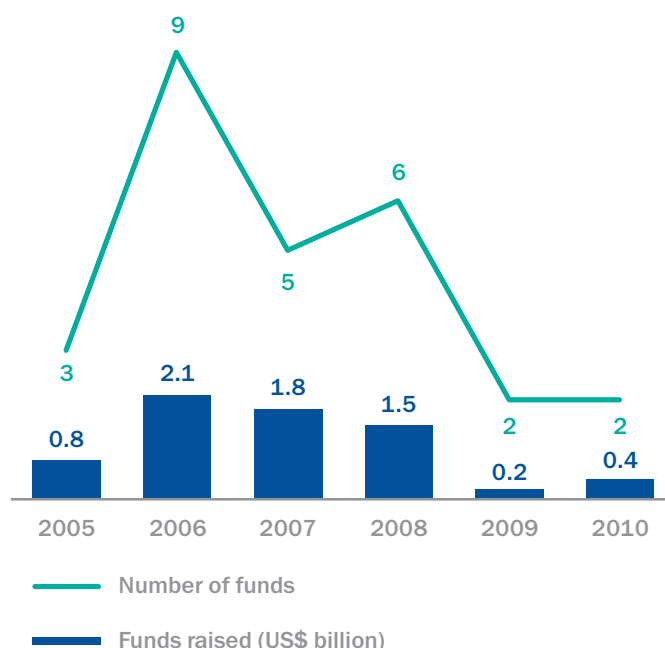


Source: Zawya

The GFC brought the boom to an end in 2009, with PE activity dropping by 55 per cent, lowering the total value of PE transactions to roughly US\$ 3 billion (see Chart 5.1).

When the financial crisis reached the MENA region, the number of PE funds managed in Egypt (although generally domiciled abroad) dropped from 6 to 2, and total capital raised decreased by 86 per cent to US\$ 0.2 billion in 2009. Even though the region was less exposed than North America was to sub-prime credit products, the slowing global economy influenced investor behaviour and risk appetite across the world. Just as fund managers had started adapting to the GFC, another shock wave hit, in the form of the Arab Spring in 2011. Due to the political unrest in the region, the total value of PE transactions dropped to US\$ 141 million in the period 2011-13, and was limited exclusively to entry transactions. Strong economic fundamentals cushioned the region against a dramatic deterioration during the GFC but funds faced difficulty in exiting their investments as IPOs and other exit strategies were not sufficiently appealing during this period.

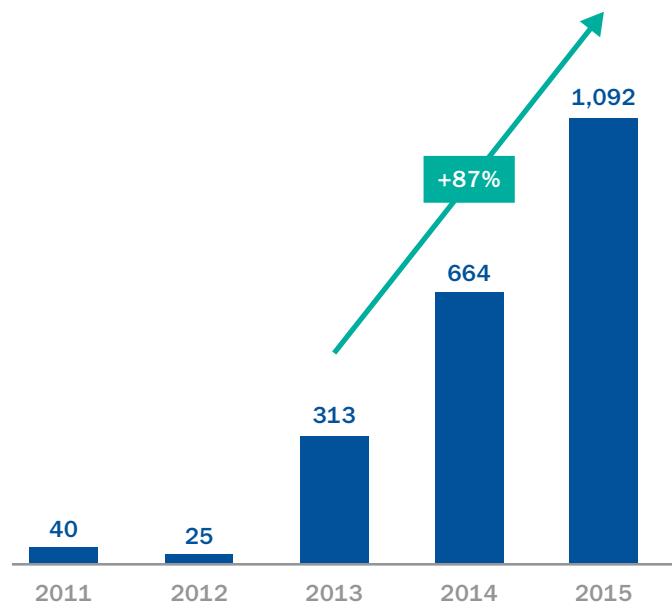
Chart 5.2. Egypt-focused fundraising, US\$ billion



Source: Preqin

Over the 10 years to March 2016, managers of domestic Egyptian funds raised a total of US\$ 2.7 billion in PE capital. However, the market witnessed a drastic decline during the period of turmoil. Between 2014 and March 2016 it gradually improved, and the total value of PE transactions reached US\$ 152 million, a 10 per cent increase on the level seen in 2011-13. Moreover, from 2013 to 2015, PE M&A activity grew by 87 per cent per year to reach US\$ 1.09 billion in 2015 – a clear indication of rising investor interest in the country.

Chart 5.3. PE M&A value, US\$ million



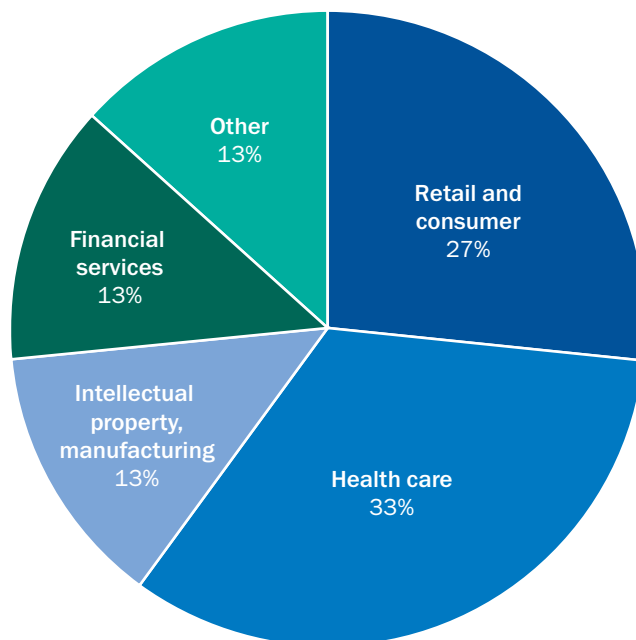
Source: Mergermarket, PwC analysis.

According to market participants, fewer than five venture capital funds are currently active in Egypt and only a handful of pure private equity firms. However, a relatively large number of companies compete with them, such as family investment firms and investment holding companies.

The Egyptian PEVC market has the potential to grow, based on its strong fundamentals and increasing efforts by the government to promote investment in the economy. In November 2015, Egypt's population surpassed 90 million people, thus accounting for over a third of the total population of the MENA region. The private sector therefore has a considerable opportunity to bridge the gaps in social infrastructure – particularly in health care and education, which tend to be underfunded and of poor quality.

Thus, it is evident that the PEVC industry can contribute significantly to the development of various sectors and play a crucial role in the continued development of Egypt's economy.

Chart 5.4. PE M&A by sector, 2015



Source: Mergermarket, PwC analysis.

This will become more evident thanks to Egypt being one of the countries to spearhead efforts to merge COMESA with two other African trading blocs: the Southern African Development Community (SADC) and the East African Community, which together would form the African Free Trade Zone (AFTZ). Since 2014 there has been notable progress in these efforts and the AFTZ is expected to take effect during 2017. Should this occur, Egypt would be well placed to act as a hub in Africa, owing to its numerous free trade agreements with other countries on the continent, as well as its free trade agreements with the EU, the Greater Arab Free Trade Area, and Turkey.

Chart 5.5. Egypt's global trade agreements and major trading partners

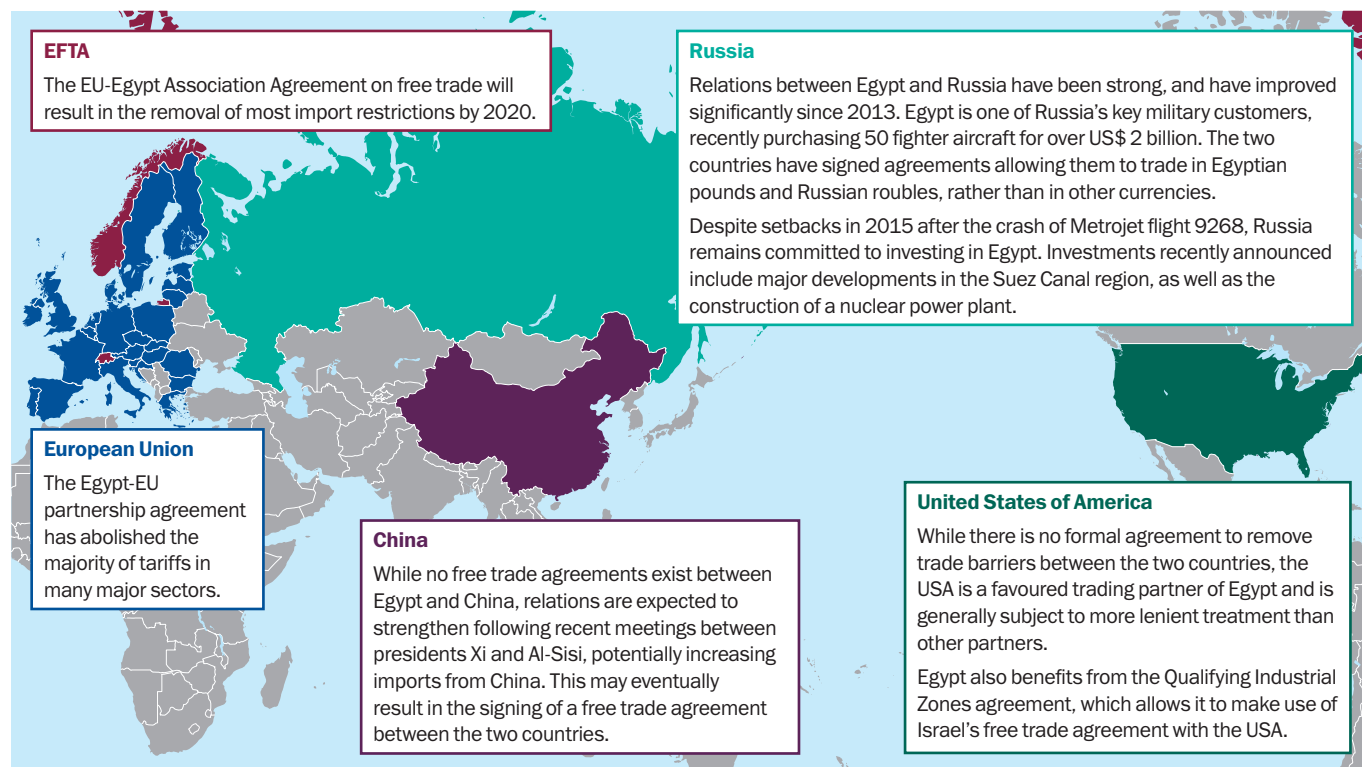
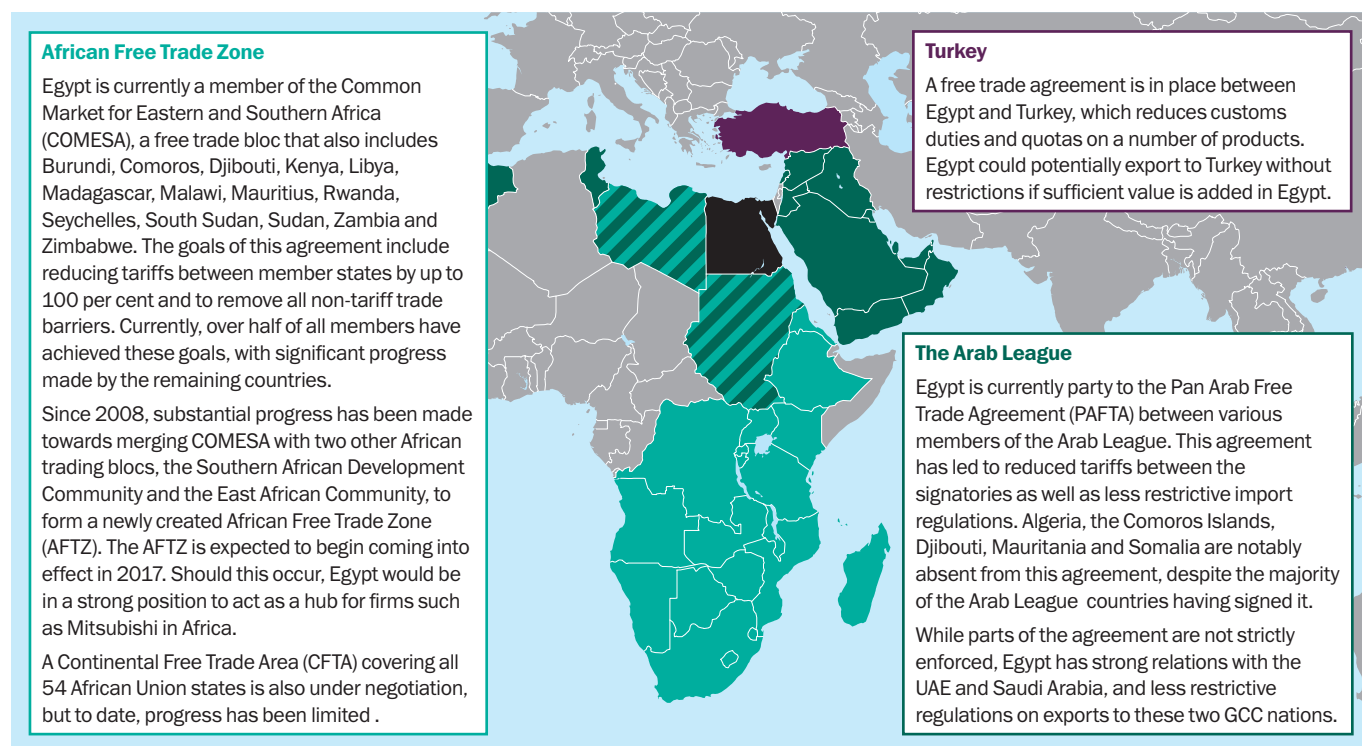


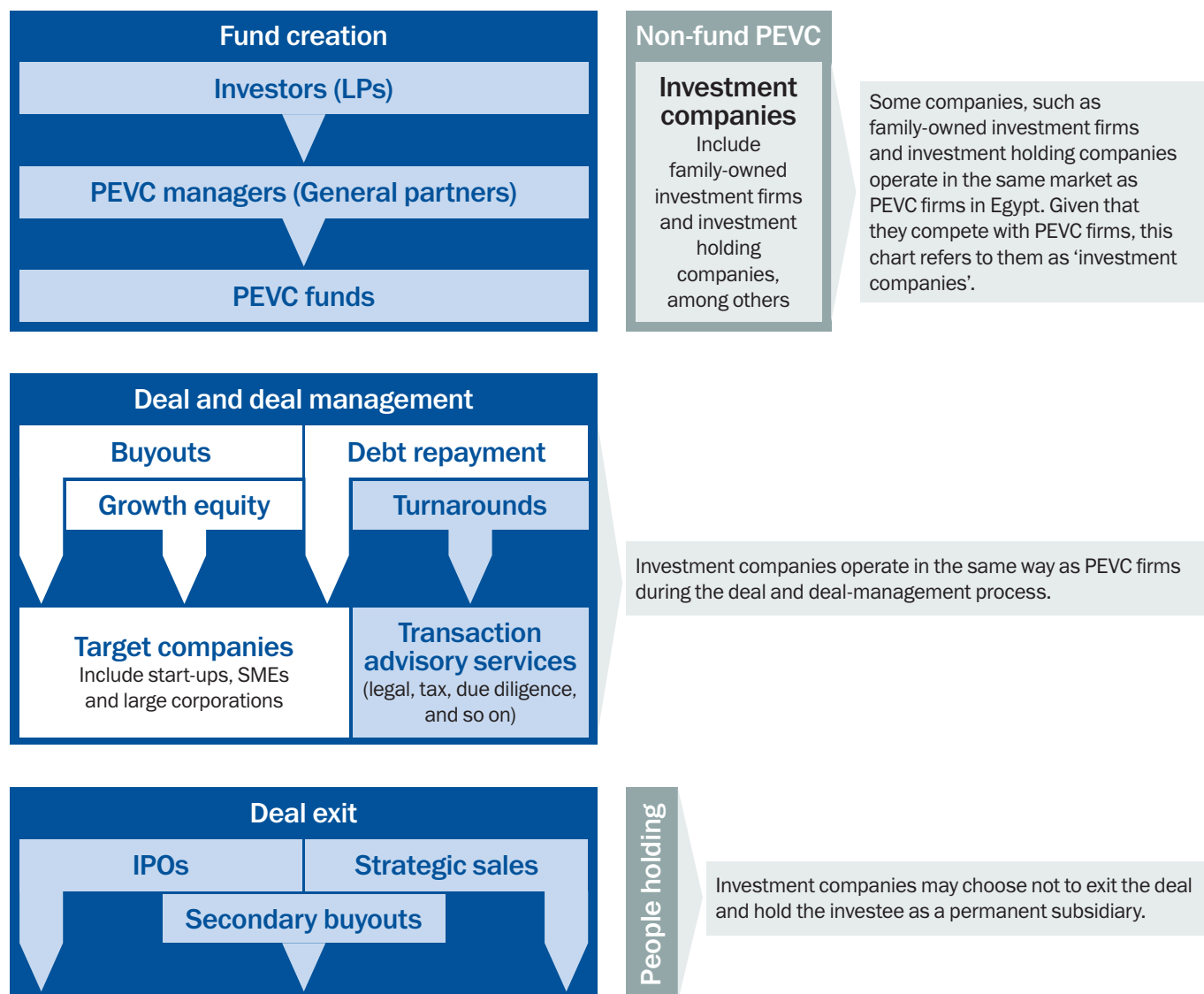
Chart 5.6. Egypt's regional trade agreements



The national borders and regional boundaries shown in the maps above are not necessarily the same as those recognised by the EBRD or its shareholders.

5.2 Current state of the PEVC industry

Chart 5.7. PEVC structure in Egypt



Source: PwC research

Despite the country's strong macroeconomic fundamentals, few domestically based funds are in place, due to Egypt's regulatory framework, with local PE firms tending to establish holding companies to manage investments in the country, while their funds are based offshore. The Egyptian PE sector may therefore seem relatively small, but this is partially due to the fact that many non-PE firms – such as family-owned investment firms, and investment holding firms – operate in the PE arena. These firms undertake PE activities but are often unaware that their activities are defined as PE and do not use business models identical to those of PE funds. For example, these companies rely on their own capital, do not seek additional LPs, and do not necessarily have a strict timeframe for exits. As these activities fall outside the typical scope of PE, and are therefore not reported as such, industry statistics currently undervalue the market.

While some family-owned firms have invested in PE funds in the past, those that have done so have gained an understanding of the PEVC sector, often establishing their own investment teams. As many of these teams do not have the same level of ability to identify investments as PEVC firms do, family-owned investment offices have often chosen to continue to invest through PE funds, but are generally more interested in co-investing with the PE fund to gain a large stake in the company, seeking to maximise their control or returns.

Family investment firms are becoming increasingly powerful due to their heightened awareness of the ways in which a management team can bring value, and therefore they tend to demand to acquire at least 15-20 per cent of the target company.

Increased competition poses another threat to local PE players, because some former LPs that took part in previous cycles of investment have since established their own investment houses and created a regional presence.

Consumer-driven sectors are attracting the most interest in Egypt, as well as renewable energy projects and public-private partnerships. Investors have identified renewable energy, fast-moving consumer goods, health care and education as the most promising sectors due to their fragmented market structure and to growing participation by the private sector.

Most sectors are characterised by market fragmentation, with education, health care, pharmaceuticals and consumer credit the most popular sectors for investment, with the highest levels of demand. However, infrastructure and renewable energy are expected to offer the greatest opportunities for growth in the future.

Competition in PEVC

Table 5.1. PEVC competition in Egypt

	Description	Ticket size (US\$ million)	Stage of development
Angel investing	<ul style="list-style-type: none"> individuals providing seed capital for start-ups 	< 0.5	Underdeveloped
Venture capital	<ul style="list-style-type: none"> funds financing greenfield and early-stage high-growth companies includes accelerators and incubators 	0.5 – 2	Underdeveloped
SME-focused funds	<ul style="list-style-type: none"> funds financing smaller firms most funds avoid this sector owing to the amount of work required per investment many family-owned investment firms operate in this space 	2 – 10	Underdeveloped, in light of the number of opportunities that are thought to exist
Mid-cap funds	<ul style="list-style-type: none"> funds that finance established firms seeking corporatisation or expansion most PE funds operate in this area most funds in the mid-cap sector also operate in the large-cap sector 	10 – 50	Relatively developed, given the number of investment opportunities that are thought to be available
Large-cap funds	<ul style="list-style-type: none"> funds that finance established firms seeking corporatisation or expansion most PE funds operate in this sector the majority of funds in the large-cap sector also operate in the mid-cap sector the most common exit route here is through IPOs 	50+	Relatively developed

Despite being in early stages of development, the overall structure of the PEVC market in Egypt is similar to those seen in mature markets, with the primary stakeholders consisting of angel investors, venture capitalists, SME investors (including family investment firms), mid-cap and large-cap players. However, there is a significant disparity in the scale of activities, level of development and degree of sophistication.

Angel investors, such as those in the Cairo Angels network, cover the smallest ticket size in the market, as their investments focus solely on start-ups or companies in early stages of development. These investors have grown in size rapidly over the past couple of years, but target SMEs still need greater support from PE firms, VCs, incubators and accelerators in order to help fulfil their role as an investment platform, promote their growth, and help determine where they belong as an asset class.

Cairo Angels typically invite VCs to invest in the Series A round, where investments range from US\$ 500,000 to US\$ 2 million.

The volume of venture capital in Egypt is limited, owing to the high-risk nature of VC investments, a lack of understanding and awareness of their role and functions, an absence of success stories and an inefficient regulatory framework. The absence of feasible alternatives means that venture capitalists are forced to use an investment-holding-company structure to allocate their investments. The SME investment market in Egypt is still developing. Some investors have found working with SMEs to be challenging, as these firms require not only growth capital, but also capacity-building, and technical and operational support, in addition to mentoring and coaching, especially with regard to corporate governance and reporting. Consequently, investors tend to avoid this market segment as they often lack the time and resources to undertake a venture requiring this level of sophistication.

Nevertheless, the SME sector is showing signs of growth thanks to initiatives introduced by the Egyptian government. This follows the approach seen in more developed economies such as the UK and USA, whose governments have taken extensive measures to incentivise investment in this sector, mainly in the form of tax breaks. Therefore, the SME market in Egypt is expected to advance in the coming years.

Most Egyptian PE firms fall into the mid-cap segment, with a few key participants in the large-cap segment in addition to large regional firms. They tend not to make investments under US\$ 10 million and are often willing to invest more than US\$ 50 million, if the right opportunity presents itself.

However, high-quality investments of that size have been in limited supply, making it difficult to produce the success stories that could heighten investor confidence. The majority of Egyptian PE funds focus on the region, with the largest percentage allocated to Egypt (due to its attractive demographics), followed by Jordan, Tunisia and Morocco. Moreover, the bulk of these funds concentrate on defensive sectors, principally in education, health care, and food and beverages, while there is also growing interest in renewable energy. The funds are established offshore, mainly in Luxembourg, the Netherlands and the Channel Island of Jersey, due to the more flexible legislative regimes available there. While Egyptian legislation provides a limited partnership structure, it does not provide the tax transparency of the traditional GP or LP structures employed in developed countries, and it also requires a majority Egyptian shareholding.

Overall, the mid-cap and large-cap segments are fairly well developed, with PE firms having competitive investment portfolios, large ticket sizes and strong fundraising capabilities. In addition, large regional players are beginning to allocate a greater percentage of their funds to Egypt. On the other hand, however, there is a gap in the country's PEVC market in both the VC and SME segments, with limited funds dedicated to their growth and fewer opportunities for small-ticket-size investments. There is currently a shortage of investment in the US\$ 500,000 to US\$ 1 million range and in the US\$ 1 million to US\$ 5 million bracket.

Angel investors

Angel investment is defined as investment by individuals in start-up firms, usually in exchange for an equity stake in the fledgling organisation. Angel investors tend to invest directly in their targets, rather than investing through a fund, in contrast to the approach used by VC and PE investors. Owing to the nature of these investments, the targets are often micro-sized enterprises or small and early-stage firms.

The most prominent angel investor network in Egypt, Cairo Angels, consists of a platform that brings together entrepreneurs who are seeking capital in Egypt or MENA and high-net-worth individuals seeking to invest privately in start-ups. Their main objective is to help investors find and screen quality investments in the SME sector.

VC activity

In 2014, the amount of VC funding raised across the MENA region reached its highest level since 2008-09, peaking at approximately US\$ 205 million, with most investment being in IT (45 per cent), services (24 per cent) and food and beverages (9 per cent). Since 2011, the venture capital market in Egypt has been following the same patterns as those seen in the wider MENA region. The greatest growth opportunities lie in mobile, internet, social media, and e-commerce services.

VC success stories

- Fawry was established in 2004 and, with the support of Ideavengers, became the largest e-payment platform in Egypt, providing online payment services to over 50 million customers and generating revenues of EGP 214 million in 2014. The company was recently acquired by a group of investors for US\$ 100 million.
- Vimov was founded in 2008 and, with the guidance of Sawari Ventures, the firm launched their own weather application (Weather HD), which became the bestselling paid application worldwide for iPads. The company also created an iPhone simulator platform called iSimulate.
- ALZWAD, alongside Sawari Ventures, launched a multiplatform infotainment and communications on-device portal, including a lifestyle portal (Me3AIMobile) and a free iPhone application, Gazar.

The overall market is growing steadily as young entrepreneurs turn their ideas into business opportunities. In addition, financial institutions, including banks, microfinance companies and PEVC firms have resumed operations with renewed confidence. Therefore, the size of investments is gradually increasing and, in 2014, Egypt's VC investment volume reached 6 per cent of the country's total M&A activity.

Egypt has a range of venture capital firms, business incubators, accelerators and angel investors. Each aims to provide mentoring, capacity-building, business development assistance and access to financing tools (leasing, factoring and so on) plus incentives for incorporating new businesses. The VC sector is the youngest among these groups, currently characterised by inexperienced investors and insufficient infrastructure.

Although there is an ecosystem for VCs, it is less helpful than may be expected in terms of providing incubation and value-added services. The large initial cost required for investment and the amount of time and effort needed to make a venture successful are often too difficult to absorb.

SME activity

Overview

SMEs are vital for the wellbeing of the Egyptian economy, accounting for over 90 per cent of Egyptian private sector businesses, but only a quarter of GDP. At the end of 2011, the private sector in Egypt consisted of around three million firms, with an average headcount of about three employees per business.

The health of the Egyptian economy is linked to the prosperity of its SMEs, and it is therefore vital to create an environment that fosters the growth of these firms. A higher level of PE and VC investment in SMEs can help to achieve this sustained economic growth.

The Central Bank of Egypt has defined SMEs based on employment and sales, for established firms, and by employment and paid-in capital, for new businesses, as outlined in Table 5.2.

Table 5.2. Central Bank of Egypt classification of micro, small and medium-sized enterprises

Classification of firms	Annual sales revenue for established firms (in in EGP)	Paid-in capital of new firms (in EGP)	Number of employees
Micro-sized	< 1 million	< 50,000	< 10
Small	1-50 million	50,000-5 million (manufacturing) 50,000-3 million (non-manufacturing)	< 200
Medium-sized	50-200 million	5-15 million (manufacturing) 3-5 million (non-manufacturing)	

SMEs are characterised by a high degree of informality, and ineffective or insufficient corporate governance. According to the Egyptian Ministry of Finance, over 90 per cent of SMEs are split between the manufacturing (51.1 per cent) and trade (40.5 per cent) sectors, which in many cases operate with a high level of informality. Larger firms, in contrast, tend to operate in highly regulated sectors, such as construction, resource extraction, financial services and heavy manufacturing.

Despite the apparently large number of SMEs, Ministry of Finance data suggest that over 90 per cent of these firms have a headcount of fewer than 10 employees (in other words, they are classified as micro-sized enterprises), accounting for approximately two-thirds of total SME employment. Egypt's economy therefore has relatively few firms that could truly be described as SMEs, and is characterised by an abundance of microenterprises as well as sufficient large-scale enterprises. Larger firms account for 0.1 per cent of all businesses, but a third of total employment. However, there are relatively few small and medium-sized enterprises. This suggests that the majority of smaller firms and microenterprises struggle to develop in size and gain market share. This relative underdevelopment of the SME sector can be attributed to three main factors:

- limited access to finance
- inexperience in market intermediaries
- an insufficiently encouraging regulatory framework.

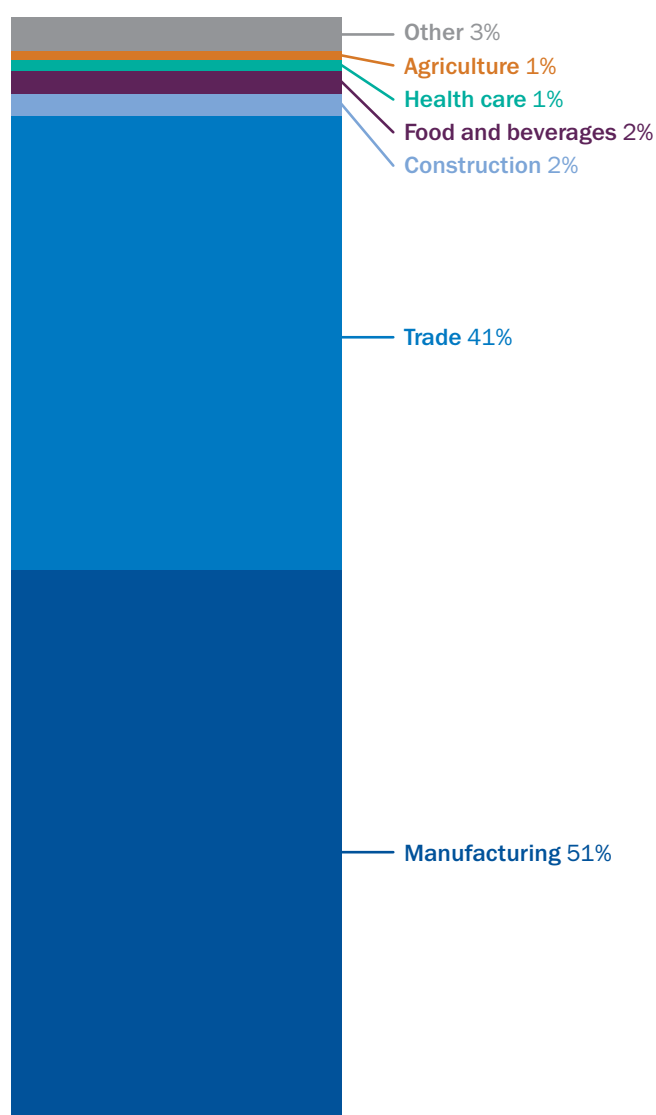
Access to finance

Financial institutions, particularly banks, do not have sufficient depth of experience and understanding of the nature of SME activities, due to:

- a strong preference for investing in large, reputable corporations
- not having a clear definition of what the term SME means.

Gaining access to finance remains a problem for SMEs due to the bureaucratic nature of banks. Requirements for extensive documentation deter SMEs, making it harder for them to raise debt. Furthermore, banks tend to require some form of collateral, such as personal assets or guarantees, which many SMEs cannot provide, and therefore often resort to using informal methods of financing.

Chart 5.8: SME activity by sector, 2012



Source: Creative Associates

Due diligence issues with regard to investment in SMEs

A number of due diligence issues can arise when targeting SMEs.

- Investees may not provide PEVC firms with the tools they need to properly assess the business, owing to inefficient or ineffective internal reporting and insufficient corporate governance.
- Investors may have a limited view of the investees' operations; financial reports are often incomplete or unavailable, and information regarding distribution platforms, production capacities and staff details are frequently missing.
- Double bookkeeping is a common problem among SMEs – an issue that is also present in many other emerging market economies and regularly dissuades larger PE firms from investing in the sector.
- Managing buyouts in Egypt require significant mentoring, as they are not purely a financial process but focus more on capacity-building.
- When VC and PE funds invest in SMEs, they sometimes encounter inadequate financial reports, double books, inefficient reporting systems, poor corporate governance and a lack of information regarding operations. It is crucial to be able to trust the investee to conduct business effectively, especially a start-up.
- SMEs are mainly interested in the know-how and capabilities that investors bring to the table rather than in the accumulation of capital; they look for added value in a partnership.
- There is a substantial opportunity for SMEs to flourish in Egypt, but only if they are managed efficiently.

In addition to these challenges during the initial investment process, limited exit options are a challenge for VC and PE firms. The NILEX is underused, with limited trading, making it a relatively unattractive route for exiting an investment. Therefore, the only feasible options available to PE firms are secondary buyouts and trade sales to strategic investors.

Government and international support

There is an opportunity to improve the business and regulatory environment in Egypt in order to better support SMEs. Egypt's legal framework is already showing signs of development. For instance, it currently takes an average of 8 working days to register a newly established company, but 10 years ago this process could take up to 40 days.

Egypt has also received support from international bodies and is receiving increased global recognition:

- The EBRD introduced its Women in Business programme to the country in 2015. By June 2017 the programme had successfully assisted 91 female entrepreneurs in more than 130 business advisory projects with local consultants, of which 66 projects had been successfully completed and evaluated. Under the programme, more than 270 women had been trained in leadership skills, financial literacy and digital marketing. The projects that have been evaluated indicated that:
 - 74 per cent of implemented projects were rated successful or highly successful
 - 88 per cent of assisted enterprises reported an increase in annual turnover with a median of 89 per cent
 - 61 per cent of assisted enterprises reported an increase in their number of employees, on average by 46 per cent, creating more than 200 new jobs.As of 30 April 2017, 28 female entrepreneurs had succeeded in sourcing external finance of more than EGP 31.5 million. The programme is operational in Alexandria, Assuit, Cairo and Gharbia and will extend its activities during 2017-18 to Mansoura, cities along the Suez Canal, and Menia.
- The German Federal Foreign Office has agreed to finance a mentoring programme undertaken by Enpact (an NGO created in 2013) that focuses on establishing relations among entrepreneurs in Egypt and across Australia, Germany, Jordan, Morocco, Switzerland and Tunisia.
- In 2013, the Egyptian-American Enterprise Fund, financed by the US Department of the Treasury and worth US\$ 60 million, was created to invest in Egyptian SMEs.

Despite being hampered by various issues, the SME sector is displaying signs of growth due to increasing awareness, private sector interest, and greater government support through initiatives geared towards the development of the SME sector. For example, The Social Fund for Development, established in 1991, has been working alongside government bodies, NGOs, private associations, community-level groups and other parties to help SMEs acquire financing and licenses.

Large and mid-cap activity

The PE market in Egypt is currently dominated by large and mid-cap investments. The largest PE investors in the country – including Abraaj Group, BPE Partners (formerly Beltone Private Equity), Al Qalaa Holdings, Actis, and EFG Hermes Holding – tend to focus on buyouts in defensive and consumer-focused sectors, such as health care, education, oil and gas, and consumer-driven manufacturing. Abraaj, for example, has capitalised on the decline in Egypt's government spending and shifted its focus towards education and health care, while BPE and Qalaa Holdings are redirecting their resources towards the development of alternative sources of energy. These investments involve buy-and-build strategies, but usually result in significant ticket sizes.

Although many opportunities with different sizes and scopes are available across the large- cap, mid-cap and small-cap segments, most investments and opportunities lie in the mid-cap segment.

5.3. Challenges and potential of the PEVC market

The PEVC market in Egypt is supported by extensive efforts from the private sector to develop and sustain the market, coupled with comments from the Egyptian government in support of VC activity. Despite the setbacks since the global financial crisis, some encouraging developments indicate that the sector may be recovering. These developments include:

- growing demand from consumers
- increasing liberalisation of industrial sectors
- growing appreciation among entrepreneurs for the expertise that PE funds could bring to their firms.

Overall, the government shows a keen interest in creating an environment that nurtures the development of PE and VC firms. In 2013, GAFI launched Bedaya, its first sovereign fund for SMEs. The fund has an estimated total value of EGP 134 million and has made six investments since May 2016. Bedaya aims to provide capital and technical expertise to aid the growth of SMEs in Egypt. While many firms openly welcome assistance, many local businesses are wary of the government investing in their companies, owing to the requirement for an additional level of supervision by the Central Audit Bureau for companies in which government holdings exceed 25 per cent.

There are conflicting views about working alongside a government entity. Some SME owners believe that it is a fast route to accessing national resources, while others are uncomfortable with the idea of a partnership with the government. This is because current regulations require additional auditing by the Central Auditing Bureau should the total of government entities' shareholding surpass a quarter of the shares.

However, the Egyptian PEVC market remains in the early stages of development, with certain areas requiring further attention. The World Economic Forum has indicated that the two most problematic areas for doing business in Egypt are:

- the instability of policies, and constant changes in regulations
- excessive bureaucracy.

According to David Wilton, former CIO of the IFC,⁴ it is vital to implement a transparent and efficient legal system in order to accelerate deal flow. While there is a high level of transparency in the Egyptian legal system, the level of efficiency is low.

A shortage of management talent in potential investee companies is a significant issue in Egypt. In these target firms, managers are often untrained and unable to implement a professional system of management. A possible solution – particularly for smaller firms – would be for companies to establish themselves in clustered, 'incubator' business parks. This would allow firms to use shared, non-core facilities, such as accounting or legal services, enabling them to focus on their core business. Unfortunately, there are few business parks available and these can often be prohibitively expensive for smaller firms.

Another obstacle that needs to be overcome is the lack of proper management teams in many firms. The basic transactions undertaken by management teams (for example, management buy-out, management buy-in) in developed economies are often not carried out in Egypt and firms struggle to attract from multinational firms managers who have the necessary expertise.

A PE transaction can only be successful if the target firm is a good business, has a focused management team, experienced investors and a good investment proposal. In Egypt, some of those components need further work.

5.4. Summary

Despite the small number of local funds, the PEVC sector is performing relatively well in the country, thanks to the presence of non-PEVC firms in the sector, such as family-owned investment offices and investment holding companies. In general, this market is developing rapidly, and appears to have a promising future, given the initiatives that have been applied or are currently under implementation. However, despite the positive outlook for the sector, a number of areas still require significant development and would benefit from increased attention from the government and the private sector alike.

⁴ See Wilton (2016).

6. Annex 3: Sources

In researching for this paper, the authors drew on a variety of primary and secondary sources.

Primary research

We would like to thank the following companies and organisations for their contributions to this report.

The Abraaj Group	First Equity Partners
Actis	FTP Capital
Abu Dhabi Islamic Bank	Flat6Labs
African Development Bank	Guardian Capital
Al Ahly Capital Holding	Gulf Capital
Al Ahly for Development and Investment	Insurance Holding Company
Amwal al Khaleej	International Investors
Arab African Investment Management	Kamal & Dreny Law Firm
The Archer Consulting Group	Lorax Capital Partners
Arqaam Capital	Matouk Bassiouny
Association Française des Investisseurs pour la Croissance	Misr Asset Management
BDO	Misr El Kheir
BPE partners	Misr Insurance Holding Company
The Cairo Angels	Nile Capital
CDC Group	Nile Holding Co. for Development and Investment
Cedar Bridge	ORBIS
CI Capital/Duet	Paradise Capital
Cairo Financial Holding	Pharos
Capital Trust Group	Pioneers Funds
Catalyst Partners	Qalaa Holdings
Delta Inspire	RiseUp Summit
EFG Hermes	Sarie-Eldin & Partners
EK Holding	Sawari Ventures
Ekuity Holding	Shalakany Law Office
Emerging Investment Partners	SOFICO
Ezdehar	Zulficar & Partners Law Firm

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7. Annex 4:

List of abbreviations

AFTZ	African Free Trade Zone
ASEAN	Association of Southeast Asian Nations
CBE	Central Bank of Egypt
CIS	Commonwealth of Independent States
CIV	Collective investment vehicle
COMESA	Common Market for Eastern and Southern Africa
DFIs	Development finance institutions
EBRD	European Bank for Reconstruction and Development
EFSA	Egyptian Financial Supervisory Authority
EGX	Egyptian Stock Exchange
EMPEA	Emerging Markets Private Equity Association
EPEA	Egyptian Private Equity Association
EU	European Union
FDI	Foreign direct investment
GAFI	General Authority for Investment and Free Zones
GAFTA	Greater Arab Free Trade Area
GCC	Gulf Cooperation Council
GDP	Gross domestic product
GFC	Global financial crisis
GP	General partnership
G7	Canada, France, Germany, Italy, Japan, the UK and USA
ICT	Information and communication technology
IFC	International Finance Corporation
IMF	International Monetary Fund
IPO	Initial public offering
IT	Information technology
LLC	Limited liability company
LLP	Limited liability partnership
LP	Limited partnership
M&A	Mergers and acquisitions
MSMEs	Micro, small and medium-sized enterprises
MENA	Middle East and North Africa
NGO	Non-government organisation
NILEX	Nile Stock Exchange
PE	Private equity
PEVC	Private equity and venture capital
SADC	South African Development Community
SMEs	Small and medium-sized enterprises
VC	Venture capital

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