Investigating challenges of private equity investment in agro-processing in South Africa

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ABSTRACT

The South African agro-processing sector receives substantial attention from government planning commissions and other stakeholders because of the crucial role it can play in growing the South African economy. To achieve its potential, the agro-processing sector has to grow and expand itself to such an extent that industrialisation and meaningful job creation can indeed take place. Funding is required to grow the sector, of which a substantial portion can come from private equity investors.

If the critical criteria considered by private equity investment professionals are known and well understood, it is possible to identify the challenges that prevent more private equity funding from flowing into agro-processing in South Africa. International studies showed that aspects such as growth and profit prospects are essential considerations. Literature differs on aspects such as minimum shareholding and the extent to which investors want to control the boards of the companies they have invested in. Furthermore, due to South Africa's unique socio-economic characteristics, it cannot be assumed that the results of international studies would apply to South Africa. Therefore, there is uncertainty about the relevance of aspects seen to be essential and posing challenges when private equity investment in agro-processing businesses is considered.

Through literature research followed by qualitative and quantitative empirical studies, this study identified the most critical criteria that private equity investors in South Africa use when making agro-processing investment decisions. If these criteria are not achieved satisfactorily, investments will not be made. The investors' ability to identify favourable investment opportunities and aspects associated with this aspect were identified as extremely important. Another important aspect was the intention of co-shareholders.

It is proposed that agro-processing ventures wanting to attract private equity funding should consider the findings of this study and orientate themselves so that they become a more attractive investment opportunity.

Key words: private equity; agro-processing; challenges; key consideration; South Africa; investment

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LIST OF ABBREVIATIONS

BB-BEE	Broad-based Black Economic Development
BEE	Black Economic Empowerment
BRICS	Brazil, Russia, India, China, South Africa
CAPM	Capital Asset Pricing Model
CEO	Chief Executive Officer
CFO	Chief Financial Officer
FAO	Food and Agricultural Organization of the United Nations
IPO	Initial Public Offering
IRR	Internal Rate of Return
ISIC	International Standard Industrial Classification
KMO	Kaiser-Meyer-Olkin
LSM	Living Standards Measure
ROE	Return On Equity
SAVCA	Southern Africa Venture Capital Association
USA	United States of America
WACC	Weighed Average Cost of Capital

CHAPTER 1– INTRODUCTION TO THE STUDY

1.1 Preamble

Since the past decade, the agro-processing sector in South Africa has received substantial attention from government planning commissions and other stakeholders because of the crucial role it can play in growing the South African economy. The Department of Agriculture, Forestry and Fisheries established its Directorate: Agro-processing in 2010. The new directorate adopted the concept of agro-processing as set out by the Food and Agricultural Organization (FAO) of the United Nations in 1997. The FAO defines agro-processing as “the subset of manufacturing that processes raw materials and intermediate products derived from the agricultural sector”. Agro-processors, therefore, transform products that originate from agriculture, forestry and fisheries.

The Directorate used International Standard Industrial Classification (ISIC) codes to identify 11 sub-sectors in the agro-processing industry, namely: food, beverages, paper and paper products, wood and wood products, textiles, wearing apparel, furniture, tobacco, rubber products, footwear, and leather and leather products (Republic of South Africa. Department of Agriculture Forestry and Fisheries, 2010?).

Several governmental bodies, including the Department of Economic Development, the National Planning Commission, and the Department of Trade and Industry, published documents and plans highlighting the importance of agro-processing to the South African economy. These documents include *The New Growth Path* (Republic of South Africa. Department for Economic Development, 2010), *The National Development Plan* (Republic of South Africa. National Planning Commission, 2012), *The Industrial Policy Action Plan* (Republic of South Africa. Department of Trade and Industry, 2018) and *A South African Trade Policy and Strategy Framework* (Republic of South Africa. Department of Trade and Industry, 2010). These documents all identify that agro-processing has the potential to contribute to economic growth and accelerate the pace of industrialisation and job creation.

Researchers argue that poorer (developing) countries with surplus labour have little choice but to industrialise. This is possibly the only viable strategy for absorbing large numbers of workers into productive employment which, in turn, catalyses reinvestment, resulting in economic growth (Weiss, 2018:63).

To achieve its potential, the agro-processing sector has to grow and expand to such an extent that industrialisation and meaningful job creation can indeed take place. There are various definitions for the concept of industrialisation, but the overarching concept refers to the economic transformation from an agricultural and artisanal economic dispensation to an industrial economic system by developing and adopting technologies such as mechanisation (Naudé & Nagler, 2015:1-4; Odeleye, 2019:50; Tok *et al.*, 2016).

To grow the sector requires funding, of which a substantial portion can come from private equity investors. Chipeta (2016:25) and Kaplan and Strömberg (2003:312) refer to the contracting cost theory when stating that growing companies with relatively high valued intangible assets are probably not able to employ borrowed funds because the collateral value of their assets does not support such borrowings. In such cases, funding must come from other sources, which shifts the focus to sources such a private equity funding.

When economies are in a transformative state, for example, transforming from agrarian to industrialisation to robust domestic consumption (Tok *et al.*, 2016:30), coupled with deregulation, private equity investors take note as these market dynamics offer potential investment opportunities. Private equity investment is then the precursor for institutional investment or, put differently, institutional investment offers an exit mechanism to private equity investors (Lerner *et al.*, 2016:18).

If private equity investment is an essential catalyst for industrialisation through the funding mechanisms it provides, it stands to reason that a broad audience will be keen to understand how private equity investment decisions are made (Gui-Diby & Renard, 2015:43-57). In an emerging economy, industrialisation can span across various economic sectors; therefore, it is incorrect to assume that private equity investors use the same investment criteria to inform their investment decisions across all these sectors. To avoid the risk of generalisation and because South Africa's economic planners flagged agro-

processing as a focus sector, this study aims to investigate challenges that discourage private equity investors from expanding their investments into agro-processing.

1.2 Background

Lydia Shadrach-Razzino, a director at ENSafrica, states that, “there are many undervalued sectors in Southern Africa, which could use a private equity investment boost” and adds “that dealmakers will have to get a bit more creative if the true value of potential is to be unlocked” (SAVCA, 2018:22). This sentiment as expressed by the experienced private equity investment professional highlights the idea that set investment criteria and methodologies should make way for more innovative approaches. For example, is it essential to obtain a majority shareholding as traditionally thought? The statement by Shadrach-Razzino further suggests that new innovative approaches will see traditionally less attractive sectors or sectors that have not been the focus area of private equity investors coming to the fore as key value centres. It stands to reason that a superior understanding and insights into the targeted business sector allow for superior investment decisions. The question then arises: Is the ability to obtain superior insights a challenge for private equity investment professionals and, if so, how do private equity investors gain such superior insights?

This study assumes that private equity investment professionals have specific criteria that they consider when making investment decisions. It follows that when a target company or broader business sector does not meet these criteria, investing in the sector is challenging for the investors.

Numerous studies have been undertaken internationally to identify and prioritise the investment criteria used by private equity investors (Dhochak & Sharma, 2016; Mishra *et al.*, 2017). However, as far as can be established, similar research has not been done or published in South Africa. This study suggests that South Africa has a unique socio-economic environment and matters such as black economic empowerment (BEE), corruption, redistribution of land (possibly without compensation) and other related matters pose unique challenges to private equity investors.

Researchers found that private equity investors are diverse and certainly use different investment criteria; therefore, they encounter different challenges. Dhochak and Sharma (2016:23) explain that investors follow a multi-criteria decision-making process. Meglio *et al.* (2017:519) state that private equity investors themselves are not similar – private equity investors vary a great deal in terms of legal form, size and stage of investment; motives and criteria for investing; timing; and exit methods. Because of these differences, private equity investors are known by different names. For example, institutional investor, formal investor and professional investor are terms used to distinguish private equity investors from informal angel investors who generally invest only their own funds and typically only in the very early funding stages.

Other studies identified generic investment criteria. However, it stands to reason that superior investment insights are required if investors expect superior returns. Gejadze *et al.* (2017:259) indeed argue that private equity firm-level specialisation improves its ability to raise capital from its limited partners. An example of generic investment criteria include high growth coupled by under-representation in public markets. A recent study revealed that private equity investors focus on companies in high-growth sectors that are underrepresented in public markets (Lerner *et al.*, 2016:8). Generic investment criteria could probably identify high growth prospects, but specialised insights are required to understand the fundamental drivers of such growth and the likeliness of going public with the target in future (Mason *et al.*, 2017:519-534). It is widely acknowledged that higher financial returns are associated with higher risk-taking.

Within this context, it becomes evident that private equity investors focus on specific characteristics of the target company. However, the investment analysis that is performed by private equity investors also identifies factors that are absent, which then discourage investment. For example, what is missing and is preventing the company from achieving a more significant growth rate, market share and profitability?

From the above, it seems that there is uncertainty regarding the relevance of aspects that are seen to be essential and that pose challenges when private equity investment in agro-processing businesses is considered.

1.3 Problem Statement

In the context of the background provided, one has to determine the critical criteria that present a challenge to private equity investment professionals when considering an investment in agro-processing ventures in South Africa.

1.4 Research Objectives

This study divides the research objectives into one primary objective and three secondary objectives. These are as follows:

Primary research objective

The primary research objective is to identify the most critical criteria that private equity investment professionals in South Africa consider when making agro-processing investment decisions and that would prevent such an investment if not achieved satisfactorily.

Secondary research objectives

- Through a study of existing literature, consider the critical criteria used by private equity investors when making investment decisions.
- Determine the criteria currently considered as essential for private equity investment in agro-processing in South Africa.
- Prioritise the investment criteria identified in this study in order of relative importance.

1.5 Delimitations and Assumptions

This study is subject to delimitations and assumptions as set out hereunder.

1.5.1 Delimitations (scope)

The research is limited to individual private equity investment professionals who are employed by private equity investment firms registered with the Southern African Venture Capital Association (SAVCA).

Within the context of the private equity investment milieu in South Africa, this study achieves representativeness as the population comprises highly reputable and experienced private equity investment professionals. The condition is, however, that the sample is selected systematically for relative homogeneity. It is argued that this approach captures heterogeneity amongst the population in an adequate manner so that the conclusion is representative of the entire spectrum of private equity investors (Bickman *et al.*, 2008:235).

This study uses an analytical hierarchal process methodology to rank the importance of different criteria, which is based on the theoretical assumption that the various criteria are independent. However, in practice, interdependencies could affect the rankings (Dhochak & Sharma, 2016:964).

1.5.2 Assumptions

The study acknowledges that investments could flow from private equity investors who do not form part of the study population. Purposeful sampling overcomes this limitation.

Within the limitations of scope, this study assumes that the views and opinions expressed by the sample surveyed are representative of the private equity investor community as a whole.

1.6 Research Design and Methodology

Bryman and Bell (2014:100) define a research design as “a framework for the collection and analysis of data”. The research design is determined by factors such as the methods chosen to express casual relationships between variables and whether and how results can be generalised to apply to a larger group than those participating in the study.

1.6.1 Description of overall research design

Bryman and Bell (2014:12-16) state that epistemology refers to the question of what can be considered adequate knowledge in a specific field or discipline. The authors note that there are three central epistemological positions, namely, positivism, realism and

interpretivism. Interpretivism stands in contrast to positivism and phenomenology is its main intellectual tradition.

Gray (2018:25) and Bryman and Bell (2014:12-16, 31) explain that positivism aims to establish linkages between variables. Positivism focuses on the facts whereas phenomenology attempts to understand what is happening and develops theories based on these understandings. The positivistic research methodology often uses quantitative research methods, whereas the phenomenological research methodology uses qualitative methods.

This study combined the positivistic methodology and phenomenological methodology through a process of triangulation. Triangulation employs multiple approaches to investigate a specific topic (Kimchi *et al.*, 1991:364-366). It allows for findings to be cross-checked and ensures the reliability, replicability and validity of the study (Bryman & Bell, 2014:44-45). Figure 1 shows the process of triangulation followed in this study.

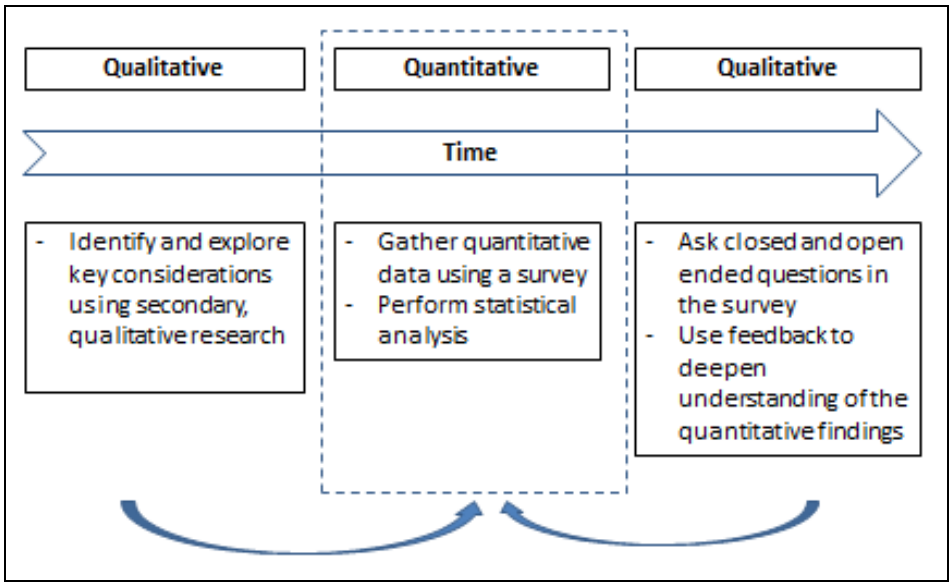

Figure 1: The process of triangulation

Source: Povaly (2006:7)

The research design of this study aligns with the designs applied by Mishra *et al.* (2017:52-68) and Dhochak and Sharma (2016:964-983) while studying the investment criteria used by private equity investors in India.

1.6.2 Secondary research

Secondary research and analysis reuse existing qualitative data that has been obtained from previous studies (Heaton, 2008:34). Hox and Boeije (2005:594) state that qualitative data include documents such as academic journals, books and media articles. The benefit of using secondary data is that it is less expensive than collecting primary data, and it is also more readily available.

This study uses secondary research and data sources to obtain relevant literature about the challenges that private equity investors face.

1.6.3 Primary data collection

To collect primary data, the researcher must define the population and choose an appropriate sampling technique, sample size and research instrument (Bryman & Bell, 2014:168).

Population

Population has been defined by various writers and researchers. Greener (2008:48) defines population as “the full universe of people or things from which a sample is selected”. Bryman and Bell (2014:170) define population as “the universe of units, like people, nations, cities, regions and firm from which the sample is to be selected”.

This study focused on individual private equity investment professionals who are employed by investment firms that are registered with SAVCA. These professionals participated in their personal capacity as private equity investment experts and not as employees of any specific investment firm.

SAVCA publishes an annual members’ directory that reflects the names and contact information of individual contact persons at each of the affiliated investment firms. This information is available publicly. The SAVCA 2017 Members’ Directory records the names of 106 full member firms (SAVCA, 2017a). The personal email addresses of 75 private equity investment professionals were obtained from the SAVCA 2017 Members’ Directory.

Therefore, the unit of analysis in this study was the 75 private equity investment professionals identified through the SAVCA 2017 Members' Directory.

The population for this study comprised private equity investment professionals employed by private equity investment firms that were full registered members of SAVCA in 2017.

Sample

Bryman and Bell (2014:170) define sample as "the segment or subset of the population that is selected for investigation". The two broad sampling techniques are probability sampling and non-probability sampling. Probability sampling takes place when a sample is selected randomly from the population so that each unit in the sample has a known chance of being selected. Given research constraints such as time and funding, it was not possible to obtain the contact details of all private equity investment professionals working for SAVCA-registered private equity investment firms. For this reason, this study used convenience sampling, which is a subset of non-probability sampling.

Therefore, 75 private equity investment professionals, who were selected through a process of convenience sampling, formed the sample for this study (Greener, 2008:48).

Research instrument

The researcher designed an original survey questionnaire to collect primary data (see Appendix A). The survey questionnaire was distributed electronically to the 75 private equity investment professionals. It consisted of five sections as set out in Table 1.

Table 1: Survey questionnaire sections

Section	Description and purpose
Section A	Gather demographic data about personal expertise and background of the participant.
Section B	Examine factors that could affect the decision-making of private equity investment professionals. The participant was asked to rate these factors using a four-point Likert scale.

Section	Description and purpose
Section C	Ask participant to indicate the most preferred option amongst the alternatives provided.
Section D	Understand the importance of aspects typically related to private equity investment by asking the participant to indicate the most preferred options amongst the alternatives provided.
Section E	Ask the participant to provide a short answer to selected questions.

1.6.4 Data analysis

The primary data collected was analysed using both descriptive and inferential statistical methods. Descriptive statistics express the sample data in a summarised form using different characteristics such as central tendency and variability, while inferential statistics assist the researcher in gaining knowledge about the population from which the sample data was obtained (Turner & Houle, 2019:300-301).

1.6.5 Research ethics

Informed consent was required from all private equity investment professionals who participated in this study. “The principle about informed consent is that participants must be fully informed about the research process” (Bryman & Bell, 2014:124). While the research process was explained to all participants, care was also taken to explain that participants would participate in their personal capacity and not represent their employer. The professionals participated in this research study voluntarily and anonymously. The data collected in the research process was kept confidential and was protected from unauthorised access. Given that a structured electronic survey was used to collect the data, no invasion of privacy took place.

1.7 Importance and Benefits of the Proposed Study

Various stakeholders can benefit from a better understanding of the aspects that affect the decision of private equity investors to invest in agro-processing ventures in South Africa. Benefits include:

- National departments responsible for trade and economic policy will have a better idea as to what policy frameworks are required to encourage investment in agro-processing and thereby eliminate challenges posed by different policy frameworks.
- National economic planning units, responsible for medium- to long-term planning, will have a better understanding of the extent it can realistically predict the participation of private equity investors in the funding (of growth) of agro-processing ventures if the challenges faced by private equity investment professionals can be eliminated.
- Potential target companies, wanting to attract funding from private equity investors, can comprehend how to organise themselves to eliminate challenges and become attractive investment opportunities.
- A critical consideration of the aspects affecting the investment in agro-processing creates a body of knowledge that other private equity investors, not investing in agro-processing, can rely on when reconsidering their investment mandate.

The study in itself will potentially create a link via mutual interest between all stakeholders and generally promote the investment case of agro-processors.

1.8 Chapter Layout

The chapter layout of this research thesis is as follows:

Table 2: Chapter layout

Chapter	Heading	Chapter description
1	Introduction to the Study	• Background • Problem Statement • Research Objectives • Delimitations and Assumptions • Research Methodology • Importance and Benefits of the Study

Chapter	Heading	Chapter description
2	Concepts of Agro-processing and Private Equity Investment	• Concept of Private Equity Investment • Concept of Agro-processing in South Africa • What History and Literature Tells us About Private Equity
3	Research Process	• Description of the Research Methodology and Research Process
4	Research Results	• Presentation of Research Results
5	Conclusion	• Explanation of Research Findings and Recommendations for Future studies

CHAPTER 2 – CONCEPTS OF PRIVATE EQUITY INVESTMENT AND AGRO-PROCESSING

2.1 Introduction

Although the private equity industry in South Africa is relatively small when compared with the United Kingdom and United States of America (USA), it is sophisticated and functions well (Reynolds, 2015:18).

This chapter describes how private equity investment funds are typically set up and how the funds operate. Thereafter, the chapter discusses the role that private equity investment funds performs in the microenvironment (i.e. on target company level) and the broader macro-environment. The chapter describes the concept of agro-processing in South Africa and identifies its unique characteristics. It concludes by drawing attention to considerations that private equity investors deem to be important when making investment decisions.

2.2 Concept of Private Equity Investment

The concept of private equity is discussed in section 2.2.

2.2.1 Characteristics of private equity investments

Krzysztof and Sławomir (2016:129) define private equity as “the provision of capital by financial investors to non-quoted companies with high growth potential”. Brigham *et al.* (2016:22) state that private equity investors hold shares in the companies they invest in and could even control these companies.

A private equity fund requires two key participants, namely, the fund manager, also referred to as the general partner, and an investor, also referred to as the limited partner. In combination, these two participants are referred to as the private equity fund. The private equity fund is typically organised into a limited partnership.

Limited partners have unique characteristics and specific expectations, which Tan (2018:66) describes when suggesting that the idiom “it takes money to make money” holds

particularly true where private equity investment is concerned. High net-worth individuals and other entities with vast amounts of cash, the desire to earn an extraordinary high return, and the willingness to accept the risk that comes along invest in private equity funds (Tan, 2018:66). Typically, limited partners can include pension funds, endowment funds, foundations, investment bankers or high net-worth individuals (Müller, 2008:16).

Besides setting up the private equity fund, the general partner manages the daily operations of the fund while the limited partner plays a passive role (Tan, 2018:68). When setting up the fund, the general partner will make a small capital contribution to the fund (Müller, 2008:16).

Gejadze *et al.* (2017:259) state that the market distinguishes between two types of private equity funds, namely, a general fund and a specialised fund. The difference is that a specialised fund has a defined mandate in terms of types of assets it can invest in, for example, agro-processing in South Africa.

Managers of private equity funds, being the general partners, have a fiduciary duty towards the limited partners and are bound to operate within the mandate that was given by these limited partners. The precise nature of fiduciary duties is usually not well defined. Tan (2018:66) states that these duties can be imposed by statutory or common law and are aimed at ensuring that the general partner observes specific standards of performance and integrity when carrying out their work. At a bare minimum, fiduciary duties aim to protect the limited partner from aspects such as gross negligence and purposefully harmful acts (Tan, 2018:69).

The general partner managing the fund is remunerated for work done. Tan (2018:72) mentions that a typical remuneration arrangement is the so-called “two and twenty” situation. The general partner receives a fee of 2% of the fund capital raised and 20% of the fund’s profits, which is called the carry fee. The remuneration structure is essential and must be equitable as it can affect the fiduciary arrangement.

The general partner identifies investment opportunities. Literature studies show that the target companies (referred to as portfolio companies) in which private equity funds invest are typically plotted on the business life cycle as: start-up companies that require seed

capital to establish a business model; established companies that require capital for growth and expansion; or mature companies that require replacement capital or capital for mergers and acquisitions. Müller (2008:26) suggests that private equity fund investments are typically illiquid and have a long-term nature of up to ten years.

Van Wyk *et al.* (2012:364-365) confirm that portfolio companies are privately held as opposed to publicly traded. The authors explain that the general partner is usually actively involved in the deal-making process and, after that, in the management of the portfolio company. The investment is not indefinite as it has a defined time horizon (for example, ten years) and planned exit strategy. The authors emphasise the high risk and high return nature of private equity investments.

Fenn *et al.* (1997:2) suggest that the emergence of the limited partnership paved the way for growth in the private equity market. This contractual relationship made it possible to overcome the risks of information asymmetry that individual investors would typically face. Müller (2008:11) explains that the financial return to private equity investors is generally in the form of capital gains as opposed to dividend yields.

Within this context, Müller (2008:11) defines private equity investments as “comprising all equity investments in non-public, closely-held companies that face a transformational situation in their corporate development”. Burch and Lawrence (2013:248) describe the private equity consortium (or fund) as a limited partnership between a general partner and a limited partner. The general partner carries unlimited liability for the debt obligations of the partnership while the liability of the limited partner is restricted to the amount invested.

Wood and Wright (2009:361) broadly discuss to the same concept, but bring in language that refer to venture capital by stating that, “private equity involves investment in unlisted companies and includes both early-stage venture capital and later-stage buyouts”. While private equity and venture capital are often used interchangeably as referring to the same concept, there are distinct differences. Scholtz (2017:3) mentions research done by Wright and Robbie (1998) who found that venture capital refers mainly to a situation in which investments are made in start-up ventures and also possibly where investments are made in ventures undergoing radical restructuring, such as a business turnaround.

Tan (2018:70) explains the distinction between private equity funds and venture capital funds. Venture capital funds operate similarly to private equity funds but investments take place at an earlier stage of the business life cycle; for example, at the start-up stage when the target is still in its infancy. Consequently, the amount invested is typically smaller and of a speculative nature. Therefore, a venture capital fund, as described in this context, is a subset of private equity (Tan, 2018). Krzysztof and Sławomir (2016:129) hold a similar view by stating that venture capital is a subset of private equity.

A distinguishing characteristic of private equity funds is the process that portfolio companies follow to compensate the chief executive officer (CEO) and other members of the executive team. For example, senior executives could hold large equity stakes, which only become valuable when significant gains are recorded – often on exit through an initial public offering (IPO) (Pozen, 2007:84-85).

Figure 2 shows the sequence of the private equity investment process. The concept of private equity investment refers to limited partners and general partners who invest in a fund or funds (also referred to as private equity funds), which are set up by the general partner. The fund identifies private target companies to invest in, which are referred to as portfolio companies post-investment. The general partner actively participates in the management of the portfolio company. When setting up and managing the private equity fund, the general partner owes a fiduciary duty to the limited partners. In return for setting up and managing the fund, the general partner is remunerated through management fees. During the tenure of the investment, the portfolio company may make distributions (such as dividends), which are received by the private equity fund. Typically, no further distribution is made to the limited partners. At the end of the investment tenure, the fund disposes of the investment and records a financial gain. The fund distributes this gain proportionally to the limited partners, which constitutes the limited partners' primary financial return for an investor in the private equity fund.

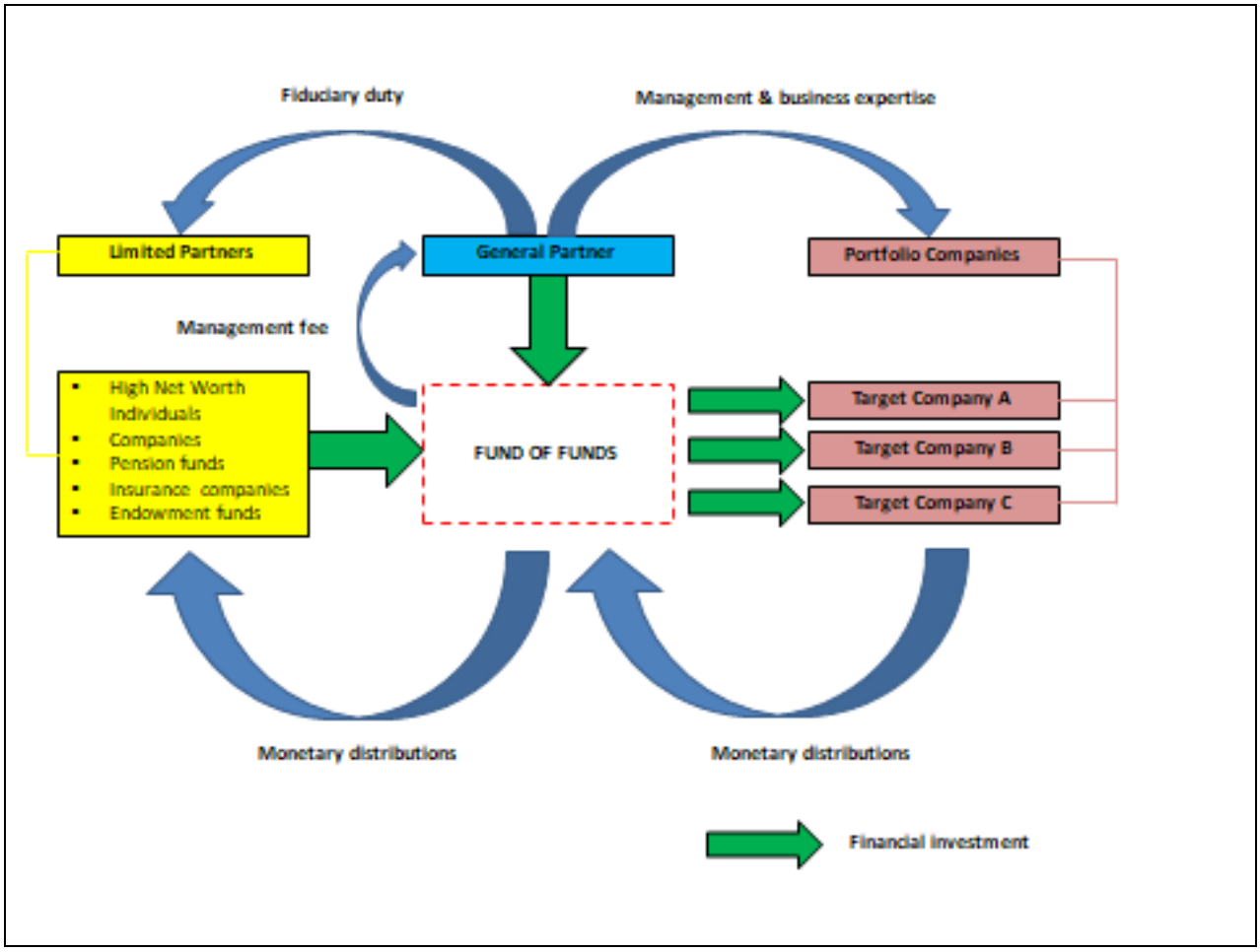

Figure 2: Private equity investment structure

This study aims to identify the most important criteria that private equity investment practitioners consider when deciding to invest in target companies involved in agro-processing in South Africa.

2.2.2 Creating value: The effect of private equity investment on the portfolio company

When considering the evolution of private equity investment funds in the early part of the 21st century, Lerner *et al.* (2016:10) observe that indigenous (local) funds supported by local limited partners are essential catalysts for the host country's economic development. The authors note that these funds create a cycle through which local limited partners support the growth of local companies, in turn creating jobs for the local population and wealth for the investors.

Private equity investment often has a high impact. Portmann and Mlambo (2013:259) quote Wright *et al.* (2009:2) who described private equity investment as being “an increasingly important mechanism to rapidly and radically restructure organisations worldwide.” Referring to studies done in the United Kingdom, Burch and Lawrence (2013:248) comment that private equity investment had a significant effect along the agro-food value chain after food manufacturing companies were acquired.

Wright *et al.* (2009:3) state that private equity investors have a detailed understanding of the fundamental aspects that drive the business success of their portfolio companies. They are active investors with access to detailed and timely information. Private equity investors do detailed pre-purchase due diligence, whereafter they take board positions in the companies they have invested in. On the other hand, institutional investors have a passive approach and do not get actively involved in the companies they invest in. When the stock performs poorly, institutional investors react by disposing of the shares, and as such, they can also be described as transient owners (Ivanova, 2017:175-176).

Many privately owned business ventures express the need for growth capital, and in this regard, private equity investors provide a solution. Already in 1997, Fenn *et al.* (1997:3) proposed that the growth of the private equity market provided much needed outside equity capital for start-up and established private companies. Private equity is considered an essential form of longer-term funding to companies at various stages of the business cycle, ranging from start-ups to more established businesses. Depending on the stage, the objective could be growth funding, development funding, business improvement funding, or a combination of these (Van Wyk *et al.*, 2012:363-364).

The capital provided by private equity investors comes with a caveat – participation. Gompers *et al.* (2016) describe that private equity investors intend to add value by participating in the management of the companies they invest in. The authors explain that these investors are more interested in growing revenue than cutting costs. Jiujin *et al.* (2017) observe a positive correlation between the enterprise value and the holding period during which the private equity investor is invested, claiming that private equity investors increase the enterprise value. Fenn *et al.* (1997:4) state that the private equity investor provides specialised input into the management of the target company and plays an active

role in monitoring their investment. Private equity investors are therefore very visible and vocal shareholders (as opposed to passive shareholders such as institutional investors). Müller (2008:11) concur with this view by stating that in addition to providing capital, private equity investors also offer management support and advice.

Investors often face various hidden risks that arise because of informational asymmetry between insiders and outsiders of the target company. Private equity investors overcome this challenge by performing a strict pre-investment due diligence inspection, whereafter they carefully monitor the investment. The fact that private equity investors lower the risks associated with adverse selection and moral hazard distinguishes them from individuals and other passive investors. Müller (2008:14-15) makes an important observation when stating that compared with individual or other passive investors, private equity investors have a lower risk of adverse selection and moral hazard as they have business and industry insights that are supported by specialised investment skills.

Private equity investors participate in the management of portfolio companies with specific objectives, which are all aimed at increasing shareholder value. Private equity investors create value in the target by, for example, improving productivity. Wright *et al.* (2009:7) refer to a study by Amess (2002) who stated that evidence was found in the United Kingdom that productivity improvements occurred for a period of up to four years following a management buyout that was backed by private equity investment. A study by Schickinger *et al.* (2018:278) conclude that private equity investors could increase shareholder value in three ways:

- Firstly, by pursuing growth via a “buy-and-build strategy”. Investors link the portfolio company to other existing companies in their portfolio and, in doing so, form conglomerates in which sister companies create synergies.
- Secondly, by providing an exchange network with other firms in their portfolio to provide expertise and other game-changing an intellectual property and research and development.
- Thirdly, it can connect the target company to relevant suppliers and customers via its business networks.

Pozen (2007:80) suggests that once a portfolio company has been acquired, the general partner will endeavour to unlock value in five possible ways. The author phrased these by asking the following questions:

- Does the balance sheet reflect lazy cash balances that could have been distributed by way of dividends or buying back shares, for example? This question focuses on the effective use of assets, including cash assets.
- Considering the weighted cost of equity, does the business have an optimal capital structure?
- Does the business have a viable operating plan that is geared towards increasing shareholder value? Does this plan have formally measurable key result areas to monitor performance?
- How are top executives remunerated? Is the remuneration policy linked sufficiently to the increase in shareholder value?
- Is the board structured optimally? Do members have enough time to devote to the business? Are the skills set sufficiently diverse to cover all aspects of the business?

Burch and Lawrence (2013:248) suggest that private equity investors will attempt to generate high returns from their investment by employing initiatives such as selling off non-core assets, effecting a business turnaround to improve performance, leveraging existing assets to achieve a return on borrowed money, or using a mix of these initiatives.

Table 3 summarises the likely areas of operations to be affected when private equity investment takes place. It is clear from existing literature that private equity investors are firmly set to create or enhance shareholder value as their primary objective. To increase value, investors participate actively in the management of portfolio companies, which regularly transform the portfolio company radically. Besides transforming the portfolio company, investors further endeavour to create synergies across their entire investment portfolio. The ability of private equity investors to reduce the risk of adverse selection and moral hazard through their skills, competencies and diligent investment process suggests that their investment success should surpass that of individual or passive investors who are also able to invest in private companies and, as such, could also be regarded as

private equity investors. This study emphasises private equity funds that invest in private companies.

Table 3: Business areas affected by private equity investment

Business areas impacted following Private Equity investment	
Private company becoming Target and then Portfolio Company	• Create optimal **capital structure** by minimizing the WACC • Maximize **operational efficiencies** to improve profits • Restructure the **Board** to ensure presence of skills, competencies, capabilities and capacity • Refocus **business strategy** to benefit from macro-economic trends and opportunities • Aligns **business operations** to benefit from synergies within the broader conglomerate of portfolio companies

2.3 Concept of Agro-processing in South Africa

The FAO defined the concept of agro-processing in 1997 as “a subset of manufacturing that processes raw materials and intermediate products derived from the agricultural sector” (Republic of South Africa. Department of Agriculture Forestry and Fisheries, 2012). Wilkinson and Rocha (2009:46) refer to agro-processing as a “sector covering a broad area of postharvest activities, comprising artisanal, minimally processed and packaged agricultural raw materials, the industrial and technology-intensive processing of intermediate goods and fabrication of final products derived from agriculture”.

Economic sub-sectors that form part of agro-processing are identified by ISIC descriptors, which are set out in Table 4 (Wilkinson & Rocha, 2009) (Republic of South Africa. Department of Agriculture Forestry and Fisheries, 2012).

Table 4: ISIC descriptors for agro-processing

Description
Manufacture of food and beverages
Manufacture of tobacco products
Manufacture of paper and wood products
Manufacture of textiles, footwear and apparel
Manufacture of leather products
Manufacture of rubber products

2.4 Importance of Agro-processing

From a national economic development point of view, the focus is on agro-processing to contribute to economic growth and job creation. Together with its upstream sector, government identified agro-processing "as a critical driver of inclusive growth in the South African economy, with very significant job creation potential". The importance of agro-processing has constantly been articulated in the *National Development Plan*; successive iterations of the *Industrial Policy Action Plan*; the *Agricultural Policy Action Plan*; *Operation Phakisa for Agriculture, Land Reform and Rural Development* (2016); and the *Presidential Nine-point Plan on the Revitalisation of the Agriculture and Agro-processing Value Chains* (Republic of South Africa. Department of Trade and Industry, 2018:127).

Dr Carlos Lopes, the former executive secretary of the United Nations Economic Commission for Africa, as quoted by Collins (2018), recently said that he firmly believes that while the industrial sector has a chance to provide jobs, it is more about agro-processing and the potential that this sector holds to bolster economic growth.

Watanabe *et al.* (2009:443) state that the concept of pro-poor growth is now generally recognised as the primary goal of development. Economic growth can be considered to be pro-poor if it allows disadvantaged people to benefit meaningfully from economic activity. The authors further comment that the impact that the development of the manufacturing sector has on the poor differs as not all industries have the same labour absorption rate.

Amongst the so-called BRICS countries (Brazil, Russia, India, China, South Africa), there are examples of national governments that prioritise agro-processing in pursuit of pro-poor economic growth. In India, linking agricultural production to processing is one of the strategies outlined by its government to double farmer income by 2022 and, in doing so, stimulate growth through increased circular spending and attracting export revenues. A study by Venkatesh *et al.* (2017) found that rapid growth in the number of agro-processing firms since the early 2000s was fuelled by export demand, assured supply of raw material, and government's policy incentives. This reference suggests a triangular support structure, namely: off-take demand (preferably export); availability of raw commodities; and, importantly, a supportive regulatory and commercial framework.

Researchers found that agro-processing could reduce poverty for two main reasons: 1) The agro-processing industry that purchases agricultural products increases demand for primary agricultural products, thereby increasing the income of primary producers (farmers); and 2) agro-processing factories are usually located in rural areas where a large part of the poor population lives. In this context, agro-processors can employ members of low-income families (Watanabe *et al.*, 2009:444).

Private equity investment is considered to be high-impact investments with the ability to radically transform the businesses in which investments are made. In return for the capital investment and active participation in the management of the portfolio companies invested in, private equity investors look for strong financial growth and high returns. The agro-processing industry could potentially offer private equity investors such opportunities. On numerous occasions, national economic planning commissions flagged agro-processing as having the potential to facilitate a national pro-poor economic development plan, suggesting a strategic fit between investor preferences and national economic imperatives.

Research done in the USA shows early indications that private equity investors are gaining an appetite for food businesses (Daks, 2017). Private investment banking firm Baker Tilly Capital LLC recently issued a report that suggested that private equity investors acquired numerous speciality food companies in 2017. The report proposed that due to generational changes and the move towards healthier eating, there has been a shift away from traditional consumer packaged goods to speciality products.

2.5 Private Equity Investment Criteria

Numerous international studies were undertaken to establish the investment criteria used by private equity investors. These criteria vary: Le Nadant *et al.* (2018:238) state that private equity investors differ in size, experience, industry preferences and affiliation, which all affect their investment criteria.

It must be noted that no studies were found that researched the specific situation in South Africa. Also, none of the international studies were sector-specific and as such the literature review in this section can be considered to be generic. Meglio *et al.* (2017:519) note that venture capital, which was previously identified as a subset of private equity, is all but homogeneous. The authors observe that these investors differ significantly on matters, including investment motives, criteria for investment, and exit methods.

Gejadze *et al.* (2017:259) remark that fundraising by the general partner is crucial and that the success of such fundraising can depend on the expertise of the fund manager. The specialisation of the general partner into a narrow set of industries could have an effect on the ability to raise funds. The authors indicate that, to the best of their knowledge, only three previous studies considered firm-level specialisation. They conclude that the results are inconclusive.

The purpose of researching existing literature is to establish a base from which the South African situation can be assessed in detail, specifically the situation regarding agro-processing. Existing literature highlights various aspects that private equity investors deem to be important when making investment decisions.

2.5.1 Investor-specific considerations: Specialised sector insights, skills and capacity by networked directors

Firstly, do superior insights and an understanding of a particular business sector encourage the private equity investor to invest? Secondly, do these insights improve the ability of the general partner to raise investment funds and achieve superior returns?

When considering these aspects from the perspective of limited partners, i.e. referring to the ability of the general partner to raise or set up the fund, Da Rin and Phalippou (2014:4)

mention that one consideration is the characteristics and attributes of the individual who manages the fund rather than the private equity firm as a whole. The authors note that attributes such as personal experience in the industry and personal networks are important considerations.

Previous studies that investigated this aspect provided mixed outcomes. Le Nadant *et al.* (2018:239) argue that this could be the result of different markets being researched at different periods. The authors conclude that industry specialisation enables private equity investors to achieve superior returns; in fact, this feature is a competitive advantage. It is further argued that such a competitive advantage is more profound when the target company is complex (Le Nadant *et al.*, 2018:238). Specialisation, however, also holds potential opportunity costs. When considered from the perspective of the fund, the limitation that specialisation puts on the private equity investor as it narrows the scope of investment opportunities could delay the investment process and therefore reduce the time frame available to generate returns. It is therefore argued that specialisation can either benefit or be to the detriment of investment activity because of two opposite effects, being;

- The ability to add value more efficiently because of specialisation; and
- The opposite being the long time it takes to make investment selections due to fewer investment opportunities (Gejadze *et al.*, 2017:260).

By its very nature, private equity investors benefit from having inside information. Because the target company is privately owned and not listed on any public exchange, this practice is legal. However, the concept of insider trading could still have a significant effect on financial returns. Bodie *et al.* (2001:90) describe inside information as non-public knowledge that is held by persons with privileged access to such information. Brigham *et al.* (2016:586) state that insider trading takes place when either a buyer or seller trades based on privileged information.

When investing in a private company, it can reasonably be argued that the seller does indeed possess inside information and will sell based on holding such privileged information. Should the buyer not have access to similar information? Could adverse selection occur as a result of information asymmetry? Information asymmetry could

potentially be detrimental to private equity investors. To overcome this challenge, the private equity investor undertakes a detailed due diligence investigation into the business of the target company. However, the question remains: Would a non-specialised private equity investor be able to assess the situation accurately?

Goergen *et al.* (2019:152) raise the aspect of networked directors, who are defined as persons having “direct or indirect connections to other corporate boards”. The authors argue that fundamental aspects affecting investment returns include privileged information about peer companies, sector trends and competitors. While such privileged insight is not targeted firm specific, and therefore not regarded as inside information as far as the target is concerned, it is argued that having access to such information can inform superior investment decision-making. When a private equity investor has networked directors, information asymmetry works in their favour. Le Nadant *et al.* (2018:239) support the argument that industry specialisation reduces informational asymmetries. In practice, however, Le Nadant *et al.* (2018) argue that private equity investors are heterogeneous as they have different skill levels. As a result, the investors do not have similar abilities to leverage higher returns from industry specialisation. Put differently – industry specialisation and insights alone are not sufficient to ensure superior returns.

Pozen (2007:86) states that expert directors, who are appointed to board positions by private equity investors, spend significantly more time on company business than directors of public companies. The author mentions that the actual time spent on company business is five days per month, which could be even more at the initial stages. From this perspective, it seems that the capacity of board members can become a crucial consideration. Alternatively, the ability to appoint networked directors with the necessary capacity could be a critical consideration. Gompers *et al.* (2016:451) suggest that when investing, the private equity investor aims to structure a smaller board that comprise a mix of outsiders (industry specialists), insiders (portfolio company-specific specialists) and private equity specialists (persons driving the private equity objectives).

Gejadze *et al.* (2017:260) conclude that the benefits brought by private equity firm-level specialisation outweigh the costs. Specialisation becomes especially beneficial as far as sector and geographic specialisation is concerned. Gejadze *et al.* (2017:261) state that

experience accumulated from specialisation benefits a faster set-up of new funds and exiting of portfolio investments. Lerner *et al.* (2016:11) make a similar observation when stating that to identify the best investment opportunities, the general partner must differentiate sectors. Limited partners must choose the general partner who is most skilled to do so.

This study proposes that having specialised industry insights could influence private equity investment decisions. It also proposes that the investment decision could be affected by the ability to appoint networked directors with the necessary expert credentials to the board of the target company.

2.5.2 Investor-specific consideration: Alignment of target company with other portfolio companies

The concept of conglomerates is closely linked to industry specialisation and networked directors. Brigham *et al.* (2016:577) describe conglomerates as a group of companies with unrelated products. Anon (2019:1) defines a conglomerate as a corporation that shows rapid growth by acquiring target companies with unrelated product ranges.

A study by Schickinger *et al.* (2018:278) suggests that private equity investors can create shareholder value by, for example, linking individual portfolio companies into conglomerates, which creates synergies across the broader conglomerate. The viability of linking target companies into an existing conglomerate could potentially affect the investment decision. Put differently, the investment decision may not always be a stand-alone decision, but may be influenced by the broader investment portfolio. Le Nadant *et al.* (2018:240) have a similar view. They found that specialised private equity investors use their existing business networks to create more business opportunities for portfolio companies. These opportunities can be achieved by refocusing the strategic activities of the target company (Wright *et al.*, 2009:9). However, Da Rin and Phalippou (2014:4) note that private equity investment teams often only manage “loosely related assets” across which synergetic benefits cannot be achieved.

Daks (2017) refers to an actual example when stating that:

> *"We negotiated a sale of the majority interest in the company to a private equity firm that injected growth capital into the company, and moved production to a shared facility with another portfolio company of the private equity firm, increasing its output and distribution until it was finally sold to a publicly owned company."*

It is argued that this actual example demonstrates the strategy of private equity investors to align portfolio companies and benefit from these synergies.

South Africa is an economy with large numbers of poor consumers who are traditionally seen as a deterrent for innovation. Asakawa *et al.* (2019:2) argue that, conceptually, this view has changed. Historically emerging economies used to be a market for low-cost products, but it is now a market for innovation. This innovation, now referred to as 'frugal innovation' is defined as (Hossain, 2018:927):

> *"… a resource-scarce solution that is designed and implemented despite financial, technological, material or other resource constraints, whereby the outcome is significantly cheaper than competitive offerings and is good enough to meet the basic needs of customers who would otherwise remain un(der)served."*

Schleinkofer *et al.* (2019:247) state that the concept of frugal innovation describes the strategy used to develop performance-orientated goods for cost-sensitive consumers.

Asakawa *et al.* (2019) introduced the concept of 'frugality-based advantage', which is described as a strategic advantage that a company can create by using frugal innovations (innovations that overcome external resource constraints). Addressing the shortage of input supplies is considered an input frugality-based advantage. Income frugality-based advantages address the income limitation of consumers whereas infrastructure frugality-based advantages overcome infrastructure limitations.

In this study, it is argued that functioning within a conglomerate is likely to provide a frugality-based advantage. It could also mean that a company that is financially

unattractive to any other investor could be financially extremely attractive to another because of the potential frugality-based advantages it offers.

Within this context, private equity investors can consider investing in private companies where alignment with existing portfolio companies is possible, mainly if frugality-based advantages can be achieved.

2.5.3 Target-specific consideration: Willingness of the target company to accept an outside shareholder

Lerner *et al.* (2016:14) observe that both general and limited partners are often sceptical about taking up a minority interest in a target company. However, within an emerging market, the founders of the company are generally sceptical about selling a majority stake.

In a study that aimed to understand the wealth creation and transfer aspects of private equity investment, Harford and Kolasinski (2014:893) found that private equity investors neither owned the majority of the target companies nor were they subsidiaries of other companies at the time of acquisition. These investments could include family-owned businesses. The second-most prominent category of target companies included companies that were subsidiaries of other companies before the acquisition.

Privately owned companies, including family-owned ventures, are often owner-managed as opposed to having agents who manage the businesses. This position changes when private equity investment takes place. Schickinger *et al.* (2018) quote academic research that suggests that private equity investors find it challenging to invest in family-owned private businesses as they have different objectives, which could cause friction. For example, private equity investors may have a shorter investment horizon and be more profit-orientated than family-owned businesses. Le Nadant *et al.* (2018:238) indicate that private equity investors benefit when they can position themselves inside the target company, which can be achieved by appointing directors to the board. Some companies find it challenging to transition from being accountable only to themselves to being accountable to a broader stakeholder base.

Capasso *et al.* (2014:638) introduced a concept called ‘equity willingness’, which is the willingness of a target private company to accept an outside equity investor. They argue that this matter is as important as the target’s equity worthiness, which is the target’s ability to meet the investor’s other requirements. Schickinger *et al.* (2018:275) suggest that the possible reluctance of family-owned businesses to accept private equity investment is often associated with their “aversion regarding socio-emotional wealth”. In this context, socio-emotional wealth refers to the non-economic or non-financial utility that the current owners derive from their ownership, which includes personal reputation and social standing utility, for example.

A study by Daks (2017) argues that succession planning could be a catalyst for private equity investment in the agro-processing sector. Wright *et al.* (2009:3) observe that private equity investors want to play an active role when investing and do so by demanding board positions. Wood and Wright (2009:361) confirm the view that private equity firms intend to become active investors by taking directorships. These investors often have specific contractual arrangements with the management team, which include detailed reporting requirements. Schickinger *et al.* (2018:275) observe that when investing in a family business, for example, the more significant resources and capabilities contributed by the private equity investors could unlock more significant potential.

While the intention of this close involvement is mostly to add value through specialised expertise, as noted in previous studies, the motive to overcome information asymmetry and avoid a possible agency problem should also be considered. Schickinger *et al.* (2018:275) comment that empirical studies suggest that an “owner-owner agency problem” could occur when the current shareholders retain a majority interest after private equity investor buy-in. Le Nadant *et al.* (2018:240) had similar findings and went so far as to state that private equity investors want to control the boards of portfolio companies. While the concept of control seems to be important, Lerner *et al.* (2016:8) found that the performance of majority investments (where investors have control) is similar to minority investments. A study by van Niekerk and Krige (2009:8) found that private equity investors in South Africa do not acquire ownership control as the common ownership acquired is only 44%. The same study further revealed that majority ownership do not translate into a

superior internal rate of return (IRR). If this is true, it raises questions as to the benefit of ownership control.

These arguments raise questions regarding the ideal equity stake that the private equity investor should pursue. Is it necessary to gain control over the board? The arguments further raise questions about the desirability and potential value of follow-on rights.

2.5.4 Growth prospects

Private equity investors focus on companies operating within growth sectors (Lerner *et a*l., 2016:8). Daks (2017:4) quotes Stevenson, an experienced US private equity practitioner, who states that, “with consumer goods, including food and beverage products, private equity firms are looking for companies that need the business acumen or the financial resources to take the organisation or product to the next level”. It is argued that referring to ‘the next level’ emphasises growth.

Previous studies revealed that growth prospects are critically important. Block *et al.* (2019) and Schickinger *et al.* (2018:275) suggest that growth potential is probably of primary importance in the decision-making process. Within the South African context, van Niekerk and Krige (2009:11) found that earnings growth is the most critical driver of financial returns to private equity investors.

Wright *et al.* (2009:7) propose that although value is created occasionally by merely improving efficiencies, strong growth is the objective at other times. The authors argue that when substantial growth is the objective, incentivising the management team through equity holding becomes essential. Gompers *et al.* (2016:450) confirm that equity incentives form part of the financial engineering that private equity investors bring to their portfolio companies.

The position can also be considered in reverse. If the target is outperforming its peers pre-buy, investment is unlikely as there are only a few performance gains to be obtained (Wright *et al.*, 2009). This suggests that underperforming firms are more likely targets because initiatives such as management equity incentives could create financial benefits to investors.

It does happen that recently acquired portfolio companies sell non-core or surplus assets. A study by Burch and Lawrence (2013:248) report that private equity investors attempt to 'shake out' capital by restructuring underperforming companies or selling non-core assets. This approach possibly seems contradictory to achieving strong growth. One can intuitively argue that it may be better to utilise the specific asset more effectively. However, the proceeds of the sale of unproductive assets could be reinvested in activities that offer higher growth potential, or it could be distributed to investors to provide an initial return (Wright *et al.*, 2009:10).

2.5.5 Ability to restructure the balance sheet of the target company

Pozen (2007:81) echoes general public sentiment by stating that private equity investors often achieve superior returns by only leveraging the target company after acquisition. If this is the case, it raises the possibility that the extent to which the target's balance sheet could be leveraged influences the investment decision. Gompers *et al.* (2016:450) categorise this as part of the financial engineering done by private equity investors, which is a crucial consideration in achieving superior financial returns.

Restructuring the balance sheet includes considering an optimal capital structure. Chipeta (2016:25) refers to the trade-off theory of capital structure and suggests that companies attempt to achieve an optimal balance between the after-tax cost of debt (benefitting from the tax shield) and the risk (cost) of financial distress. Agathis (2016) raises the topical aspect of leveraged buyouts. A leveraged buyout takes place when the private equity investor invests in the target company using a combination of equity and debt funding. The concern is that while debt funding usually has a lower cost, it does increase financial leverage and risk. However, it does skew the return on investment favourably, hence the reason for the practice. The author makes the argument that overleveraging portfolio companies create undue risk. If this is the case, it raises the question as to the optimal capital structure that private equity investors should pursue. Also, outside of minimising the weighted average cost of capital, what are the criteria used to determine an optimal capital structure?

2.5.6 Viable and defined exit strategy

Private equity investors typically seek to extract the maximum value of their investment at the exit point. Thus, these investors are said to be exit-driven (Reynolds, 2015:10). Schickinger *et al.* (2018:275) mention that a private equity investment transaction could carry transaction costs, which in itself could result in minimum investment thresholds to be set and more significant transactions to be favoured. The authors further state that the absence of a defined exit route could be detrimental to the transaction. This would especially be the case if the private equity investor holds a minority interest and the majority equity holder has the option to veto a possible exist, such as an IPO.

Previous research suggests that private equity investments have a limited lifespan. Scholtz (2017:6) quotes Povaly (2006) who suggest that private equity investments generally have a lifespan of seven to ten years. The author states that private equity investors have an exit strategy planned as early as the initial investment. Lerner *et al.* (2016:8) note that private equity investments are always of a longer-term nature.

In a study aimed at explaining the substantial returns generated by private equity investors, Harford and Kolasinski (2014:892) categorise the exits into four categories, namely: an IPO; selling to a strategic buyer (a buyer who is not engaged in business acquisitions as their primary line of business); selling to financial buyer (typically a private equity sponsor or investor); and restructuring (generally referring to a failed investment entering a workout process such as bankruptcy procedures). In the same study, the authors observe that only about 10% of the private equity investment transactions observed were investments bought from other private equity investors. Furthermore, only a small percentage of exits were from IPOs whereas the majority of exits were sales to strategic buyers.

Other studies found that an IPO is often the preferred exit mechanism for private equity investors. Pozen (2007:81) raises the possibility that private equity investors could achieve excess returns by hastily taking the target public and benefit from a profitable IPO. If this is the case, the readiness of the target to go public could affect the investment decision. If this is the case, holding a minority interest potentially compromises such an exit strategy

because, without majority voting rights, the private equity investor has less control over ownership and the decision to go public (Lerner *et al.*, 2016:15).

Tan (2018) also highlights the idea that a popular exit strategy for private equity investors is to take the target company public and benefit from a capital gain on the stock price when listing. Another option is to sell its shares in the target to other private equity investors. Choosing between these alternatives, Lerner *et al.* (2016:16) found that an IPO has historically been the dominant exit mechanism in emerging markets. If actual financial gain is only realised on exit instead of distributions, such as dividends, throughout the investment period, the importance of a defined and viable exit strategy becomes more prominent. This view is shared by Daks (2017) who quotes Stevenson who state that private equity investors typically plan for a three-to-five-year exit strategy. The author notes that this exit strategy usually includes taking the company public, selling it to another private equity investor, or selling it to any other strategic buyer who absorbs it into existing operations.

While previous studies agree that private equity investments have a longer-term nature, this reference seems to have different interpretations. It raises questions as to the actual tenure of private equity investments. It is also worth investigating the most likely exit routes for private equity investors in South Africa. Furthermore, there is a view that if private equity investors take on a longer investment tenure, a higher rate of return would be required to compensate for the lower investment liquidity and higher perceived investment risk (Lerner *et al.*, 2016:11). The possible link between the required investment returns and planned investment tenures should also be investigated.

2.5.7 Financial return expectations

When investment returns in North America and Europe are considered, private equity investments outperform investments in public companies (Harris *et al.*, 2016). Although a paper presented by Missankov *et al.* (2008) is now dated, it is still a relevant point of reference. Missankov *et al.* (2008) suggest that the financial performance of private equity funds over 13 years ending 2005 exceeded that of public investments by up to 18% per annum. More recently, the SAVCA (2018:27) reports that the pooled returns for private

equity in South Africa are significantly higher than those achieved on public markets with an average difference of 7% over the ten years ending 2018. The financial returns achieved by the fund is firstly distributed to the general partner in the form of management fees whereafter the remainder is distributed to the limited partner. Fees paid to the general partner significantly reduces the returns eventually earned by the limited partner. The following questions then arise: What is the typical investment returns sought by private equity investors on a fund level in South Africa? What is the return expectations of the limited partner?

Attractive financial returns are a crucial consideration for private equity investment (Block *et al.*, 2019; Dhochak & Sharma, 2016); Schickinger *et al.* (2018:275). Wright *et al.* (2009) ask the question: “Do private equity investors earn superior returns?” The authors propose that private equity investments return value to their investors by “creating value within an investment”; “by appropriating value from vendors by buying under-value”; or “a combination of the two”. Put differently: private equity investors transform the target into a significantly more valuable business; they acquire the shares at a below market value price; or they use a combination of these methods. When attempting to understand how private equity investors in South Africa create value, financial returns are essential mechanisms to consider. The questions arise:

- How do private equity investors measure returns?
- What are the actual return expectations?
- How are investment opportunities evaluated financially?

Some studies found that valuation techniques such as discounted cash flow and net present value are not popular with private equity investors. It is suggested that IRR and capital invested multiples are preferred (Gompers *et al.*, 2016:450). This view is shared by (van Niekerk & Krige, 2009) who also cite the primary measure of financial performance as the IRR achieved on the funds invested by the general partners. Earnings multiples were also used. In contrast, financial officers use net present value as often as they use IRR. Private equity investors do not explicitly use the capital asset pricing model (CAPM) to determine its required rate of return. These investors instead targets a specific IRR between 20% and 25% (expected rate of return). It is suggested that these levels of return

are above the CAPM-based return (required rate of return) (Gompers *et al.*, 2016:450). This scenario implies that when plotted on the security market line, the share would be plotted above the line, which suggests an undervalued position (Bodie *et al.*, 2001; Brigham *et al.*, 2016). If this is the case, it is suggested that private equity investors invest in companies where the share is undervalued (acquired at a bargain) and then generate superior returns based on the bargain purchase. Chen *et al.* (2015:41) propose that assets that are not readily marketable, such as shares in a private company, be bought at a discount because of the lack of liquidity or marketability thereof.

It is widely acknowledged that compensating the general partner creates strong incentives for the general partner to generate high returns. In turn, such strong financial performance by the portfolio company directly translates into high returns for the limited partner. These high returns are achieved with a combination of value-adding activities, which can be grouped into categories such as financial engineering, governance engineering, and operational engineering (Gompers *et al.*, 2016:450).

Pozen (2007:84) states that while increasing the financial leverage could contribute to the success of private equity investments, the operating performance of the portfolio company is a more significant contributor to the success of the investment. Interestingly, a study by van Niekerk and Krige (2009) found that the financial performance of the portfolio does did not benefit from the private equity investor having controlling ownership.

2.5.8 Considering the management team

Block *et al.* (2019) state that the track record of the incumbent management team is a crucial consideration whether to invest. However, it is unclear which aspects of the track record are being considered. Gompers *et al.* (2016:451) note that top management is often replaced either before or after investing. If this is the case, it suggests that private equity investors look for something very particular in the management team. Pozen (2007:85) states that private equity investors prefer that members of the executive management team of the target company hold a material equity interest, mentioning numbers of up to 20%. The findings by Gompers *et al.* (2016:450) are similar and they emphasise that private equity investors provide strong equity incentives to management teams of its

portfolio companies. Incentives ensure that the executive team focuses on adding value for shareholders by avoiding the so-called agency problem. Le Nadant *et al.* (2018:240) confirm that equity incentives encourage managers of portfolio companies not to waste money.

Regarding early-stage private equity investment (i.e. the start-up phase), Dhochak and Sharma (2016:977) argue that the personality and experience of the entrepreneur are the most crucial considerations for venture capital investors to consider. If the track record and the general characteristics of the management team are regarded as essential investment considerations, it is appropriate to ask: Which general management characteristics are being considered and how important are these?

2.5.9 Position of primary product in the market

It is argued that the primary use of the product or service provided by the target company influences investment decisions. Block *et al.* (2019) mention that the concept of 'value-added' becomes essential. In this sense, the target company provides a product or service that is complementary to the original product, in which case the demand for the original product should be well understood. It could be that the target company has always had an excellent product, but did not have proper marketing channels. New marketing channels and technologies, such as e-commerce, allow small businesses to expand their sales rapidly and effectively to a broad target market. This growth and further opportunities exploited by food companies have attracted private equity investments (Daks, 2017:11).

Dhochak and Sharma (2016:977) show that the products or services produced by the target company rank as one of the significant issues that private equity investors consider. The authors found that investors strongly consider product characteristics that lead to differentiation, such as a unique and patented nature of products.

2.5.10 Black economic empowerment

In South Africa, BEE potentially plays an important role where private equity investment decision-making is concerned. To this effect, Portmann and Mlambo (2013) suggest that BEE is an essential consideration in private equity investment in South Africa. The authors

quote Missankov *et al.* (2006:56) who estimate that more than 90% of total private equity transactions in South Africa have a BEE element. Reynolds (2015:18) affirms this view by stating that private equity investments in South Africa facilitate broad-based black economic empowerment (BB-BEE) shareholding and that many private equity transactions have a BB-BEE element. Dhochak and Sharma (2016:978) declare that institutional and regulatory environments are amongst the critical investment criteria to be considered, which elevate the aspect of BEE in South Africa.

Alessandri *et al.* (2011:230) state that BEE transactions closely resemble corporate and social responsibility actions by corporate South Africa, which are encouraged by the South African government. These BEE transactions involve selling equity stakes to black investors or investor groups. In this context, a BEE transaction intends to achieve social benefits. There may however also be potential economic gains, which include access to government contracts and access to other new markets. These, together with potential improved social capital, offer opportunities for new business.

Although BEE offer social and economic benefits, Alessandri *et al.* (2011:230) remark that BEE transactions are expensive. A BEE-driven private equity transaction becomes expensive when it causes distributions to shareholders, which result in less cash being retained in the business to fund growth. Critics highlight that only a handful of black persons benefitted from BEE. Black investors or investor groups usually do not have the financial means to fund investments, which leads to a highly leveraged transaction that brings with it a significant financial risk. Alessandri *et al.* (2011:239) explain that during an average BEE transaction, 20% of issued shares are sold to a BEE investor. It is also suggested that some BEE transactions are executed at a premium while others are executed at a discount. If true, it contradicts the previous notion that all private equity transactions are at a discount.

Within the context of the referenced research, it is appropriate to ask:

- What role does BEE play in private equity investment?
- Does this aspect attract different investment criteria?

2.6 Conclusion

Previous studies identified numerous aspects that private equity investors consider while making investment decisions. The views on some of these are inconclusive. Researchers often noted that results differed from previous studies because of industry changes that are taking place over time.

It is also noted that while private equity investment received substantial attention in the USA, Europe and Asia, the current position in South Africa is far less researched, especially regarding agro-processing. It is therefore unclear which aspects private equity investors consider as important when investing in agro-processing in South Africa.

CHAPTER 3 – THE RESEARCH PROCESS

3.1 Introduction

This chapter first sets out the critical elements of the research plan, whereafter it discusses the empirical research results. The research process is structured as set out in Table 5.

This study entails business research that focuses on the challenges faced by private equity investors when investing in agro-processing ventures. Hair *et al.* (2015:5) define business research as “a truth-seeking function that gathers, analyses, interpret and report information so that business decision makers become more effective”.

Table 5: Research process followed in this study

Step	Key activities	Chapter references
1	Identify and formulate the research problem	Chapter 1, Section 1.3
2	Determine the research objectives	Chapter 1, Section 1.3
3	Develop a research design	Chapter 1, Section 1.6
3.1	Select the appropriate research methodology	Chapter 3, Section 3.2.1
3.2	Identify the type of research to be undertaken	Chapter 3, Section 3.2.2
4	Conduct secondary research	Chapter 3. Section 3.3
5	Conduct primary research	Chapter 3, Section 3.4
5.1	Determine the population and sample	Chapter 3, Section 3.4.1
5.2	Design the research instrument	Chapter 3, Section 3.4.2
6	Collect the data	Chapter 3, Section 3.5
7	Analyse the data and report findings	Chapter 4
8	Make recommendation	Chapter 5

Source: adapted from Scholtz (2017:67)

The research problem and research objectives were described in Chapter 1. Although aspects of the research design and methodology were discussed in Chapter 1, these topics will be elaborated in this chapter.

3.2 Developing the Research Design

Step 3 in Table 5 refers to the development of the research design. Bryman and Bell (2014:100) state that the research design "creates a framework for the collection and analysis of data". The importance of aspects such as the expression of casual connections between variables, whether the results can be interpreted as universal to the population, and how to understand specific behaviours all affect the research design that is chosen.

3.2.1 Selecting an appropriate research methodology

Section 1.6.1 explained that this study combined a positivistic research methodology and a phenomenological research methodology through a process of triangulation, which increases the validity and reliability of the study. Emphasis is, however, on the positivistic research methodology as the objective of combining the phenomenological research methodology is to add depth to the empirical findings.

3.2.2 Type of research undertaken in this study

This study attempted to identify the challenges faced by private equity investors when investing in agro-processing ventures in South Africa. Given the research objectives set out in Section 1.4, the study was descriptive as it identified characteristics of investment decision-making and further aimed to explore associations between the different characteristics (Cooper & Schindler, 2014:133-135).

Exploratory research is undertaken to study a specific research problem that has not been studied before. The intention is to create a testable hypothesis (Cooper & Schindler, 2014:134). The primary objective of exploratory research undertaken in this study was to identify the salient variables that could be relevant when private equity investors invest in an agro-processing venture in South Africa. Exploratory research was done though secondary literature studies as detailed in Chapter 2.

Finally, explanatory research aims to identify links between the variables that pertain to the research problem (Saunders *et al.*, 2009:140). This study aimed to rank the variables that affect private equity investment decisions in order of importance and also to identify the

causal links between these variables. This study therefore has a descriptive, exploratory and explanatory nature.

3.2.3 Deductive as opposed to inductive research

A deductive research approach starts with theory and produces a hypothesis or identifies variables about the research problem for further empirical testing through a process of secondary literature research (explanatory research). An inductive research approach starts by observing the research problem and create general conclusions (Bryman & Bell, 2014:9; Greener, 2008:16).

This study was deductive as deductions were made about aspects that could affect investment decisions. The steps set out in Table 6 were followed during the study.

Table 6: Deductive research process followed in this study

Step	Description
1	Research theory (background and secondary literature research)
2	Propose hypothesis and identify salient variable
3	Collect primary data
4	Analyse and make findings
5	Confirm or reject the hypothesis
6	Revise theory through recommendations

Source: Bryman and Bell (2014:9)

3.2.4 Qualitative and quantitative research

The primary data collected in an empirical study is either qualitative or quantitative in nature. Bryman and Bell (2014:382) explain that a qualitative research approach focuses on words and does not attempt to make any quantification in the collection or analysis of the primary data collected. This research approach is typically associated with inductivism. A quantitative research approach attempts to quantify the collection and analyse the primary data collected. This approach is typically associated with deductivism and positivism.

This study used a mixed-method approach, explained in Section 1.6.1, while emphasising the quantitative findings. Bryman and Bell (2014:62) state that a mixed-method approach combines qualitative and quantitative research in one single study. The mixed-method approach has become increasingly popular in business research over the last decade as it allows the researcher to benefit from the strengths of both research methods.

3.3 Conducting Secondary Research

Conducting the secondary research is the fourth step in Table 5. The secondary research was performed as part of the exploratory research referred to in Section 3.2.2 and resulted in the salient variables identified in Section 2.5 of this study.

Cooper and Schindler (2014:86) and Walliman (2011:71) warn that researchers often want to use secondary data for other reasons than what it was initially intended for. Furthermore, the data has been subjected to previous interpretations. These characteristics compromise the usefulness of secondary data and research; therefore, making further empirical testing imperative.

Care was taken to ensure that the secondary literature studies were relevant to the purpose and objectives of this study but with the caveat that these literature studies were done in North America, Europe and Asia where different economic conditions prevail. The purpose of the secondary study was however limited to develop the theoretical framework (detailed in Chapter 2) and research design.

3.4 Conducting Primary Research

Primary research, listed as Step 5 in Table 5 and Step 3 in Table 6, was conducted after completing the secondary research. Zikmund and Babin (2010:186) explain that the goal of primary research is to “gather, assemble and analyse primary data which is specific to problem statement and research objectives”. Researchers obtain primary data through observation, experience or recordings (Walliman, 2011:69). Surveys can be used to gather both qualitative and quantitative primary data (Bryman & Bell, 2014:191-210).

This study used a survey to collect both qualitative and quantitative primary data.

3.4.1 Determining the population, sample frame and sample

The population, sample frame and sample were described in Section 1.6.3.

3.4.2 Designing the research instrument

Table 1 in Section 1.6.3 provided background information on the research instrument used, namely, an electronic survey. The survey consisted of five different sections, each aimed at collecting different information, which can be classified as either qualitative or quantitative. After the survey was developed, it was converted into an electronic format and the link was sent to the 75 possible participants.

The research instrument incorporated the informed consent, disclaimer and a brief explanatory note as to the concept of agro-processing. This explanation was necessary to ensure that participants had an aligned understanding of the core aspect under investigation.

The research survey used in this study is attached as Appendix A. The sections that follow briefly describes each section of the research survey.

Section A: Gathering general information

This section collected essential demographic information about participants. Participants were asked to select the option that best describes their situation. The 11 demographic questions were compiled purposefully because answers in this section could potentially influence the answers provided in the remainder of the survey.

Saunders *et al.* (2009:418) indicate that descriptive data is usually measured on a nominal scale. Therefore, using a nominal scale was appropriate for responses to the questions in Section A as the researcher was only interested in knowing the number of occurrences for each variable.

Section B: Understanding the private equity investment approach

Zikmund and Babin (2010:336) state that it is essential that the survey questionnaire is designed correctly because the responses are only as good as the questions asked. The

researcher designed the questionnaire primarily for the purpose of this research and based the questions on the secondary literature research detailed in Chapter 2. The researcher intuitively added questions to cover topics such as BEE as this is unique to South Africa.

The researcher formulated between three and six statements for each of the factors identified in Section 2.5.1 to Section 2.5.10 for the purpose of collecting data about the research problem. The 51 statements were closed-ended, and a four-point Likert scale was used to rate the responses.

The Likert scale produces ordinal scale, quantitative data. Ordinal scales are used to depict the order of variables, but they do not record the difference between variables. Ordinal scales are mostly used to reflect non-mathematical concepts such as satisfaction and happiness (Cooper & Schindler, 2014:252).

Section C: Understanding pertinent matters regarding equity investment

Section C consisted of nine questions that asked the participant to select the option that best describes their opinion regarding the statement question. Each statement question was derived from the secondary literature study detailed in Chapter 2. The intention was to gain deeper insight into the variables tested. The descriptive qualitative data gathered in Section C used a nominal scale, similar to Section A.

Section D: Understanding the most important agro-processing investment issues

Section D consisted of seven questions that asked the participant to select two options that best described their likely course of action during and after investing. Each statement question was derived from the secondary literature study detailed in Chapter 2. The intention was to gain more in-depth insight into the variables tested.

Section E: Obtaining opinions regarding private equity investment

Section E consisted of three open-ended questions that asked the participant to provide responses to three topics that could not be determined clearly in the literature studies

detailed in Chapter 2. The intention was to gain a more in-depth insight about the three aspects by obtaining qualitative information.

The three questions were initially intended to be surveyed by way of a structured interview after the initial quantitative research phase (Section B of the research survey). However, because of time constraints, it was decided to incorporate this section into the main survey questionnaire.

3.5 Collecting Primary Data

The collection of primary data was the sixth step shown in Table 5 and part of the third step shown in Table 6. The primary data was collected through an electronic research survey questionnaire as detailed in Section 3.4.2.

Seventy-five private equity investment professionals were identified to participate in the study on an anonymous and voluntary basis. Forty-four private equity investment professionals responded with a response rate of ±60%. The initial request to participate in the research survey was followed up by two more reminder requests. Because of time constraints, the primary data collection process was limited to 30 days.

3.6 Analysing Primary Data

The seventh step in the research process, as detailed in Table 5, was analysing the primary data gathered. Both descriptive and inferential statistics were used to analyse the data. Descriptive statistics reveal how the values of the variables are distributed while inferential statistics infer results of the study relative to the population (Walliman, 2011:116).

Section A of the survey questionnaire collected qualitative demographic data from all participants. The data was analysed to identify commonality amongst participants and describe the respondents in terms of the number of occurrences.

Section B of the survey questionnaire collected quantitative data from all participants. This quantitative data was first analysed descriptively to establish the mean and standard deviation of each of the 51 components (survey questions). Thereafter, the components

were loaded to four initial factors through initial exploratory factor analysis. These components were evaluated statistically for sampling adequacy using the Kaiser-Meyer-Olkin (KMO) test and for sphericity using Bartlett's test. KMO test results in the range of 0.60–0.70 are considered mediocre to good, which are acceptable for analysis (Howard, 2016:52).

Subsequently, Cronbach's alpha was used to test for construct reliability. Reliability refers to the ability of the instrument to measure consistently. Cronbach's alpha indicates internal consistency of the construct (reliability), which it expresses as a number between 0 and 1 (Tavakol & Dennick, 2001:53). Depending on the construct tested, different results could be deemed to be appropriate. For example, Field (2009:675) states that while a value of 0.8 is appropriate for an intelligence test, a value of 0.7 is acceptable for ability tests. The author further notes that when testing psychological constructs, values below 0.7 are obtained because the constructs are diverse.

It may be challenging to get an acceptable Cronbach's alpha value while testing a construct with a few components. Pallant (2010:100) suggests that for a small number, for example, less than ten, the researcher may opt to report the mean inter-item correlation. Clark and Watson (1995:309-319) explain that a mean inter-item correlation between 0.15 and 0.55 is acceptable. Therefore, this study used the mean inter-item correlation.

3.7 Reporting Research Findings

Reporting the research finding was the final step in the research process, as shown in Table 5. The research findings are reported in Chapter 4.

CHAPTER 4 – THE RESEARCH FINDING

After following the research process detailed in Chapter 3, Table 5, the research findings are reported in Chapter 4.

4.1 Demographic Make-up of the Research Participants

Section A of the research survey provided qualitative data about the demographic backgrounds of the participants in this study.

4.1.1 Participants' roles in the organisation

Table 7 summarises the role of participants in their respective organisations. This information is essential as it shows that participants occupy senior decision-making positions, which adds credibility to their responses and the study. Based on the qualitative information obtained, the respondents were categorised as executive (important decision makers but not directly involved in the investment negotiation process) or investment principals (directly involved in the investment process). In summary, 53.6% of respondents were classified as investment principals while 46.4% were classified as executives.

Table 7: Participants' roles in the organisation

Participant role	Percentage of participants	Grouped
Investment principal	39.6%	Investment principal
Partner/director	28.0%	Executive
Analyst	7.0%	Investment principal
Vice-president	2.3%	Executive
Executive	4.6%	Executive
Board member	4.6%	Executive
Associate	7.0%	Investment principal
CEO	2.3%	Executive
Chief investment officer	4.6%	Executive
Total	**100.0%**	

4.1.2 Participants' experience in the specific position

The level of experience (measured in time) that participants have in their current position (detailed in Section 4.1.1) is shown in Table 8. The qualitative data shows that 53.5% of the participants have been in their current position for three years and longer. Therefore, the participants' experience levels in their current roles suggest an experienced sample and that their responses are credible for the purposes of this study.

Table 8: Participants' experience in current position

Years in current position	Percentage of participants
0–3 years	46.5%
3–5 years	16.3%
> 5 years	37.2%
Total	**10.00%**

4.1.3 Participants' overall experience in the private equity sector

Section 4.1.3 is linked to Section 4.1.2 as it investigates the overall experience levels of the participants in order to provide credibility to their responses and this study. Table 9 shows that 67.4% of participants have been involved in the private equity sector for more than five years. This level of experience, linked to the role-specific experience detailed in Section 4.1.2, suggests a high level of experience, which adds credibility to the responses and research study.

Table 9: Participants' overall experience in the private equity sector

Years in private equity	Percentage of participants
0 – 3 years	18.6%
3 – 5 years	14.0%
> 5 years	67.4%
Total	**100.0%**

4.1.4 Participants' primary field of study and expertise

The primary field of expertise of private equity investment professionals could be an influential aspect of the private equity investment decision-making process as it may orientate the focus of investment professionals. For example, the researcher hypothesises that a person with a law background can emphasise legal agreements whereas a person with an operations background could emphasise the operational efficiencies of the target company. This hypothesis was not tested further, but it is noteworthy that Table 10 shows that 88.4% of the participants had accounting, finance or investment management as a core skill set. If the hypothesis is correct, it suggests that the financial aspects of the investment would receive the primary focus.

Table 10: Participant's primary field of expertise

Primary field of expertise	Percentage of participants
Accounting, finance, investment management	88.4%
Operations management	2.3%
Law	2.3%
General management	4.7%
Agricultural economics	2.3%
Total	**100.0%**

4.1.5 Investment stage focus

Section 2.2.1 and Section 2.2.2 defined and discussed aspects of private equity investment. The researcher pointed out that private equity investors focus on different investment stages. Table 11 shows the investment stage focus of the participants of this study. View participants expressed a preference for early-stage investment. The focus is, therefore, on private equity investment rather than venture capital.

Table 11: Investment stage focus

Investment stage	Percentage of participants
Development/growth stage	58.2%
Mature/buyout stage	37.2%
Development and mature stage	2.3%
All except early stage	2.3%
Total	**100.0%**

4.1.6 Targeted individual investment size

By collecting qualitative information, the researcher tried to establish a preferred (targeted) individual transaction size. Table 12 shows that the targeted (preferred) individual investment size is in the R101m–R200m range. The weighted average targeted individual transaction size is R190.260m on the assumption that the average individual investment size above R500m is R501m.

When considered holistically, the weighted average targeted individual investment size of R190.260m is meaningful when seen in relation to the targeted equity stake as it hints towards the size (value) of the companies targeted for investing.

Table 12: Targeted individual investment size

Preferred investment size (a)	Percentage of participants (b)	Average [average of (a)] (c)	Weighted average (b × c)
R11m–R50m	4.7%	R30.5m	R1.433m
R51m–R100m	20.9%	R75.5m	R15.780m
R101m–R200m	30.2%	R150.5m	R45.451m
R201m–R300m	25.6%	R250.5m	R64.128m
R50m–R300m	2.3%	R125.0m	R2.875m
R100m–R500m	7.0%	R200.0m	R14.000m
> R500m	9.3%	R501.0m	R46.593m
Total	**100%**		**R190.260m**

4.1.7 Preferred investment geography

This study focused on private equity investment in South Africa agro-processors. Therefore, South Africa as an investment destination is essential. Table 13 shows that South African private equity investment professionals focus on South Africa with 53.5% seeing South Africa as their preferred investment geography.

Table 13: Preferred investment geography

Preferred investment country/region	Percentage of participants
South Africa	53.5%
Southern Africa Development Community	4.7%
Sub-Saharan Africa	39.5%
Africa	2.3%
Total	**100.0%**

4.1.8 Preferred economic sector for investing

Agro-processing forms part of the secondary economic sector in which all manufacturing takes place. It is therefore essential to understand whether private equity investment professionals in South Africa have a preference to invest in the secondary economic sector. The data gathered and reflected in Table 14 is important as it shows that 34.9% of participants focus specifically on the secondary sector, which includes agro-processing. However, 53.5% are sector agnostic, which suggests that sector specialisation may not be an all-important consideration.

Table 14: Preferred economic sector

Preferred economic sector	Percentage of participants
Primary sector	2.3%
Secondary sector	34.9%
Tertiary sector	9.3%
Quaternary sector	0.0%
A combination of the sectors	53.5%
Total	**100.0%**

4.1.9 Investor classification

The private equity investment firms associated with SAVCA are typically classified as detailed in Table 15. This classification affects the investors' approach when investing. As shown in Table 15, 69.8% of participants are associated with an independent fund, which aligns the sample to the broader population of private equity investors.

Table 15: Investor classification

Investor classification	Percentage of participants
Independent fund	69.8%
Captive – government	2.3%
Captive – corporate	20.9%
Captive – other	7.0%
Total	**100.0%**

4.1.10 Investment history

With the focus on investing in agro-processing, the previous history in investing in this sector or interest to invest in this sector makes the survey responses more relevant. Table 16 shows that 53.5% of the respondents have invested in agro-processing and would consider further investments. A further 41.8% have not invested but want to consider making such investments. The qualitative data suggests that private equity investment professionals are willing to invest in agro-processing if investment opportunities can be found.

Table 16: Investment history

Investment history	Percentage of participants
Have invested in agro-processing, unlikely to repeat	0.0%
Have invested in agro-processing, likely to repeat	53.5%
Have not invested in agro-processing, will not consider	4.7%
Have not invested in agro-processing, want to consider	41.8%
Total	**100.0%**

4.1.11 Level of specialisation

The levels of specialisation were referred to in Section 4.1.8 but from an economic sector perspective. The literature studies in Chapter 2 suggested that sector specialisation could be an essential aspect of private equity investments. Responses received about this aspect, as shown on Table 17, suggest that most private equity investment professionals (67.4%) do not specialise in a particular business sector (such as agro-processing), but rather invest in various business sectors. Research shows in Section 4.8 that specialists responded differently to generalists in this study.

Table 17: Sector focus

Specialisation	Percentage of participants
Specialised fund (specific sector focus)	32.6%
General fund (invest across diverse sectors)	67.4%

4.2 Descriptive Statistics Quantitative Study

Section B of the survey instrument collected quantitative data, which is analysed in Section 4.3. The data collected is described qualitatively in terms of mean and standard deviation, as shown in Table 19. The data was measured on a four-point Linkert scale as given in Table 18.

Table 18: Mean and standard deviation of quantitative responses

Rating	Description
1	Not at all
2	To a small extent
3	To a moderate extent
4	To a large extent

Table 19: Survey questions: descriptive statistics

	Component (question)	Number of responses	Minimum value	Maximum value	Mean	Standard deviation
1	How necessary is it to have existing industry-specific insights (for example in agro-processing) when considering an investment opportunity in that sector?	44	2	4	3.41	0.787
2	Being recognised as a sector specialist (for example in agro-processing) improves my ability to raise funds from limited partners.	44	2	4	3.34	0.776
3	Limited partners are more likely to invest in the fund I manage if I have a demonstrable track record in the industry in which the fund will invest.	44	2	4	3.66	0.526
4	Having an existing investment track record in a specific industry (for example agro-processing) assist with efficiently concluding the transaction.	44	2	4	3.32	0.639
5	Having an investment track record in a specific industry (for example agro-processing) assist in identifying investment opportunities.	44	2	4	3.39	0.722
6	I am generally more confident in my ability to invest successfully in industries that I am familiar with.	44	2	4	3.41	0.658
7	Having specialised industry expertise (for example in agro-processing) assist in the due diligence process as pertinent matters are more readily identified.	44	2	4	3.70	0.509
8	I am generally keen to consider investing in agro-processing.	44	1	4	3.43	0.728
9	Industry specialisation (for example in agro-processing) is necessary to achieve superior investment returns.	44	1	4	2.39	0.993

Component (question)	Number of responses	Minimum value	Maximum value	Mean	Standard deviation
10 Sector specialisation narrows down investment opportunities that affect the fund performance adversely because of associated opportunity costs (taking too long to find investable assets).	44	1	4	2.57	0.661
11 Synergetic benefits with existing portfolio companies is an important investment consideration.	44	1	4	2.45	1.022
12 The fund I am involved with is more likely to invest if it obtains a controlling interest in the target company through the investment.	44	1	4	2.57	1.087
13 The fund I am involved with is more likely to invest if I can influence board decisions after investing by having representation on the board of the target company.	44	3	4	3.77	0.424
14 It is more difficult to negotiate a transaction when the target company/ business is family owned.	44	1	4	2.55	0.848
15 I prefer to avoid investment opportunities where the target company is family owned.	44	1	3	1.48	0.628
16 I am generally keen to invest in family-owned businesses.	44	2	4	3.07	0.789
17 I found that the business objectives of family-owned businesses differ from those that are not family owned.	44	2	4	2.89	0.655
18 The intentions of co-shareholders are important to consider.	44	3	4	3.89	0.321
19 Having the ability to significantly influence board decisions makes it possible to achieve superior financial returns.	44	2	4	3.48	0.590

Component (question)	Number of responses	Minimum value	Maximum value	Mean	Standard deviation
20 The mandate of the fund I am involved with stipulates that the boards of the portfolio companies must be made up of suitably qualified business professionals.	44	1	4	3.00	0.915
21 Top management of the target company is often changed soon after investing.	44	1	4	1.98	0.762
22 I am generally in favour of providing share incentives in the target company to top management of the target company.	44	3	4	3.68	0.471
23 The fund I am involved with is an active investor.	44	1	4	3.52	0.762
24 I prefer to invest in target companies that recently showed strong financial performance.	44	2	4	3.30	0.668
25 The prospect to grow revenue of the target company is an important investment criterion.	44	3	4	3.84	0.370
26 The prospect to reduce operating costs of the target company is an important consideration.	44	2	4	2.70	0.632
27 The prospect to cut operating costs is more important than the prospect to grow revenue.	44	1	3	1.48	0.549
28 The prospect to grow revenue is more important than the prospect to cut costs.	44	2	4	3.61	0.538
29 Target companies that have assets which can be leveraged with additional debt are generally more attractive investment options.	44	1	4	2.77	0.711
30 The prospect of selling surplus assets after investing and using the proceeds to declare a special dividend is an attractive investment strategy.	44	1	4	2.27	0.845

Component (question)	Number of responses	Minimum value	Maximum value	Mean	Standard deviation
31 Improving productivity in the target company is an important consideration.	44	2	4	3.45	0.663
32 The target company achieving an optimal capital structure through the investment we make is an important investment consideration.	44	3	4	3.52	0.505
33 Having a likely exit strategy in mind is important when making the investment decision.	44	1	4	3.66	0.680
34 The net asset value, as stated in the most recent annual financial statements, is generally a good indication of the market value of the target company.	44	1	4	1.52	0.762
35 I would generally not pay a premium to the recorded net asset value per share.	44	1	4	1.77	0.803
36 I generally use the discounted cash flow method when valuing the target company.	44	1	4	2.95	0.806
37 Receiving annual cash dividends from the investment is more important than achieving capital gains.	44	1	4	1.80	0.734
38 The prospect of annual cash dividends is a crucial investment consideration.	44	1	4	2.45	0.848
39 Achieving capital gains is more important than receiving annual cash dividends.	44	1	4	3.18	0.786
40 The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration.	44	2	4	3.82	0.446
41 Ultimately capital gains on exit of the investment is the principal source of superior returns.	44	2	4	3.61	0.655

Component (question)	Number of responses	Minimum value	Maximum value	Mean	Standard deviation
42 The ability to generate free cash available for distribution to shareholders is more important than generating high operating profits.	44	1	4	2.82	0.971
43 High financial leverage introduces unacceptable risk and disqualifies the investment opportunity.	44	1	4	2.43	0.789
44 The competence of the incumbent management team is the most important investment consideration.	44	1	4	3.45	0.663
45 The proven demand for the product being manufactured is the most important investment consideration.	44	2	4	3.05	0.371
46 I am more likely to invest when the target company produces highly innovative products even tough demand for the product is yet to be proven.	44	1	3	1.68	0.674
47 Understanding consumer trends is an important consideration when making investment decisions.	44	3	4	3.82	0.390
48 I will be reluctant to invest if the target company cannot export its products.	44	1	4	1.66	0.713
49 The BEE status of the target company is a crucial investment criterion.	44	1	4	2.48	0.876
50 I am keen to invest in companies not complying with BEE codes as I will bring the necessary BEE compliance to the company.	44	1	4	2.48	1.023
51 Complying with BEE codes is considered to be a competitive advantage.	44	2	4	2.98	0.628

The following components in Table 20 ranked high with the component mean trending towards 4 on the Likert scale.

Table 20: High-ranking survey components

Component	Mean	Alignment to literature research
18. The intentions of co-shareholders are important to consider.	3.89	This finding aligns with the literature research reported in Section 2.5.3.
25. The prospect to grow revenue of the target company is an important investment criterion.	3.84	This finding aligns with the literature research reported in Section 2.5.4.
40. The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration.	3.82	This finding aligns with the literature research reported in Section 2.5.7.
47. Understanding consumer trends is an important consideration when making investment decisions.	3.82	This finding aligns with the literature research reported in Section 2.5.9.
13. The fund I am involved with is more likely to invest if I can influence board decisions after investing by having representation on the board of the target company.	3.77	This finding aligns with the literature research reported in Section 2.5.3.

The following components in Table 21 ranked low with the component mean trending towards 1 on the Likert scale. However, the interpretation of the component mean is important as some of the statement questions were asked in the negative.

Table 21: Low ranking components

Component	Mean	Alignment to literature research
27. The prospect to cut operating costs is more important than the prospect to grow revenue.	1.48	The result means that the prospect to grow revenue is more important than the prospect to cut operating costs. This component is opposite to Component 28 (i.e. the prospect to grow revenue is more important than the prospect to cut costs).

Component	Mean	Alignment to literature research
15. I prefer to avoid investment opportunities where the target company is family owned.	1.48	The result means that family-owned target companies are considered as investment opportunities.
34. The net asset value, as stated in the most recent annual financial statements, is generally a good indication of the market value of the target company.	1.52	The result means that investors do not consider the net asset value as a good indicator of the market value of the target company.
48. I will be reluctant to invest if the target company cannot export its products.	1.66	The result means that the inability to export its products does not disqualify the investment opportunity.
46. I am more likely to invest when the target company produces highly innovative products even tough demand for the product is yet to be proven.	1.68	The result means that investors are likely to avoid investment opportunities where the demand for the product has not been proven yet.

4.3 Qualitative Assessment of Matters About Private Equity Investment

Section C of the survey questionnaire asked participants to indicate which one of the multi-choice answers best described them or their actions. The data received was assessed and described by way of frequency analysis.

4.3.1 Source of superior industry insights

Table 22 shows that private equity investment professionals prefer to ask existing industry experts for advice (48.8%). Very few private equity investment professionals would become industry experts themselves.

Table 22: Source of superior industry insights

Source	Percentage of participants
I specialise in a specific industry and is known as the industry expert.	23.3%
I ask for advice from an existing industry expert.	48.8%
I use research reports to analyse the industry.	27.9%
Total	**100.0%**

4.3.2 Minimum level of ownership control required when investing

The participants were asked what they would consider the minimum level of ownership control when investing. This question refers to the actual level of equity interest required when making an investment. Table 23 shows that the minimum level of ownership control required through shareholding is between 25% and 34%, with 90.7% of the respondents indicating that a minimum level of ownership control (through shareholding) of 50% and less is required.

Table 23: Minimum level of ownership control through shareholding

Minimum level of ownership control	Percentage of participants
< 25%	9.3%
25% ≤ 34%	62.8%
35% ≤ 50%	18.6%
51% ≤ 75%	9.3%
> 75%	0.0%
Total	**100.0%**

4.3.3 Minimum level of influence on board level through representation

Table 24 shows that 65.1% of respondents indicated that the minimum level of influence at board level is 65.1%. It is further evident that 97.7% of the respondents would accept a minimum representative position of 50% and lower.

Table 24: Minimum level of influence on board level through board representation

Minimum level of influence	Percentage of participants
25%	65.1%
35%	25.6%
50%	7.0%
75%	2.3%
Total	**100%**

4.3.4 Minimum acceptable annual revenue growth

Table 25 shows that 39.5% of the respondents require annual revenue growth of at least inflation plus 5% and 20.9% require annual revenue growth of at least inflation plus 7% when investing in agro-processing.

Table 25: Minimum annual revenue growth rate required

Minimum annual revenue growth	Percentage of participants
Equal to inflation	4.7%
Inflation + 3%	16.3%
Inflation + 5%	39.5%
Inflation + 7%	20.9%
Inflation + 10%	16.3%
Inflation + 15%	2.3%
Total	**100.0%**

4.3.5 Defining growth prospects of the target company

When private equity investment professionals refer to growth, they refer to growth in operating profits rather than growth in revenue, as shown in Table 26.

Table 26: Defining growth prospects

Growth refers to …	Percentage of participants
Growth in sales volumes	4.7%
Growth in sale revenue	2.3%
Growth in operating profits	88.4%
Growth in operating margin	4.6%
Total	**100.0%**

4.3.6 Targeted interest-bearing debt-to-equity ratio

Table 27 shows that the preferred targeted interest-bearing debt-to-equity ratio is 40:60.

Table 27: Targeted interest-bearing debt-to-equity ratio

Targeted interest-bearing debt-to-equity ratio (debt: equity)	Percentage of participants
20:80	7.0%
30:70	27.9%
40:60	34.9%
50:50	11.6%
60:40	16.3%
70:30	2.3%
Total	**100.0%**

4.3.7 Minimum acceptable annual rate of return on investment

Table 28 shows that the minimum annual rate of return on an investment made is either inflation plus 10% or inflation plus 15%.

Table 28: Minimum annual rate of return on investment

The minimum acceptable annual rate of return	Percentage of participants
Equals to inflation	2.2%
Inflation + 3%	0.0%

The minimum acceptable annual rate of return	Percentage of participants
Inflation + 5%	0.0%
Inflation + 7%	14.0%
Inflation + 10%	41.9%
Inflation + 15%	41.9%
Total	**100.0%**

4.3.8 LSM categories targeted by the investee company

Table 29 shows that private equity investment professionals prefer to invest in target companies who in turn focus on the Living Standards Measure (LSM) consumer base from LSM 3 to LSM 7.

Table 29: LSM category targeted by the investee company

LSM category targeted by the investee company	Percentage of participants
LSM 3–6	60.5%
LSM 7–10	39.5%
Total	**100.0%**

4.3.9 Typical investment horizon

Table 30 shows that the most frequent investment tenure is five to seven years.

Table 30: Most frequent investment tenure

Investment horizon	Percentage of participants
5–7 years	58.1%
8–10 years	25.6%
> 10 years	16.3%
Total	**100.0%**

4.4 Making an Impact on the Target Company

Section D of the survey questionnaire requested participants to indicate what actions they are likely to take after investing. This data was analysed using the frequency tables discussed hereunder.

4.4.1 Changes often required to optimise shareholder value

Table 31 shows that if changes are required to optimise shareholder value after the investment has been made, these changes mainly focus on aspects such as business model, business strategy, group structure and management team.

Table 31: Frequent changes to optimise shareholder value

Change required	Frequency	Percent
• Change the business model. • Change the business strategy.	7	15.9
• Change the business model. • Change the business strategy. • Make changes to the management team. • Sell off non-core assets to ensure better asset usage.	1	2.3
• Change the business model. • Make changes to the management team.	1	2.3
• Change the business strategy.	6	13.6
• Change the business strategy. • Make changes to the management team.	4	9.1
• Change the business strategy. • Make changes to the management team. • Sell off non-core assets to ensure better asset usage.	1	2.3
• Change the business strategy. • Sell off non-core assets to ensure better asset usage.	4	9.1
• Change the group structure. • Change the business model. • Change the business strategy. • Make changes to the management team.	1	2.3

Change required	Frequency	Percent
• Change the group structure, • Change the business strategy.	2	4.5
• Change the group structure. • Change the business strategy. • Make changes to the management team.	1	2.3
• Change the group structure. • Make changes to the management team.	7	15.9
• Change the group structure. • Make changes to the management team. • Sell off non-core assets to ensure better asset usage.	1	2.3
• Change the group structure. • Sell off non-core assets to ensure better asset usage.	1	2.3
• Change the capital structure.	1	2.3
• Make changes to the management team.	1	2.3
• Align to market forces.	1	2.3
• Not an active investor.	1	2.3
• Sell off non-core assets to ensure better asset usage.	2	4.5
• We are not active investors thus do not look to change the companies we invest in.	1	2.3
Total	**44**	**100.0**

4.4.2 Occasional changes required

Table 32 shows that the majority of private equity investors (20.5%) would typically not insist on making any changes to the target company. However, if changes are made, it could include making changes to executive management positions.

Table 32: Typical changes made at the target company after investing

Action	Frequency	Percent
• Appointing a new CEO or chief financial officer (CFO).	7	15.9
• Appointing a new CEO or CFO. • Appointing external auditors.	7	15.9
• Appointing a new CEO or CFO. • Appointing external auditors. • Chairing the audit and risk committee.	1	2.3
• Appointing a new CEO or CFO. • Chairing the audit and risk committee.	5	11.4
• Appointing external auditors.	2	4.5
• Appointing external auditors. • Chairing the audit and risk committee.	6	13.6
• Appointing external auditors. • Chairing the audit and risk committee. • Chair the remuneration committee.	1	2.3
• Appointing external auditors. • None of the above.	1	2.3
• Chairing the audit and risk committee.	3	6.8
• Chairing the audit and risk committee. • Participating in the investment committee.	1	2.3
• None of the above.	9	20.5
• Insist on Top 10 external auditor.	1	2.3
Total	**44**	**100.0**

4.4.3 Actions taken to optimise the capital structure

Table 33 shows that the primary actions taken to optimise the capital structure of the target company include restructuring existing debt to improve cash flows and increasing the capital base with an optimal mix of debt and equity to expand the asset base, thereby making it possible to grow revenue.

Table 33: Actions taken to optimise the capital structure of the target company

Action	Frequency	Percent
• Expand the existing capital structure by an optimum mix of debt and equity to increase the asset base to generate revenue growth.	8	18.2
• Restructure existing debt to improve cash flow and liquidity.	8	18.2
• Restructure existing debt to improve cash flow and liquidity. • Expand the existing capital structure by an optimum mix of debt and equity to increase the asset base to generate revenue growth.	16	36.4
• Take up additional debt to improve return on equity (ROE). • Expand the existing capital structure by an optimum mix of debt and equity to increase the asset base to generate revenue growth.	2	4.5
• Take up additional debt to improve ROE. • Restructure existing debt to improve cash flow and liquidity.	4	9.1
• Take up additional debt to improve ROE. • Restructure existing debt to improve cash flow and liquidity. • Expand the existing capital structure by an optimum mix of debt and equity to increase the asset base to generate revenue growth.	4	9.1
• Take up additional debt to improve ROE. • Take up additional debt to declare a special cash dividend.	2	4.5
Total	**44**	**100.0**

4.4.4 Preferred exit strategy

Table 34 shows that the preferred exit strategy is to dispose of the shares in the target company to any other investor in the open market. An exit via an IPO is not used often in the South African private equity environment.

Table 34: Preferred exit strategy

Action	Frequency	Percent
• Via an IPO. • Disposing the assets to any buyer in the open market.	1	2.3
• Via an IPO. • Disposing the equity interest to another investor.	3	6.8
• Via an IPO. • Disposing the equity interest to another investor. • Disposing the assets to any buyer in the open market.	1	2.3
• Disposing the assets to any buyer in the open market.	7	15.9
• Disposing the assets to any buyer in the open market. • Disposing via a management buyout.	1	2.3
• Disposing the assets to any buyer in the open market. • Disposing via absorption by another company in which the fund I am involved with is invested.	1	2.3
• Disposing the equity interest to another investor.	10	22.7
• Disposing the equity interest to another investor. • Disposing via absorption by another company in which the fund I am involved with is invested.	1	2.3
• Disposing the equity interest to another investor. • Disposing the assets to any buyer in the open market.	17	38.6
• Disposing the equity interest to another investor. • Disposing the assets to any buyer in the open market. • Disposing via a management buyout.	1	2.3
• Disposing to a trade player.	1	2.3
Total	**44**	**100.0**

4.4.5 Competence of the target company's incumbent management team

Table 35 shows that the competence of the incumbent management team is mainly evaluated by considering its track record.

Table 35: Competence of the incumbent management team

Action	Frequency	Percent
• Demonstratable track record (have achieved key performance objectives in the past and present).	13	29.5
• Demonstratable track record (have achieved key performance objectives in the past and present). • Connectedness/value of connections (the extent to which the person is well known and respected in the industry).	7	15.9
• Demonstratable track record (have achieved key performance objectives in the past and present). • Engagement with management team	1	2.3
• Demonstratable track record (have achieved key performance objectives in the past and present). • Number of years' experience (number of years involved in the specific business).	19	43.2
• Demonstratable track record (have achieved key performance objectives in the past and present). • Number of years' experience (number of years involved in the specific business). • Connectedness/value of connections (the extent to which the person is well known and respected in the industry).	1	2.3
• Demonstratable track record (have achieved key performance objectives in the past and present). • Number of years' experience (number of years involved in the specific business). • Connectedness/value of connections (the extent to which the person is well known and respected in the industry). • Academic qualifications (holds academic qualifications which are considered to be relevant to the job position).	1	2.3

Action	Frequency	Percent
• Demonstratable track record (have achieved key performance objectives in the past and present). • Number of years' experience (number of years involved in the specific business). • Connectedness/value of connections (the extent to which the person is well known and respected in the industry). • Academic qualifications (holds academic qualifications which are considered to be relevant to the job position); considered savvy.	1	2.3
• Number of years' experience (number of years involved in the specific business). • Have managed through an up and down cycle.	1	2.3
Total	**44**	**100.0**

4.4.6 Competitive advantage as a result of BEE

Table 36 shows that the main advantages derived from BEE are benefitting from government contracts and initiatives and ensuring statutory compliance (permits, licences and other consents to conduct business).

Table 36: Benefits of BEE

Action	Frequency	Percent
• Being able to charge a premium price for the product manufactured. • Opportunities to benefit from government contracts and initiatives.	1	2.3
• Being able to negotiate better terms of trade. • Being able to charge a premium price for the product manufactured.	1	2.3
• Being able to negotiate better terms of trade. • Being able to charge a premium price for the product manufactured. • Opportunities to benefit from government contracts and initiatives.	1	2.3

Action	Frequency	Percent
• Being able to negotiate better terms of trade. • Being able to charge a premium price for the product manufactured. • Opportunities to benefit from government contracts and initiatives. • Ensuring statutory compliance (permits, licences and other consents to conduct business).	1	2.3
• Being able to negotiate better terms of trade. • Ensuring statutory compliance (permits, licences and other consents to conduct business).	7	15.9
• Being able to negotiate better terms of trade. • Favourable relationship with labour unions. • Opportunities to benefit from government contracts and initiatives.	2	4.5
• Being able to negotiate better terms of trade. • Favourable relationship with labour unions. • Opportunities to benefit from government contracts and initiatives. • Ensuring statutory compliance (permits, licences and other consents to conduct business).	1	2.3
• Being able to negotiate better terms of trade. • Opportunities to benefit from government contracts and initiatives.	4	9.1
• Being able to negotiate better terms of trade. • Opportunities to benefit from government contracts and initiatives. • Becoming a preferred supplier to the market given BEE rating.	1	2.3
• Being able to negotiate better terms of trade. • Opportunities to benefit from government contracts and initiatives. • Ensuring statutory compliance (permits, licences and other consents to conduct business).	1	2.3
• Ensuring statutory compliance (permits, licences and other consents to conduct business)	3	6.8

Action	Frequency	Percent
• Ensuring statutory compliance (permits, licences and other consents to conduct business). • Accessing customers who have procurement thresholds and policies that prescribe minimum levels of BEE.	1	2.3
• Ensuring statutory compliance (permits, licences and other consents to conduct business). • Allow one to compete on a level playing field.	1	2.3
• Ensuring statutory compliance (permits, licences and other consents to conduct business). • BEE is not a competitive advantage.	1	2.3
• Ensuring statutory compliance (permits, licences and other consents to conduct business). • BEE is not a competitive advantage as most important players have enough.	1	2.3
• Ensuring statutory compliance (permits, licences and other consents to conduct business). • Is required for a level playing field.	1	2.3
• Favourable relationship with labour unions. • Opportunities to benefit from government contracts and initiatives. • Ensuring statutory compliance (permits, licences and other consents to conduct business).	1	2.3
• Opportunities to benefit from government contracts and initiatives	6	13.6
• Opportunities to benefit from government contracts and initiatives. • Ensuring statutory compliance (permits, licences and other consents to conduct business).	8	18.2
• Opportunities to benefit from government contracts and initiatives. • Ensuring statutory compliance (permits, licences and other consents to conduct business). • Being an approved supplier.	1	2.3
Total	**44**	**100.0**

4.5 Validity and Reliability of Section B

Exploratory factor analysis was used to analyse the 51 items (statement questions) of Section B of the survey questionnaire. A principal component analysis extraction method was used with oblimin rotation to reduce the data from the 51 items to a more manageable number of factors for further analysis.

The results of the initial exploratory factor analysis were considered against the qualitative research detailed in Chapter 2. The extracted components were labelled according to the following four factors:

- Ability to identify investment opportunities.
- Realising value.
- Target company characteristics.
- Making an impact on the target company.

As the above classification was not yet crystal clear, further factor analysis was performed on the items loading under each of these four factors. The results are discussed below.

4.5.1 Ability to identify investment opportunities

The components (survey questions) loaded under this factor are detailed in Table 39. The KMO measure of sampling adequacy was applied to test the suitability of the data for factor analysis. Thereafter, Bartlett's test of sphericity was applied to test for redundancy amongst variables to summarise the data with some factors only. As shown in Table 37, the results of KMO test suggest that the data is sufficient for analysis. The Bartlett's test suggests that there is sufficient correlation between the items to do a factor analysis.

Table 37: KMO and Bartlett's test result – ability to identify investment opportunities

Test		Result
KMO		0.630
Bartlett's test of sphericity	Approximate chi-square	159.842
	df	55
	Sig.	0.000

Table 38 sets out and explains the variance between the 11 different components that are part of the factor, namely, the ability to identify investment opportunities.

Table 38: Total variance explained – ability to identify investment opportunities

	Initial end values		
Component	**Total**	**% of variance**	**Cumulative %**
1.	3.247	29.516	29.516
2.	1.937	17.608	47.124
3.	1.669	15.169	62.293
4.	1.067	9.698	71.991
5.	0.857	7.788	79.779
6.	0.555	5.047	84.826
7.	0.544	4.942	89.768
8.	0.407	3.703	93.471
9.	0.285	2.589	96.060
10.	0.226	2.055	98.114
11.	0.207	1.886	100.000

Table 39 reflects the pattern matrix of the factor, namely “the ability to identify investment opportunities”. Based on the variance explained in Table 38 from the construct “the ability to identify investment opportunities”, two factors explaining 47.1% of the variance could be extracted, as shown in Table 39, namely “internal capabilities” (the first six components listed in Table 39) and “external capabilities to identify investment opportunities” (the last five components listed in Table 39). These two components explain almost 50% of the variance, which can be regarded as sufficient.

Table 39: Pattern matrix – ability to identify investment opportunities

Factor – ability to identify investment opportunities		
Component N = 11	**Internal capabilities**	**External capabilities**
1. How necessary is it to have existing industry-specific insights (for example, in agro-processing) when considering an investment opportunity in that sector?	0.806	
4. Having an existing investment track record in a specific industry (for example agro-processing), assist with efficiently concluding the transaction.	0.804	
2. Being recognised as a sector specialist (for example in agro-processing) improves my ability to raise funds from limited partners.	0.804	
3. Limited partners are more likely to invest in the fund I manage if I have a demonstrable track record in the industry in which the fund will invest.	0.681	
5. Having an investment track record in a specific industry (for example agro-processing) assist in identifying investment opportunities	0.508	
47. Understanding consumer trends is an important consideration when making investment decisions.	−0.346	
18. The intentions of co-shareholders are important to consider.		−0.719
7. Having specialised industry expertise (for example in agro-processing) assist in the due diligence process as pertinent matters are more readily identified.		−0.651
6. I am generally more confident in my ability to invest successfully in industries that I am familiar with.		0.634
9. Industry specialisation (for example in agro-processing) is necessary to achieve superior investment returns.		0.539
10. Sector specialisation narrows down investment opportunities that adversely affect the fund performance because of associated opportunity costs (taking too long to find investable assets)		−0.478

This confirms the construct validity for the construct “the ability to identify investment opportunities”.

The Cronbach’s alpha and the mean inter-item correlation were used to test the construct reliability as shown in Table 40. Reliability for both constructs is confirmed.

Table 40: Ability to identify investment opportunities – Cronbach’s alpha and inter-item correlation

Construct	Cronbach's Alpha	Cronbach's on Standardised Items	N of Items	Inter-item Correlations	Comment
The ability to identify investment opportunities: Internal capabilities.	0.791	0.802	5	0.448	Negative component eliminated.
The ability to identify investment opportunities: External capabilities.	0.543	0.627	3	0.360	Positive components eliminated.

4.5.2 Realising value

The components (survey questions) loaded under this factor are detailed in Table 43. Similar to Section 4.5.1, the KMO measure of sampling adequacy was applied to test the suitability of the data for factor analysis. Thereafter, Bartlett’s test of sphericity was applied to test for redundancy amongst variables to summarise the data with some factors only. As shown in Table 41, the results of the KMO test suggest that the data is sufficient for analysis. The Bartlett’s test suggests that variable redundancy is possible.

Table 41: KMO and Bartlett’s test realising value

Test		Result
KMO		0.610
Bartlett’s test of sphericity	Approximate chi-square	233.979
	df	66
	Sig.	0.000

Table 42 sets out and explains the variance between the 12 different components forming part of the factor “realising value”.

Table 42: Total variance explained – realising value

	Initial end values		
Component	**Total**	**% of variance**	**Cumulative %**
1.	3.937	32.808	32.808
2.	2.227	18.558	51.365
3.	1.365	11.376	62.741
4.	1.146	9.551	72.293
5.	0.917	7.640	79.932
6.	0.765	6.378	86.310
7.	0.448	3.730	90.040
8.	0.401	3.341	93.381
9.	0.253	2.108	95.489
10.	0.223	1.858	97.347
11.	0.213	1.775	99.122
12.	0.105	0.878	100.000

Table 43 reflects the pattern matrix of the factor “realising value”. Based on the variance explained in Table 42, two factors explaining 51.3% of the variance could be extracted from the construct “realising value”, namely, “dividends and capital gains” (the first seven components listed in Table 43) and “creating and capturing value” (the last five components listed in Table 43). These two components explain more than 50% of the variance, which can be regarded as sufficient.

Table 43: Pattern matrix – realising value

Factor – realising value		
Component N = 12	**Dividends and capital gains**	**Creating and capturing value**
39. Achieving capital gains is more important than receiving annual cash dividends.	−0.881	

Factor – realising value		
Component **N = 12**	**Dividends and capital gains**	**Creating and capturing value**
38. The prospect of annual cash dividends is a crucial investment consideration.	0.822	
37. Receiving annual cash dividends from the investment is more important than achieving capital gains.	0.779	−0.310
41. Ultimately capital gains on exit of the investment are the principal source of superior returns.	−0.714	
11. Synergetic benefits with existing portfolio companies is an important investment consideration.	0.699	
42. The ability to generate free cash available for distribution to shareholders is more important than generating high operating profits.	0.682	
36. I generally use the discounted cash flow method when valuing the target company.	−0.494	
34. The net asset value, as stated in the most recent annual financial statements, is generally a good indication of the market value of the target company.		−0.716
35. I would generally not pay a premium to the recorded net asset value per share.		−0.710
30. The prospect of selling surplus assets after investing and using the proceeds to declare a special dividend is an attractive investment strategy.		0.626
40. The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration.		0.511
33. Having a likely exit strategy in mind is important when making the investment decision.		0.245

This confirms construct validity for the construct “realising value”.

The Cronbach's alpha and the mean inter-item correlation were used to test the construct reliability as shown in Table 44. Individual components were reversed because of the opposite nature of the components. Reliability for both constructs is confirmed.

Table 44: Realising value – Cronbach's alpha and inter-item correlation

Construct	Cronbach's Alpha	Cronbach's on Standardised Items	N of Items	Inter-item Correlations	Comment
Realising value – dividends and capital gains.	0.730	0.730	7	0.278	Components 39 and 41 were reversed.
Realising value – creating and capturing value.	0.540	0.551	5	0.197	Components 34 and 35 were reversed.

4.5.3 Target company characteristics

The components (survey questions) loaded under this factor are detailed in Table 47. Similar to Section 4.5.1 and Section 4.5.2, the KMO measure of sampling adequacy was applied to test the suitability of the data for factor analysis. Thereafter, Bartlett's test of sphericity was applied to test for redundancy amongst variable to summarise the data with some factors only. As shown in Table 45, the results of KMO test suggest that the data is moderately sufficient for analysis. Bartlett's test suggests that variable redundancy is possible.

Table 45: KMO and Bartlett's test – target company characteristics

Test		Result
KMO		0.455
Bartlett's test of sphericity	Approximate chi-square	431.008
	df	210
	Sig.	0.000

Table 46 sets out and explains the variance between the 21 different components forming part of the factor “target company characteristics”.

Table 46: Total variance explained – target company characteristics

Initial end values			
Component	**Total**	**% of variance**	**Cumulative %**
1.	4.097	19.509	19.509
2.	2.775	13.214	32.724
3.	2.378	11.323	44.047
4.	1.966	9.363	53.409
5	1.607	7.652	61.061
6.	1.358	6.465	67.526
7.	1.206	5.741	73.267
8.	1.061	5.052	78.320
9.	0.721	3.436	81.755
10.	0.638	3.038	84.793
11.	0.600	2.859	87.652
12.	0.556	2.648	90.300
13.	0.523	2.491	92.791
14.	0.412	1.962	94.754
15.	0.276	1.316	96.070
16.	0.253	1.203	97.272
17.	0.181	0.860	98.132
18.	0.129	0.612	98.744
19.	0.121	0.574	99.318
20.	0.084	0.402	99.721
21.	0.059	0.279	100.000

Table 47 reflects the pattern matrix of the factor “target company characteristics”. Based on the variance explained in Table 46 from the construct “target company characteristics”, four factors explaining 53.4% of the variance could be extracted, namely, “improving profitability” (the first eight components listed in Table 47), “BEE characteristics” (the second four components listed in Table 47), “management” (the third four components

listed in Table 47) and “family ventures” (the last five components listed in Table 47). These four components explain 53.4% of the variance, which is regarded as sufficient.

Table 47: Pattern matrix – target company characteristics

Target company characteristics				
Component N = 21	**Improving profitability**	**BEE characteristics**	**Management**	**Family ventures**
31. Improving productivity in the target company is an important consideration.	−0.753			
45. The proven demand for the product being manufactured is the most important investment consideration.	0.697			
27. The prospect to cut operating costs is more important than the prospect to grow revenue.	−0.692			
48. I will be reluctant to invest if the target company cannot export its products.	−0.593			
28. The prospect to grow revenue is more important than the prospect to cut costs.	0.550			
46. I am more likely to invest when the target company produces highly innovative products even tough demand for the product is yet to be proven.	−0.500			
25. The prospect to grow revenue of the target company is an important investment criterion.	0.396			
26. The prospect to reduce operating costs of the target company is an important consideration.	−0.371			

Target company characteristics				
51. Complying with BEE codes is considered to be a competitive advantage.		0.765		
50. I am keen to invest in companies not complying with BEE codes as I will bring the necessary BEE compliance to the company.		0.670		
43. High financial leverage introduces unacceptable risk and disqualifies the investment opportunity.		0.598		
49. The BEE status of the target company is a crucial investment criterion.		0.576		
20. The mandate of the fund I am involved with stipulate that the boards of the portfolio companies must be made up of suitably qualified business professionals.			−0.778	
17. I found that the business objectives of family-owned businesses differ from those that are not family owned.			0.739	
29. Target companies that have assets which can be leveraged with additional debt is generally a more attractive investment option.			−0.700	
44. The competence of the incumbent management team is the most important investment consideration.			0.490	
16. I am generally keen to invest in family-owned businesses.				0.881
24. I prefer to invest in target companies that recently showed strong financial performance.				0.661
8. I am generally keen to consider investing in agro-processing.				0.645
15. I prefer to avoid investment opportunities where the target company is family owned.				−0.590

Target company characteristics				
14. It is more difficult to negotiate a transaction when the target company/ business is family owned.				−0.485

This confirms construct validity for the construct “target company characteristics”.

The Cronbach’s alpha and the mean inter-item correlation were used to test the construct reliability as shown in Table 48. Individual components were reversed because of the opposite nature of the components. Reliability for all four constructs was confirmed.

Table 48: Target company characteristics – Cronbach’s alpha and inter-item correlation

Construct	Cronbach's Alpha	Cronbach's on Standardised Items	N of Items	Inter-item Correlations	Comment
Target company characteristics: improving profitability.	0.698	0.718	8	0.241	Components 25, 28 and 45 were reversed.
Target company characteristics: BEE characteristics.	0.669	0.688	4	0.355	
Target company characteristics: management.	0.669	0.670	4	0.337	Components 17 and 44 were reversed.
Target company characteristics: family ventures.	0.705	0.711	5	0.330	Components 15 and 15 were reversed.

4.5.4 Making an impact on the target company

The components (survey questions) loaded under this factor are detailed in Table 51. Similar to Section 4.5.1, Section 4.5.2 and Section 4.5.3, the KMO measure of sampling adequacy was applied to test the suitability of the data for factor analysis. Thereafter, Bartlett’s test of sphericity was applied to test for redundancy amongst variables to summarise the data with some factors only. As shown in Table 49, the results of the KMO

test suggest that the data is sufficient for analysis. The Bartlett's test suggests that variable redundancy is possible.

Table 49: KMO and Bartlett's test – making an impact on the target company

Test		Result
KMO		0.618
Bartlett's test of sphericity	Approximate chi-square	60.868
	df	21
	Sig.	0.000

Table 50 sets out and explains the variance between the seven different components forming part of the factor "making an impact on the target company".

Table 50: Total variance explained – making an impact on the target company

Initial end values			
Component	**Total**	**% of variance**	**Cumulative %**
1.	2.503	35.755	35.755
2.	1.353	19.326	55.082
3.	0.937	13.388	68.470
4.	0.831	11.865	80.335
5	0.680	9.720	90.055
6.	0.361	5.162	95.217
7.	0.335	4.783	100.000

Table 51 reflects the pattern matrix of the factor "making an impact on the target company". Based on the variance explained in Table 50 from the construct "making an impact on the target company", two factors explaining 55.0% of the variance could be extracted, namely, "active participation" (the first five components listed in Table 51) and "incentivisation" (the last two components listed in Table 51). These two components explain 55% of the variance, which can be regarded as sufficient.

Table 51: Pattern matrix – making an impact on the target company

Factor – making an impact on the target company		
Component N = 7	**Active participation**	**Incentivisation**
23. The fund I am involved with is an active investor.	0.831	
12. The fund I am involved with is more likely to invest if it obtains a controlling interest in the target company through the investment.	0.723	
19. Having the ability to significantly influence board decisions makes it possible to achieve superior financial returns.	0.683	
32. The target company achieving an optimal capital structure through the investment we make is an important investment consideration.	0.595	
21. Top management of the target company is often changed soon after investing.	0.510	
22. I am generally in favour of providing share incentives in the target company to top management of the target company.		0.826
13. The fund I am involved with is more likely to invest if I can influence board decisions after investing by having representation on the board of the target company.		0.605

This confirms construct validity for the construct “making an impact on the target company”.

The Cronbach’s alpha and the mean inter-item correlation were used to test the construct reliability as shown in Table 52. Reliability for all four constructs was confirmed.

Table 52: Making an impact on the target company – Cronbach's alpha and inter-item correlation

Construct	Cronbach's Alpha	Cronbach's on Standardised Items	N of Items	Inter-item Correlations	Comment
Making an impact on the target company: active participation.	0.686	0.707	5	0.325	
Making an impact on the target company: incentivisation.	0.348	0.349	2	0.212	Inter-item correlations confirm reliability.

4.6 Descriptive Analysis of Constructs Identified

Table 53 provides a descriptive analysis of the constructs identified and tested for validity and reliability in Section 4.5. Five of the nine constructs measured between "to a moderate extent" and "to a large extent".

- The internal ability of the fund manager to identify investment opportunities is ranked as a critical consideration with a construct mean of 3.42.
- The external ability of the fund manager to identify investment opportunities is also ranked as a critical consideration with a construct mean of 3.39.

Two of the nine constructs measured between "to a small extent" and "not at all".

- Realising value through dividends and capital gains achieved a construct mean of 2.12 meaning "to a small extent". The result can be interpreted with reference to Table 18 in Section 4.2 as meaning that:
  a. The prospect of annual cash dividends is not a crucial investment consideration (Component 38).
  b. Achieving capital gains from the investment is more important than receiving annual cash dividends (stating the opposite of Component 37).

c. Synergetic benefits with existing portfolio companies is not an important investment decision (stating Component 11 in reverse).

d. The ability to generate free cash for distribution to shareholders is not more important than generating operating profits (stating Component 42 in reverse).

- The target company profitability construct recorded a mean of 1.93 mean between “to a small extent” and “not at all”. The result can also be interpreted with reference to Table 18 in Section 4.2 as meaning that:

  a. Improving productivity in target company is an important consideration (Component 31).

  b. The proven demand for the product being manufactured is moderately important.

  c. The prospect to cut operating costs is not more important than the prospect to grow revenue (Component 27 stated opposite).

  d. The investors will not be reluctant to invest if the target company cannot export its products.

  e. The prospect to grow revenue is indeed more important than the prospect to cut cost (Component 28), being the opposite to Component 27.

  f. The investor is not more likely to invest if the target company manufactures an innovative product for which there is not a proven demand (Component 46 stated opposite).

  g. The prospect to grow revenue of the target company is an important investment criterion (Component 25).

  h. The prospect to reduce operating cost of the target company is only moderately important.

- Individual components were already referenced to explain the results of the constructs, but it is worth noting the following individual components as set out in Table 18:

  a. Understanding consumer trends (Component 47) with a mean of 3.82 marked towards “to a large extent” is an important consideration when making investment decisions.

b. The anticipated investment return, consisting of both dividends and capital gains (Component 40), with a mean of 3.82 marked towards “to a large extent”, is the most important investment criterion.

c. The ability to influence board decision post making the investment (Component 13), with a mean of 3.77 marked toward “to a large extent” is an important investment criterion.

d. The net asset value, as stated in the most recent annual financial statement of the target company (Component 34) is not a good indication of the market value of the target company, as suggested by the mean of 1.52, which lies between “to a small extent” and “not at all”.

e. With a mean of 1.77 and marked between “not at all” and “to a small extent”, investors are likely to pay a premium to the net asset value per share (Component 35).

Table 53: Descriptive analysis of constructs

Construct/key component	Mean	Std. Deviation
Constructs		
The ability to identify investment opportunities: fund manager internal abilities.	3.42	0.51
The ability to identify investment opportunities: fund manager external abilities.	3.39	0.37
Realising value: creating and capturing value.	3.25	0.43
Target company characteristics: family ventures.	3.15	0.50
Making an impact on the target company: active participation.	3.01	0.51
Target company characteristics: management.	2.89	0.68
Target company characteristics: BEE.	2.59	0.59
Realising value: dividends and capital gains.	2.12	0.64
Target company characteristics: profitability.	1.93	0.33

Construct/key component	Mean	Std. Deviation
Components		
47. Understanding consumer trends is an important consideration when making investment decisions.	3.82	0.39
40. The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration.	3.82	0.45
13. The fund I am involved with is more likely to invest if I can influence board decisions after investing by having representation on the board of the target company.	3.77	0.42
22. I am generally in favour of providing share incentives in the target company to top management of the target company.	3.68	0.47
33. Having a likely exit strategy in mind is important when making the investment decision.	3.66	0.68
44. The competence of the incumbent management team is the most important investment consideration.	3.45	0.66
6. I am generally more confident in my ability to invest successfully in industries that I am familiar with.	3.41	0.66
36. I generally use the discounted cash flow method when valuing the target company.	2.95	0.81
17. I found that the business objectives of family-owned businesses differ from those that are not family owned.	2.89	0.66
9. Industry specialisation (for example in agro-processing) is necessary to achieve superior investment returns.	2.39	0.99
30. The prospect of selling surplus assets after investing and using the proceeds to declare a special dividend is an attractive investment strategy.	2.27	0.85
35. I would generally not pay a premium to the recorded net asset value per share.	1.77	0.80
34. The net asset value, as stated in the most recent annual financial statements, is generally a good indication of the market value of the target company.	1.52	0.76

4.7 Comparison with Demographic Information

By way of a correlation matrix, Table 54 compares the constructs and components identified in Table 53 with the ordered demographic data gained in Section A and Section C of the survey questionnaire.

Correlation set a significance level of 0.10

Based on the correlation, set at a significance level of 0.10 (two-tailed), the following findings are made:

- A more experienced private equity investor will endeavour to make a larger impact on the target company. This is evidenced by the positive correlation (0.258) between the length of time that the investors have been involved in the private equity industry and the importance that the investor assigns to making an impact on the target company.
- While the strategy to sell off surplus assets after investing is not rated as popular, having minimum board representation to make such a decision possible is required. This is evident from the positive correlation (0.293) between the importance assigned to minimum ownership control and the prospect of selling surplus assets.
- The lower the level of ownership control, the higher the importance assigned to having a likely exit strategy in mind at the time of making the investment. This can be seen from the negative correlation (−0.273) between ownership control and importance of the exit strategy.
- Investors who place a premium on the importance of their external ability to identify investment opportunities are also likely to acquire a higher ownership stake in the target company. There is a positive correlation (0.258) between minimum ownership control and the external capabilities of the investor.
- Investors who rank the management characteristics of the target company as very important are further likely to demand a higher minimum annual revenue growth rate. This can be seen from the positive correlation (0.292) between the minimum annual revenue growth rate required and the importance assigned to the management characteristics of the target company.

- Investors who regard the anticipated annual investment rate of return as the most important investment consideration are also likely to give special consideration to the level of financial risk as reflected in the debt-to-equity ratio. This view is substantiated by the positive correlation (0.283) between the importance assigned to the annual return on investment and the acceptable debt-to-equity ratio.
- Investors who assign greater importance in their internal ability to identify investment opportunities are also likely to accept greater financial risk as reflected in the debt-to-equity ratio of the target company. This view is substantiated by the positive correlation (0.275) between the importance assigned to the internal capabilities of the investor and the acceptable debt-to-equity ratio.
- Strangely, investors who assign a high level of importance to their ability to make an impact on the target company, are likely to assume a lower level of financial risk, as reflected in the debt-to-equity ratio. This is evidenced by the negative correlation (−0.293) between importance assigned to their ability to impact on the target company and the level of acceptable debt-to-equity ratio.
- Investors who assign a high level of importance to investing in sectors they are familiar with are also likely to demand a higher rate of return on these investments. This can be seen in the positive correlation (0.273) between the importance assigned to the investing in familiar sectors and the minimum return requirements.
- Investors who assign greater importance to their ability to influence board decisions are also likely to demand a higher rate of return. This is evidenced by the positive correlation (0.262) between the importance of influencing board decisions and the minimum return requirements.
- Investors who regard the possibility of selling off surplus assets and using the proceeds to declare a special dividend as very important are likely to have lower overall return expectations. This is evidenced by the negative correlation (−0.269) between the importance assigned to selling off surplus assets and the overall minimum return expectations. It is suggested that investors who are pursuing this strategy are perhaps investing for shorter-term, opportunistic gains.

- Strangely, the importance assigned to realising value (through dividends, capital gains and creating and capturing value) is negatively correlated to the minimum return requirements (-0.265). It is suggested that this anomaly be investigated in further studies.
- Investors assigning a high level of importance to industry specialisation in order to achieve superior investment returns are also likely to accept longer investment horizons. This statement is supported by the positive correlation (0.292) between the acceptable investment horizon and the level of importance assigned to industry specialisation in order to achieve superior investment returns.
- Similarly, investors who assign a high level of importance to the profitability characteristics of the target company are also likely to invest for a longer period of time. This is evidenced by the positive correlation (0.251) between the importance assigned to the profitability characteristic and the investment horizon.

Correlation set at a significance level of 0.05

Based on the correlation, set at a significance level of 0.05 level (two-tailed), the following findings are made:

- Investors who are less experienced in their current positions (as measured by the length of time in the current position) are more likely to focus on a possible exit strategy at the time of investing. This statement is supported by the inverse correlation (−0.302) between the importance assigned to having an exit strategy and the tenure of holding the current position.
- More experienced investors carefully consider the competence and suitability of the management team of the target company when making investment decisions. This statement is supported by the positive correlation (0.298) between the importance assigned to considering the competence of the incumbent management team and the tenure spent by the investor in the private equity sector.
- Investors who place a premium on their internal abilities to identify investment opportunities are willing to accept a lower level of ownership control when investing.

This statement is supported by the inverse correlation (−0.364) between the importance assigned to their internal capabilities and the level of ownership control sought.

- Investors who invest with the intention to sell off surplus assets and use the proceeds to declare a special dividend are more likely to want board control to execute this strategy. This statement is supported by the positive correlation (0.299) between the importance assigned to the selling off surplus assets and declaring a dividend as an investment strategy and the level of board representation required.

- Investors who place a premium on their external capabilities to identify investment opportunities also want to participate actively in decision-making at the target company by having larger board representation. This statement is supported by the positive correlation (0.452) between the importance assigned to external capabilities to identify opportunities and the level of board representation required.

- Similarly, investors who put a premium on realising value through dividends and capital gains want larger board representation. This can be seen by the positive correlation (0.528) between importance assigned to this construct and level of board representation required.

- Investors who focus on the management characteristics of the target company further require larger board representation. This is as evidenced by the positive correlation (0.343) between the importance assigned to this construct and the level of board representation required.

- The focus on management aligns with the focus on family ventures. When investing in a family venture, investors require larger board representation. This is given by the positive correlation (0.303) between the importance assigned to the family venture characteristics of the target company and the level of board representation required.

- When investors believe that industry specialisation results in superior investment returns, they are more likely to demand more significant annual revenue growth rates. This is evidenced by the positive correlation (0.403) between the importance assigned

to industry specialisation as a means of achieving superior returns and the annual revenue growth rate required by this category of investors.

- While this study showed that few investors regard the net asset value of the target company as a good indication of its value, it is evident that those investors who do think that it is a good indication of value demand higher annual growth rates when investing. This is typical of a business turnaround. This statement is supported by the positive correlation (0.311) between those who see the net asset value as a good indicator of value and the annual growth rates that these investors require.

- Investors do not want to sit on the boards of companies with high financial risk as is evidenced by the debt-to-equity ratio. Perhaps this is because of the risk of personal liability if the company should fail. This statement is supported by the inverse correlation (−0.457) between the level of board representation sought and the level of financial risk.

- Investors who are typically keen to invest in family ventures, do not invest in family ventures when the financial risk, as evidenced by the debt-to-equity ratio, is too high. This statement is evidenced by the inverse correlation (−0.474) between the importance assigned to the family venture characteristics of the target company and the level of the debt-to-equity ratio.

- Investors are generally keen to give share incentives with the management team of the target company as they believe that this incentivises the management team to achieve a higher annual rate of return. This statement is confirmed by the positive correlation (0.394) between the importance assigned to give share incentives and the expected annual rate of return.

- Strangely, investors settle for a lower annual rate of return when they emphasise the management characteristics of the target company. This phenomenon can be explained by investors believing that when a competent management team is in place, it results in lower investment risk; therefore, they are willing to accept a lower return. This statement is supported by the inverse correlation (−0.345) between the

importance assigned to the management characteristics of the target company and the minimum return requirements.

- An analysis of the data shows an unusual positive correlation (0.324) between the importance assigned to the selling of surplus assets and then declaring a special dividend and investment horizon. This suggests that if the intention is to invest to sell assets, the investment horizon will also be longer term. A possible explanation could be that an initial return is achieved by selling these assets. However, the investment is not liquidated thereafter, but held for a long term while the target company rebuilds its asset base and again achieve superior returns in the ordinary course of business.

- Investors with a longer investment horizon do not emphasise a possible exit strategy at the time of investing. This statement is supported by the inverse correlation (−0.305) between the importance assigned to having an exit strategy when investing and the investment horizon.

- There is an unusual inverse correlation (−0.300) between the importance assigned to the anticipated investment return, which consists of capital gains, dividends and the investment horizon. A possible explanation is that longer-term investors do not believe that the anticipated return is the most important investment consideration.

- When investors emphasise their external capabilities to identify investment opportunities, they are also likely to invest for a longer period of time. This statement is supported by the positive correlation (0.341) between the importance assigned to their external capabilities and the investment horizon.

- Investors who assign importance to realise value through dividends and capital gains are likely to invest for a longer period of time. This is evidenced by the positive correlation (0.457) between the importance assigned to this construct and the investment horizon.

Table 54 compares the constructs and components by way of a correlation matrix.

Table 54: Comparison with demographic information

Construct/Component	Statistical Measure	2. How long have you been in this position?	3. For how long have you been involved in the private equity sector?	2. I will only invest if ownership control is obtained at the following minimum level.	3. I will only invest if I can influence board decisions and therefore require board representation at the following preferred minimum level.	4. When investing in agro-processing, I will be satisfied if the target company grow revenue by/at a minimum of _____ per annum:	6. Generally, I prefer the total interest-bearing debt-to-equity ratio to be in the following proportion:	7. Generally, I would consider an acceptable annual rate of return to be a minimum of:	9. The typical investment horizon of the funds I am involved with is:
6. I am generally more confident in my ability to investment successfully in industries that I am familiar with.	Correlation coefficient	−0.005	−0.150	−0.221	−0.215	−0.102	−0.190	0.273*	0.085
	Sig. (two-tailed)	0.976	0.331	0.149	0.162	0.510	0.216	0.072	0.584
	N	44	44	44	44	44	44	44	44
9. Industry specialisation (for example in agro-processing) is necessary to achieve superior investment return.	Correlation coefficient	0.246	0.089	−0.109	−0.077	0.403**	0.145	−0.112	0.292*
	Sig. (two-tailed)	0.108	0.568	0.483	0.618	0.007	0.349	0.471	0.054
	N	44	44	44	44	44	44	44	44
13. The fund I am involved with is more likely to invest if I can influence board decisions after investing by having representation on the board of the target company.	Correlation coefficient	−0.236	0.109	0.120	0.000	0.033	−0.457**	0.262*	0.012
	Sig. (two-tailed)	0.123	0.482	0.438	1.000	0.830	0.002	0.085	0.938
	N	44	44	44	44	44	44	44	44
17. I found that the business objectives of family-owned businesses differ from those that are not family owned.	Correlation coefficient	0.230	0.218	−0.190	−0.163	−0.143	−0.052	0.160	−0.092
	Sig. (two-tailed)	0.133	0.156	0.216	0.290	0.353	0.739	0.299	0.552
	N	44	44	44	44	44	44	44	44
22. I am generally in favour of providing share incentives in the target company to top management of the target company.	Correlation coefficient	0.019	0.231	−0.148	0.111	−0.090	−0.114	0.394**	−0.147
	Sig. (two-tailed)	0.905	0.132	0.339	0.474	0.561	0.462	0.008	0.342
	N	44	44	44	44	44	44	44	44
30. The prospect of selling surplus assets after investing and using the proceeds to declare a special dividend is an attractive investment strategy.	Correlation coefficient	−0.072	−0.046	0.293*	0.299**	−0.004	−0.104	−0.269*	0.324**
	Sig. (two-tailed)	0.642	0.768	0.053	0.049	0.978	0.502	0.077	0.032
	N	44	44	44	44	44	44	44	44

Construct/Component	Statistical Measure	2. How long have you been in this position?	3. For how long have you been involved in the private equity sector?	2. I will only invest if ownership control is obtained at the following minimum level.	3. I will only invest if I can influence board decisions and therefore require board representation at the following preferred minimum level.	4. When investing in agro-processing, I will be satisfied if the target company grow revenue by/at a minimum of _____ per annum:	6. Generally, I prefer the total interest-bearing debt-to-equity ratio to be in the following proportion:	7. Generally, I would consider an acceptable annual rate of return to be a minimum of:	9. The typical investment horizon of the funds I am involved with is:
33. Having a likely exit strategy in mind is important when making the investment decision.	Correlation coefficient	−0.302**	−0.058	−0.273*	−0.092	−0.278	−0.032	0.044	−0.305**
	Sig. (two-tailed)	0.046	0.710	0.073	0.551	0.068	0.836	0.777	0.044
	N	44	44	44	44	44	44	44	44
34. The net asset value, as stated in the most recent annual financial statements, is generally a good indication of the market value of the target company.	Correlation coefficient	0.007	−0.032	−0.112	−0.103	0.311**	0.044	−0.096	0.029
	Sig. (two-tailed)	0.966	0.834	0.469	0.507	0.040	0.774	0.535	0.854
	N	44	44	44	44	44	44	44	44
35. I would generally not pay a premium to the recorded net asset value per share.	Correlation coefficient	0.078	−0.049	−0.140	−0.094	0.162	−0.054	−0.080	−0.075
	Sig. (two-tailed)	0.613	0.751	0.365	0.545	0.293	0.726	0.608	0.628
	N	44	44	44	44	44	44	44	44
36. I generally use the discounted cash flow method when valuing the target company.	Correlation coefficient	0.084	−0.068	0.061	−0.186	−0.062	0.152	0.077	−0.230
	Sig. (two-tailed)	0.587	0.661	0.695	0.227	0.688	0.324	0.621	0.133
	N	44	44	44	44	44	44	44	44
40. The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration.	Correlation coefficient	0.086	−0.186	0.078	−0.057	−0.198	0.283*	−0.230	−0.300**
	Sig. (two-tailed)	0.579	0.226	0.615	0.712	0.198	0.062	0.134	0.048
	N	44	44	44	44	44	44	44	44
44. The competence of the incumbent management team is the most important investment consideration.	Correlation coefficient	0.033	0.298**	0.086	0.063	−0.047	−0.056	0.101	0.050
	Sig. (two-tailed)	0.830	0.050	0.577	0.683	0.762	0.719	0.515	0.746
	N	44	44	44	44	44	44	44	44

Construct/Component	Statistical Measure	2. How long have you been in this position?	3. For how long have you been involved in the private equity sector?	2. I will only invest if ownership control is obtained at the following minimum level.	3. I will only invest if I can influence board decisions and therefore require board representation at the following preferred minimum level.	4. When investing in agro-processing, I will be satisfied if the target company grow revenue by/at a minimum of _____ per annum:	6. Generally, I prefer the total interest-bearing debt-to-equity ratio to be in the following proportion:	7. Generally, I would consider an acceptable annual rate of return to be a minimum of:	9. The typical investment horizon of the funds I am involved with is:
Investment_opport_fundmanager_internal	Correlation coefficient	0.123	−0.018	−0.364**	−0.019	0.157	0.275*	−0.092	0.155
	Sig. (two-tailed)	0.427	0.909	0.015	0.905	0.308	0.070	0.552	0.317
	N	44	44	44	44	44	44	44	44
Investment_opport_fundmanager_external	Correlation coefficient	−0.011	0.019	0.258*	0.452**	0.327**	−0.147	−0.187	0.341**
	Sig. (two-tailed)	0.943	0.901	0.090	0.002	0.031	0.342	0.224	0.024
	N	44	44	44	44	44	44	44	44
Realise_value_dividents_capital gain	Correlation coefficient	0.097	−0.245	0.468**	0.528**	−0.117	−0.304**	−0.259*	0.457**
	Sig. (two-tailed)	0.533	0.109	0.001	0.000	0.449	0.045	0.089	0.002
	N	44	44	44	44	44	44	44	44
Realise_value_dividents_creating_value	Correlation coefficient	−0.220	−0.131	0.081	0.143	−0.195	0.078	−0.265*	−0.101
	Sig. (two-tailed)	0.151	0.396	0.600	0.355	0.205	0.615	0.082	0.513
	N	44	44	44	44	44	44	44	44
Target_character_ profitablity	Correlation coefficient	0.101	−0.077	−0.068	0.066	0.092	0.037	−0.150	0.251*
	Sig. (two-tailed)	0.515	0.618	0.659	0.671	0.553	0.810	0.331	0.099
	N	44	44	44	44	44	44	44	44
Target_character_BEE	Correlation coefficient	0.001	−0.111	−0.024	0.018	−0.048	−0.040	0.035	−0.164
	Sig. (two-tailed)	0.995	0.474	0.875	0.908	0.758	0.797	0.820	0.286
	N	44	44	44	44	44	44	44	44

Construct/Component	Statistical Measure	2. How long have you been in this position?	3. For how long have you been involved in the private equity sector?	2. I will only invest if ownership control is obtained at the following minimum level.	3. I will only invest if I can influence board decisions and therefore require board representation at the following preferred minimum level.	4. When investing in agro-processing, I will be satisfied if the target company grow revenue by/at a minimum of _____ per annum:	6. Generally, I prefer the total interest-bearing debt-to-equity ratio to be in the following proportion:	7. Generally, I would consider an acceptable annual rate of return to be a minimum of:	9. The typical investment horizon of the funds I am involved with is:
Target_character_management	Correlation coefficient	−0.004	−0.291	0.074	0.343**	0.292*	0.207	−0.345**	0.045
	Sig. (two-tailed)	0.982	0.055	0.632	0.023	0.054	0.177	0.022	0.770
	N	44	44	44	44	44	44	44	44
Target_character_family_ventures	Correlation coefficient	−0.111	−0.033	0.210	0.303**	0.026	−0.474**	0.242	0.095
	Sig. (two-tailed)	0.474	0.831	0.171	0.046	0.867	0.001	0.114	0.538
	N	44	44	44	44	44	44	44	44
Impact_target_company	Correlation coefficient	0.194	0.258*	0.114	0.204	0.274*	−0.293*	−0.042	0.232
	Sig. (two-tailed)	0.207	0.090	0.463	0.183	0.071	0.054	0.785	0.129
	N	44	44	44	44	44	44	44	44

**Correlation is significant at the 0.10 level (two-tailed)*
***Correlation is significant at the 0.05 level (two-tailed)*

4.8 Considering the Effect of Nominal Biographic Data on the Factors

T-tests were used to compare the effect of nominal biographic data on the factors. Table 55 compares the effects of private equity investors involved in a general fund with those involved with a specialist fund. The data is filtered to an effect size of greater than 0.35. The independent sample T-test p-value is assumed to be significant on a 5% level and it does not assume equal variance.

Table 55: T-tests comparing generalist and specialist investors

Construct/Component	Grouping	N	Mean	Std. Deviation	Effect size	T-test p-value
Investment_opport_fundmanager_ internal	General	29	3.35	0.569	0.37	0.149
	Specialised	15	3.56	0.364		
Realise_value_dividents_capitalgain	General	29	1.97	0.477	0.54	0.071
	Specialised	15	2.41	0.821		
Realise_value_dividents_creating_value	General	29	3.32	0.383	0.44	0.155
	Specialised	15	3.11	0.482		
Target_character_profitability	General	29	1.86	0.306	0.65	0.048
	Specialised	15	2.07	0.330		
Target_character_family_ventures	General	29	3.01	0.420	0.77	0.016
	Specialised	15	3.42	0.539		
Impact_target_company	General	29	2.93	0.588	0.41	0.066
	Specialised	15	3.17	0.260		
6. I am generally more confident in my ability to invest successfully in industries that I am familiar with.	General	29	3.24	0.689	0.71	0.007
	Specialised	15	3.73	0.458		
9. Industry specialisation (for example in agro-processing) is necessary to achieve superior investment returns.	General	29	2.24	0.872	0.36	0.229
	Specialised	15	2.67	1.175		
22. I am generally in favour of providing share incentives in the target company to top management of the target company.	General	29	3.76	0.435	0.44	0.161
	Specialised	15	3.53	0.516		
34. The net asset value, as stated in the most recent annual financial statements, is generally a good indication of the market value of the target company.	General	29	1.38	0.622	0.45	0.133
	Specialised	15	1.80	0.941		
35. I would generally not pay a premium to the recorded net asset value per share.	General	29	1.59	0.682	0.60	0.053
	Specialised	15	2.13	0.915		

Construct/Component	Grouping	N	Mean	Std. Deviation	Effect size	T-test p-value
36. I generally use the discounted cash flow method when valuing the target company.	General	29	3.10	0.673	0.45	0.135
	Specialised	15	2.67	0.976		
40. The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration.	General	29	3.90	0.409	0.47	0.131
	Specialised	15	3.67	0.488		
44. The competence of the incumbent management team is the most important investment consideration.	General	29	3.59	0.501	0.45	0.126
	Specialised	15	3.20	0.862		

Considering the results shown in Table 55, it is clear that investment professionals who operate as a specialised fund are more specific when they consider the following aspects:

- The profitability characteristics of the target company (mean 2.07).
- The family business characteristics of the target company (mean 3.42).

The implication is that specialised investors ask very specific questions, which they interpret and evaluate against their existing insights. Their reference point is, therefore, sector-specific while the reference point of the general investor may be of a more general nature.

- In line with the specific questions, specialised investors are also more confident in their ability (mean 3.73) to invest successfully in sectors they are familiar with. This confidence can lead to a more efficient transaction process.
- Specialised funds have a more conservative approach to valuations as they are less inclined to pay a premium to the net asset value (mean 2.13).

Table 56 compares the effects of private equity investors involved in the buyout stage with those involved in the development phase. The data is filtered to an effect size of greater than 0.35. The independent sample T-test p-value is assumed to be significant on a 5% level, and it is not assuming equal variance.

Table 56: T-test comparing buyout and development phase investors

Construct/Component	Grouping	N	Mean	Std. Deviation	Effect size	T-test p-value
Investment_opport_fundmanager_ external	Buyouts	15	3.53	0.351	0.58	0.864
	Development/ growth phase	26	3.30	0.387		
Realise_value_dividents_capitalgain	Buy_out	15	2.25	0.645	0.41	0.203
	Development/ growth phase	26	1.99	0.572		
30. The prospect of selling surplus assets after investing and using the proceeds to declare a special dividend is an attractive investment strategy.	Buy_out	15	2.47	0.915	0.38	0.213
	Development/ growth phase	26	2.12	0.711		
47. Understanding consumer trends is an important consideration when making investment decisions.	Buy_out	15	3.60	0.507	0.64	0.034
	Development/ growth phase	26	3.92	0.272		

The results in Table 56 shows that investors focusing on the buyout stage investment put greater focus on their external capabilities to identify investment opportunities (mean 3.53). In turn, these external capabilities focus on sector specialisation and, importantly, the intentions of co-shareholders; therefore, considerations outside of the target company itself are considered carefully and influence their investment decision. It is also clear that investors focusing on the growth phase emphasise understanding consumer trends (mean 3.92) as this is the principal driver of expected growth.

Table 57 compares the effect of private equity investors focusing on South Africa as investment geography with those focusing on the wider sub-Saharan regions. The data is filtered to an effect size of greater than 0.35. The independent sample T-test p-value is assumed to be significant on a 5% level and does not assume equal variance.

Table 57: T-test comparing investment focus on South Africa with sub-Saharan Africa

Construct/Component	Grouping	N	Mean	Std. Deviation	Effect size	T-test p-value
Realise_value_dividents_creating _value	South Africa	24	3.09	0.410	0.91	0.002
	Sub-Saharan Africa	17	3.47	0.290		
Target_character_BEE	South Africa	24	2.82	0.618	0.93	0.001
	Sub-Saharan Africa	17	2.25	0.441		

Construct/Component	Grouping	N	Mean	Std. Deviation	Effect size	T-test p-value
6. I am generally more confident in my ability to invest successfully in industries that I am familiar with.	South Africa	24	3.54	0.588	0.61	0.049
	Sub-Saharan Africa	17	3.12	0.697		
9. Industry specialisation (for example in agro-processing) is necessary to achieve superior investment returns	South Africa	24	2.79	0.779	1.18	0.000
	Sub-Saharan Africa	17	1.71	0.920		
30. The prospect of selling surplus assets after investing and using the proceeds to declare a special dividend is an attractive investment strategy.	South Africa	24	2.04	0.859	0.50	0.110
	Sub-Saharan Africa	17	2.47	0.800		
33. Having a likely exit strategy in mind is important when making the investment decision.	South Africa	24	3.54	0.658	0.61	0.010
	Sub-Saharan Africa	17	3.94	0.243		
34. The net asset value, as stated in the most recent annual financial statements, is generally a good indication of the market value of the target company.	South Africa	24	1.63	0.875	0.38	0.127
	Sub-Saharan Africa	17	1.29	0.470		
36. I generally use the discounted cash flow method when valuing the target company.	South Africa	24	3.13	0.850	0.56	0.057
	Sub-Saharan Africa	17	2.65	0.702		
40. The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration.	South Africa	24	3.71	0.550	0.53	0.016
	Sub-Saharan Africa	17	4.00	0.000		

For investors focusing on Sub-Sahara regions, realising value through dividends and capital gains is relatively more important (mean 3.47), which includes receiving annual cash dividends, for example. Understandably, for investors focusing on South Africa, the BEE characteristics of the target company are important (mean 2.82). It is evident that for investors focusing on South Africa, sector specialisation is more important (mean 2.79).

It is argued that for investors focusing on sub-Saharan regions, aspects such as country risk can be substantial, making sector specialisation relatively less critical. Aligned with this comment is the evidence that South African focused investors are more confident in their ability to invest in sectors they are familiar with (mean 3.54). Having a likely exit strategy is

more critical for investors focusing on sub-Saharan regions, which can be explained by having to deal with more risk aspects and perhaps fewer exit opportunities than South African focused investors.

Table 58 compares the effect of private equity investors operating in a corporate captive scenario with those operating in an independent scenario. The data is filtered to an effect size of greater than 0.35.

Table 58: T-test comparing a captive corporate scenario with an independent scenario

Construct/Component	Grouping	N	Mean	Std. Deviation	Effect size	T-test p-value
Investment_opport_fund manager_internal	Captive – Corporate	10	3.62	0.304	0.52	0.047
	Independent fund	30	3.32	0.569		
Target_character_profitability	Captive – Corporate	10	1.77	0.352	0.56	0.139
	Independent fund	30	1.97	0.305		
Target_character_BEE	Captive – Corporate	10	2.90	0.357	0.71	0.013
	Independent fund	30	2.48	0.590		
Target_character_management	Captive – Corporate	10	3.20	0.349	0.56	0.026
	Independent fund	30	2.80	0.714		
Target_character_family_ ventures	Captive – Corporate	10	2.92	0.500	0.55	0.154
	Independent fund	30	3.19	0.491		
Impact_target_company	Captive – Corporate	10	2.54	0.632	0.93	0.018
	Independent fund	30	3.12	0.361		
9. Industry specialisation (for example in agro-processing) is necessary to achieve superior investment returns.	Captive – Corporate	10	2.60	0.843	0.39	0.236
	Independent fund	30	2.20	1.031		
13. The fund I am involved with is more likely to invest if I can influence board decisions after investing by having representation on the board of the target company.	Captive – Corporate	10	3.50	0.527	0.63	0.089
	Independent fund	30	3.83	0.379		
33. Having a likely exit strategy in mind is important when making the investment decision.	Captive – Corporate	10	3.50	0.850	0.39	0.257
	Independent fund	30	3.83	0.379		
35. I would generally not pay a premium to the recorded net asset value per share.	Captive – Corporate	10	1.50	0.707	0.52	0.126
	Independent fund	30	1.93	0.828		

Investors involved with independent funds focus more on the impact they can make on the target company (mean 3.12). This implies that they are more active investors than those involved with captive funds. They want board positions (mean 3.83) and are more likely to require a larger shareholding in the target company. Investors involved with corporate captive funds emphasise the BEE characteristics of the target company (mean 2.90). This focus is probably associated with its investment mandate.

Table 59 compares the effect of private equity investors focusing on LSM 3–6 with those focusing on LSM 7–10. The data is filtered to an effect size of greater than 0.35.

Table 59: T-test comparing investment focused on LSM 3–6 with LSM 7–10

Construct/Component	Grouping	N	Mean	Std. Deviation	Effect size	T-test p-value
Investment_opport_fundmanager_ external	LSM 3–6	27	3.33	0.369	0.37	0.242
	LSM 7–10	17	3.47	0.373		
Target_character_management	LSM 3–6	27	3.01	0.509	0.40	0.153
	LSM 7–10	17	2.67	0.864		
Target_character_family_ventures	LSM 3–6	27	3.06	0.477	0.44	0.152
	LSM 7–10	17	3.29	0.515		
Impact_target_company	LSM 3–6	27	2.91	0.533	0.50	0.081
	LSM 7–10	17	3.17	0.440		
9. Industry specialisation (for example in agro-processing) is necessary to achieve superior investment returns.	LSM 3–6	27	2.56	0.934	0.42	0.171
	LSM 7–10	17	2.12	1.054		
13. The fund I am involved with is more likely to invest if I can influence board decisions after investing by having representation on the board of the target company.	LSM 3–6	27	3.67	0.480	0.57	0.016
	LSM 7–10	17	3.94	0.243		
35. I would generally not pay a premium to the recorded net asset value per share.	LSM 3–6	27	1.59	0.694	0.52	0.079
	LSM 7–10	17	2.06	0.899		
36. I generally use the discounted cash flow method when valuing the target company.	LSM 3–6	27	3.19	0.483	0.56	0.042
	LSM 7–10	17	2.59	1.064		
44. The competence of the incumbent management team is the most important investment consideration.	LSM 3–6	27	3.33	0.734	0.43	0.097
	LSM 7–10	17	3.65	0.493		

Investors focusing on companies targeting the LSM 7–10 bracket are more likely to invest if they get board positions and can affect decision-making (mean 3.94). This implies that target companies operating in this environment could expect investors taking a more active approach. Investors investing in companies targeting the LSM 3–6 category are more inclined to use the discounted cash flow method when valuing companies. This means that the ability of these companies to generate high cash flows is essential if they want to achieve a high valuation.

CHAPTER 5 – CONCLUSION AND RECOMMENDATION

5.1 Introduction

The agro-processing sector requires funding to grow and achieve the objectives set by, amongst others, various South Africa economic planning agencies. Although such funding can originate from various sources, private equity investment funding could make a significant contribution.

This study showed that private equity investors focus on growth opportunities. In order to invest, private equity investors have specific criteria and objectives that should be achieved or that are likely to be achieved and, in doing so, encourage investments. The primary objective of this study was to identify the most critical criteria that specifically relate to an investment in agro-processing ventures.

The findings of this study, as detailed in Chapter 4, clearly showed that the vast majority of private equity investors in South Africa have in the past, or is keen to invest in agro-processing ventures. It stands to reason that if more ventures meet the investors' defined investment criteria, more investments will flow.

This study concludes by summarising the main findings of the research and making pertinent recommendations, which include recommendations for future research.

5.2 Research Conclusions

The conclusions reached in this study are discussed in line with the respective research objectives. The research objectives were divided into a primary objective and three secondary objectives. The primary research objective shall be considered as achieved when the three secondary objectives are achieved in combination.

5.2.1 Conclusions reached from secondary literature studies

One of the secondary research objectives was to consider the critical criteria used by a private equity investor when making investment decisions. A significant shortcoming was

that limited research was found about South African private equity investment criteria. Therefore, much of the secondary literature research findings were based on markets in the US, Europe and India. These literature studies, as detailed in Section 2.5, suggested that the investment criteria as set out in Table 60 were relevant.

Table 60: Conclusions reached in literature studies

Investment criteria	Paragraph reference	Commentary
Specialised sector insights, skills and capacity.	2.5.1	• Previous studies reached a mixed conclusion regarding the need to have specialised sector insights and skills.
Alignment of the target company with other portfolio companies.	2.5.2	• Previous studies showed that private equity investors create value by aligning target companies with existing portfolio companies.
The willingness of the target company to accept an outside shareholder.	2.5.3	• Previous literature studies showed that equity willingness was a significant investment consideration. • Previous literature studies showed that 44% equity control was required. • Previous literature studies showed private equity investors want to play an active role in the companies they invest in. • Previous literature studies showed that private equity investors found it difficult to invest in family ventures.
Growth prospects.	2.5.4	• Previous literature studies showed that the growth prospects of the target company were an important consideration. • Previous literature studies showed that improving efficiencies at the target company was a significant investment consideration. • Some previous literature studies showed that the ability to sell off non-core assets was a critical investment consideration.

Investment criteria	Paragraph reference	Commentary
Ability to restructure the balance sheet of the target company.	2.5.5	• Previous studies showed that the ability to restructure the balance sheet and to create an optimal capital structure was a significant investment consideration.
Viable and defined exit strategy.	2.5.6	• Previous studies showed that private equity investors require a defined exit strategy at the time of investing and had a maximum investment horizon of three to five years. • Previous studies showed that an exit via an IPO was a popular exit strategy. Other strategies included selling to a strategic buyer, selling another financial buyer and restructuring.
Financial return expectations.	2.5.7	• Previous studies showed that financial return expectations were a significant investment consideration. • Previous studies were inconclusive and the methodology used to measure financial returns or what the actual return requirement is.
Management team.	2.5.8	• Previous studies showed that the competence of the incumbent management team is a significant investment consideration. • Previous studies showed that offering share incentives to the management team was an important consideration.
Position of the primary product in the marketplace.	2.5.9	• Previous studies showed that product differentiation and a broad target market were significant investment considerations.
BEE.	2.5.10	• Previous studies showed that aspects about BEE were a significant investment consideration

5.2.2 Linking the findings of the secondary literature primary research

This section compares the findings of the secondary literature research with the findings of the primary research as set out in Table 61.

Table 61: Comparison between secondary and primary research findings

Findings of literature research	Primary research findings
• Previous studies reached a mixed conclusion regarding the need to have specialised sector insights and skills.	• The primary research findings showed a similar mixed result.
• Previous studies showed that private equity investors create value by aligning target companies with existing portfolio companies.	• No evidence was found that this was a significant investment consideration.
• Previous literature studies showed that equity willingness was a significant investment consideration.	• Equity willingness was a significant investment consideration.
• Previous literature studies showed that an equity control of 44% was required.	• Previous findings regarding the level of equity control were substantiated.
• Previous literature studies showed that private equity investors want to play an active role in the companies they invest in.	• Previous findings regarding the active role that private equity investors play were substantiated.
• Previous literature studies showed that private equity investors found it difficult to invest in family ventures.	• The study found that private equity investors in South Africa eagerly invest in family ventures.
• Previous literature studies showed that the growth prospects of the target company were an important consideration.	• The study substantiated previous studies.
• Previous literature studies showed that improving efficiencies at the target company was a significant investment consideration.	• The study found that efficiencies were essential but less so than growth.
• Some previous literature studies showed that the ability to sell off non-core assets was a critical investment consideration.	• No evidence was found that this was a significant investment consideration.

Findings of literature research	Primary research findings
• Previous studies showed that the ability to restructure the balance sheet and to create an optimal capital structure was a significant investment consideration.	• This study substantiated previous studies that found that the ability to restructure the balance sheet and create an optimal capital structure was important.
• Previous studies showed that private equity investors require a defined exit strategy at the time of investing and had a maximum investment horizon of three to five years.	• This study, to a large extent, substantiated previous findings that an exit strategy was relatively crucial at the time of investing. • This study suggested that the investment horizon is longer than three to five years.
• Previous studies showed that an exit via an IPO was a popular exit strategy. Other strategies included selling to a strategic buyer, selling to another financial buyer, and restructuring.	• This study found that an IPO was not a popular exit mechanism.
• Previous studies showed that financial return expectations were a significant investment consideration.	• This study substantiated previous research findings that financial return expectations were a crucial investment consideration.
• Previous studies were inconclusive regarding the methodology used to measure financial returns or what the actual return requirement is.	• This study was able to identify the preferred measure of financial returns.
• Previous studies showed that the competence of the incumbent management team is a significant investment consideration.	• This study substantiated previous research findings that the competence of the incumbent management team was a crucial investment consideration.
• Previous studies showed that offering share incentives to the management team was an important consideration.	• This study substantiated previous research findings that offering share incentives to the management team was a crucial investment consideration.
• Previous studies showed that product differentiation and a broad target market was a significant investment consideration	• This study found that a proven demand for the product is more important than having a new, innovative product.
• Previous studies showed that aspects about BEE were a significant investment consideration.	• This study found that BEE considerations were not ranked as a crucial investment consideration.

5.2.3 Constructs

After analysing the primary research data, constructs were created to summarise the critical investment criteria, which are shown in Table 62. The mean, measured on a Likert scale, is an indication of the relative importance of a construct.

The ability of the investor to identify investment opportunities was rated as the most important criterion.

Table 62: Constructs describing the critical investment considerations

Construct		Mean	Discussions
The ability to identify investment opportunities	The ability to identify investment opportunities: fund manager internal abilities.	3.42	• This construct covers the reputation, skills and insights displayed/possessed by the investor, which allows the investor to make superior investment decisions. • Literature studies, set out in Section 2.5.1, suggest that sector specialisation enables this ability. However, 67.4% of the respondents in this study indicated that they have a generalist approach to investing but that industry-specific insights are indeed required. • The data suggests that investors themselves will not necessarily become sector experts, but that these investors will consult with existing sector experts when advice is required. • Should investors not be able to receive advice from a reputable sector expert, they may find it challenging to make investments in the agro-processing sector.
	The ability to identify investment opportunities: fund manager external abilities.	3.39	

Construct		Mean	Discussions
Realising value	Realising value: creating and capturing value.	3.25	• This construct covers the sources of investment returns, including: ○ Investing at the right price. ○ Realising capital gains and receiving dividends. ○ Having a likely exit strategy at the time of making the investment. • Realising capital gains was identified as the primary source of realising value. The requirement to receive annual cash dividends was identified as less important. Having a likely exit strategy in mind at the time of investing was also, generally, an important aspect. • It stands to reason that in the absence of a prospect to achieve acceptable capital gains, it will be challenging to motivate for an investment in an agro-processing venture. Linked to this is the need to buy into the agro-processing venture at an acceptable price, which would still make it possible to achieve capital gains. • The study showed that investors require an annual rate of return of at least inflation plus 10%. The study also showed that investors have an investment horizon of up to 10 years.
	Realising value: dividends and capital gains.	2.12	

Construct		Mean	Discussions
Target company characteristics	Target company characteristics: family ventures.	3.15	• The prospects of the target company to generate future profits were identified as important. • The BEE characteristics of the target company were not rated as very important (relative to the other characteristics). • The results showed that South African investors are comfortable investing in family-owned businesses. • If the target company does not have a prospect to grow profits, investors will not invest.
	Target company characteristics: management.	2.89	
	Target company characteristics: BEE.	2.59	
	Target company characteristics: profitability.	1.93	
	Making an impact on the target company: active participation.	3.01	• South African private equity investors are active and want to make an impact and contribution at the target company level. However, contrary to popular belief, they do not intend taking over control of the target company. • Investors would be satisfied with a minority interest (of below 50%) and require a board representation of 25%. Investors are in favour of providing share incentives to the management team. • If investors are not allowed to play an active role in decision-making of the target company, they are unlikely to invest.

5.2.4 Components

The components analysed in this study were ranked individually in order of importance as set out in Table 63. The findings suggest that the intentions of co-shareholders are the most crucial investment consideration, followed by the prospect to grow revenue and the anticipated return on investment. Understanding consumer trends and having the ability to influence board decisions are also considered as important.

Table 63: Components ranked in order of importance

Rank	Component	Mean
1	18. The intentions of co-shareholders are important to consider.	3.89
2	25. Prospect to grow revenue of the target company is an important investment criterion.	3.84
3	40. The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration.	3.82
4	47. Understanding consumer trends is an important consideration when making investment decisions.	3.82
5	13. The fund I am involved with is more likely to invest if I can influence board decisions after investing by having representation on the board of the target company.	3.77

5.2.5 Most critical investment criteria

The primary objective of this study was to identify the most critical criteria that private equity investment professionals in South Africa consider when making agro-processing investment decisions. These criteria are listed in Table 64 together with minimum expectation criteria. If these minimum expectation criteria are not achieved, investors will not invest. Therefore, the challenge is to achieve these minimum criteria.

Table 64: Most critical investment considerations

Most critical investment criteria in order of importance	Context and minimum expectation
1 The intentions of co-share-holders in the target company.	• By understanding these intentions, it is possible to invest in family businesses.
2 Prospects to grow the revenue of the target company.	• The minimum annual revenue growth rate is inflation plus 5–7%. • When private equity investors refer to 'growth', they refer to growth in operating profits.
3 The anticipated return on investment when investing in the target company.	• Private equity investments measure the return on investment by referring to the IRR. • The minimum acceptable IRR is inflation plus 10–15%.
4 Understanding the consumer trends that affect the business of the target company.	• A superior understanding of consumer trends is generally acquired by consulting an existing sector expert.
5 Ability to influence board decisions at the target company.	• The minimum level of board representation required is 25%. • The minimum level of ownership control required is between 25% and 35%.

5.3 Recommendations

Within the context of the critical research findings, as summarised in Section 5.2.5, the following recommendations are made:

- Independent private equity investor and those mandated by a captive fund have slightly different focus areas. Similarly, specialist investors and generalist investors have slightly different focus areas. Some private equity investors focus on target companies in a growth phase and others on mature companies where buyout opportunities exist. Agro-processors wanting to attract private equity investment funding must understand the different focus areas and choose the most appropriate private equity investor type.

- The reasons for existing shareholders wanting to dispose of part or all of their equity interests in an agro-processing venture must be disclosed. The reasons will be subject to intense scrutiny by the private equity investment professional. Private equity investors will not invest if they sense that there is a hidden agenda. Linked to this recommendation is the clear understanding that all shareholders are fully committed to the agro-processing business. Often such commitment and full disclosure of intentions are subject to representations and warranties provided in either the shareholder agreement, or the agreement of sale and purchase of shares.
- In order to attract private equity investment funding, the agro-processing business must be able to articulate its business strategy clearly with an emphasis on its prospects to grow revenue and profits.
- The return on investment consists of capital growth and dividends. If the target company cannot clearly show that minimum returns of inflation plus 10–15% can be achieved, the private equity investor will offer to pay a lower price. Agro-processing ventures wanting to attract private equity funding must develop a detailed business plan that includes financial assessments and projections, detailing all assumptions made in the preparation thereof.
- It is important to understand the consumer trends that affect the business. Private equity investors will generally consult existing sector specialists for guidance. It is recommended that researchers and analysts covering the agro-processing sector and its linkages into the consumer sector increase their research capacity and focus on producing more regular and detailed reports.
- Target companies could benefit from having suitably qualified persons on their boards. In this regard, it is advised that the recommendations of the King IV report are considered for adoption. When the board is constituted appropriately, the interests of all stakeholders will receive equitable consideration and treatment.
- Agro-processing ventures are dependent on a reliable supply of water and electricity. As such, local municipalities and their ability to guarantee such supplies are of critical importance. Local, provincial and national governments must ensure that they create an environment that guarantees the availability of infrastructure, services and utilities.

5.4 Recommendations for future research

This study focused on the most critical criteria that private equity investment professionals in South Africa consider when making agro-processing investment decisions. The study found that 53.5% of the participants have invested in agro-processing ventures and are likely to repeat these investments. The study also found that 41.8% of the participants have not yet invested in agro-processing ventures, but want to consider such investments. Given this finding, the following future research is proposed:

- Analysing the results of past and current private equity investments in agro-processing. The purpose is to understand the impact that an investment makes and whether the objectives of the investment have been achieved from the perspective of both the investor and investee. Furthermore, identifying the reasons for realising or not realising the investment objectives.
- Analysing the reasons why 41.8% of the participants who want to invest in agro-processing have not yet done so.

5.5 Summary

Once stakeholders understand the critical criteria that private equity investment professionals in South Africa consider when making agro-processing investment decisions, the limiting factors can be identified and more investment opportunities can be created. This will stimulate growth in the sectors and contribute to South Africa’s economic development.

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APPENDIX A – QUESTIONNAIRE

INVESTIGATING CHALLENGES OF PRIVATE EQUITY INVESTMENT IN AGRO-PROCESSING IN SOUTH AFRICA

1. CONSENT AND DISCLAIMER

I am researching the challenges faced by Private Equity investors when investing in an agro-processing business in South Africa.

In order to do this research, I am respectfully requesting you, as Private Equity investment professionals, to participate in this study. The study focuses on your personal views and opinions and not on that of the company you work for.

This study will assist agro-processing ventures looking for equity capital to organise themselves in such a manner that they can become an attractive investment proposition. Further, it will assist national economic planning commissions to understand better what policy frameworks are required to support growth in this sector. The research can also aid in creating more investment opportunities for Private Equity investment funds in South Africa.

Completing this questionnaire should take 10 - 15 minutes.

Your participation is voluntary, and you can withdraw at any time from participating in this study, without any penalty or prejudice. By completing this survey, you indicate that you voluntarily participate in this research in your personal capacity as a Private Equity investment professional.

Your name will not be recorded anywhere, and no one will be able to connect you to the answers you give. Your answers will be given a code number and the research results will be reported on as a whole and not on an individual basis.

If you have any concerns regarding this study, kindly contact myself or my supervisor at the contact details provided below.

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2. This questionnaire comprised of five sections

   - Section A – requesting general information about your personal expertise and background
   - Section B – understanding your approach: requesting you to rate the statement in order of agreement
   - Section C – pertinent matters: requesting your to indicate the most preferred option amongst the alternatives provided
   - Section D – understanding the importance: requesting you to indicate your 1st and 2nd choices amongst the alternatives provided
   - Section E – getting your input: requesting you to provide a short description of the methods you apply

3. Explanatory notes

   Agro-processing refers to ventures that process a primary agricultural commodity into a product which is either a final consumer product or an intermediate product into a final consumer product. Such agro-processors include manufacturers involved in the broader economic sectors set out in the table hereunder.

Description
Manufacture of food and beverages
Manufacture of tobacco products
Manufacture of paper and wood products
Manufacture of textiles, footwear and apparel
Manufacture of leather products
Manufacture of rubber products

Section A - General information section

This section consists of 11 questions with alternative answers presented in a multiple-choice format. You are requested to please choose the most accurate description. Where "other", please indicate/elaborate.

1. What is your current role?

Chief Investment Officer	
Senior associate	
Investment principle	
Partner / Director	
Other (please provide a short explanation)	

2. How long have you been in this position?

0 – 1 year	
1 – 2 years	
2 – 3 years	
3 – 5 years	
More than 5 years (please indicate)	

3. For how long have you been involved in the Private Equity sector?

0 – 1 year	
1 – 2 years	
2 – 3 years	
3 – 5 years	
More than 5 years (please indicate)	

4. What is your primary field of expertise leading to you becoming a Private Equity investment professional?

Finance / accounting / investment management	
Operations management	
Law	
General management	
Engineering	
Other (please provide a short explanation)	

5. What is your investment stage focus?

Seed capital / early stage	
Development / Growth phase	
Buyout / mature phase	
Business turnarounds	
Other (please indicate)	

6. What is your preferred individual investment size?

< R 10m	
R 11m – R 50m	
R 51m – R 100m	
R 101m – R 200m	
R 201m – R 300m	
Other (please specify)	

7. What is your preferred investment geography?

South Africa	
Southern Africa Development Community	
Sub-Sahara Africa	
Africa	
Other (please specify)	

8. What is your preferred economic sector for investment

Primary sector (mining, agriculture, fishing etc.)	
Secondary sector (agro-processing, manufacturing, processing, construction)	
Tertiary sector (retail, transport, financial services, media, law)	
Quaternary Sector (technological innovation, research, information technology)	
A combination of these four sectors	

9. What investor classification best describes you?

Independent fund (an even spread of investors are the main source of capital)	
Captive – Government (A Government Department is the main source of capital)	
Captive – Corporate (An individual corporate is the main source of capital)	
Captive – Other (Capital sourced mainly from an individual family)	

10. The investments I am currently involved with or have been in the past;

Have been invested in agro-processing before but is unlikely to make further investments	
Have been invested in agro-processing before and is considering further investments	
Have not been invested in agro-processing before and is also not considering such investments	
Have not been invested in agro-processing before but is considering such investments	

11. The investments I am currently involved with can be considered to be;

Specialised (having a specific sector focus)	
General (investing in various sectors)	

Section B – Understanding your approach to Private Equity investment

This section consists of 51 statement questions. Please rate each of the statement questions on a scale of 1 – 4 with the rating described as follows

Rating	Description
1	Not at all
2	To a small extent
3	To a moderate extent
4	To a large extent

Statement	1	2	3	4
1. How necessary is it for you to have existing industry-specific insights (for example, in agro-processing) when considering an investment opportunity in that sector?				
2. Being recognised as a sector specialist (for example in agro-processing) improves my ability to raise funds from limited partners				
3. Limited partners are more likely to invest with me if I have a demonstrable track record in the industry in which I propose investing				
4. Having an existing investment track record in a specific industry (for example agro-processing), assist me to efficiently conclude the transaction				
5. Having an investment track record in a specific industry (for example agro-processing) assist me in identifying investment opportunities				
6. I am generally more confident in my ability to successfully invest in industries that I am familiar with.				
7. Having specialised industry expertise (for example in agro-processing) assist in the due diligence process as pertinent matters are more readily identified				
8. I am generally keen to consider investing in agro-processing				
9. Industry specialisation (for example in agro-processing) is necessary to achieve superior investment returns				
10. Sector specialisation narrows down investment opportunities which adversely impact on the performance of the investment portfolio because of associated opportunity costs				
11. Synergetic benefits with existing portfolio companies is an important investment consideration				

Statement	1	2	3	4
12. I am more likely to invest if I can obtain a controlling interest in the target company through the investment				
13. I am more likely to invest if I can influence Board decisions post the investment by having representation on the Board of the target company				
14. It is more difficult to negotiate a transaction when the target company/business is family owned				
15. I prefer to avoid investment opportunities where the target company is family owned				
16. I am generally keen to invest in family-owned businesses				
17. I found that the business objectives of family-owned businesses differs from those that are not family owned				
18. The intentions of co-shareholders are important to consider				
19. Having the ability to significantly influence Board decisions makes it possible to achieve superior financial returns				
20. The investment mandate I hold stipulate that the Boards of the Portfolio companies must be made up of suitably qualified business professionals				
21. Top management of the Target Company is often changed soon after investing				
22. I am generally in favour of providing share incentives in the target company to top management of the target company				
23. I am an active investor				
24. I prefer to invest in target companies that recently showed strong financial performance				
25. Prospects to grow the revenue of the Target company is an important investment criterion				

Statement	1	2	3	4
26. The prospect to reduce operating costs of the Target company is an important consideration				
27. The prospect to cut operating costs is more important than the prospect to grow revenue				
28. The prospect to grow revenue is more important than the prospect to cut costs				
29. Target companies that have assets which can be leveraged with additional debt is generally a more attractive investment option				
30. The prospect of selling surplus assets after investing and use the proceeds to declare a special dividend is an attractive investment strategy				
31. Improving productivity in the Target company is an important consideration				
32. The target company achieving an optimal capital structure through the investment I make is an important investment consideration				
33. Having a likely exit strategy in mind is important when making the investment decision				
34. The Net Asset Value, as stated in the most recent annual financial statements, is generally a good indication of the market value of the target company				
35. I would generally not pay a premium to the recorded Net Asset Value per share				
36. I generally use the discounted cash flow method when valuing the target company				
37. Receiving annual cash dividends from the investment is more important than achieving capital gains				
38. The prospect of annual cash dividends is a very important investment consideration				
39. Achieving capital gains is more important than receiving annual cash dividends				

Statement	1	2	3	4
40. The anticipated return on investment, consisting of capital growth and dividends, is the most important investment consideration				
41. Ultimately capital gains on the exit of the investment are the principal source of superior returns				
42. The ability to generate free cash available for distribution to shareholders is more important than generating high operating profits				
43. High financial leverage introduces unacceptable risk and disqualifies the investment opportunity				
44. The competence of the incumbent management team is the most important investment consideration				
45. The proven demand for the product being manufactured is the most important investment consideration				
46. I am more likely to invest when the target company produces highly innovative products even tough demand for the product is yet to be proven				
47. Understanding consumer trends is an important consideration when making investment decisions				
48. I will be reluctant to invest if the Target company cannot export its products				
49. The BEE status of the Target Company is a very important investment criterion?				
50. I am keen to invest in companies not complying with BEE codes as I will bring the necessary BEE compliance to the company				
51. Complying with BEE codes is considered to be a competitive advantage				

Section C – Pertinent matters about Equity investment

This section consists of 9 questions with alternative answers presented in a multiple-choice format

You are requested to please choose the most accurate description.

1. I mostly obtain superior industry insights by:

Specialising in a specific industry and becoming known as the industry expert	
Asking for advice from an existing industry expert	
Using research reports analyse the industry	

2. I will only make an investment if ownership control is obtained at the following level

<25%	
26% - 34%	
35% - 50%	
51% - 75%	
>75%	

3. I will only invest if I can influence Board decisions and therefore require board representation at the following preferred minimum level

25%	
35%	
50%	
75%	

4. When investing in agro-processing, I will be satisfied if the target company grow revenue by/at a minimum of _____ per annum:

Inflation rate	
Inflation plus 3%	
Inflation plus 5%	
Inflation plus 7%	
Inflation plus 10%	
Inflation plus 15%	

5. When referring to the growth prospects of the target company, I mainly refer to

Growth in sales volumes	
Growth in sales revenue	
Growth in operating profits	
Growth in total assets	
Growth in operating margin	
Growth in accounting Net Asset Value per share	

6. Generally, I prefer the total interest-bearing debt to equity to be in the following proportion

Debt: equity	
10:90	
20:80	
30:70	
40:60	
50:50	
60:40	
70:30	
80:20	
90:10	

7. Generally, I would consider an acceptable annual rate of return to be a minimum of

= inflation rate	
Inflation plus 3%	
Inflation plus 5%	
Inflation plus 7%	
Inflation plus 10%	
Inflation plus 15%	

8. I prefer to invest in Companies targeting the following Living Standards Measure (LSM) category

LSM 1-2: Consumers have very few household possessions and are driven to satisfy only their basic needs as they have very little disposable income.	
LSM 3-6: Consumers have basic household appliances and have more money to spend on the things they want as opposed to need. Still, however, in the lower-income brackets.	
LSM 7-10: Consumers in this bracket have the most household possessions, and their needs are satisfied.	

9. The typical investment horizon of the investments I am involved with is;

1 – 4 years	
5 – 7 years	
8 – 10 years	
10 years +	

Section D – Understanding what your consider to be the most important matters when investing in agro-processing in South Africa

This section consists of 7 questions. At each question, please indicate your **1st and 2nd** choices amongst the alternative option provided by marking the checkbox with either a 1 for 1st choice or 2 for 2nd choice.

1. When considering an investment opportunity, I regularly identify opportunities where the following changes are required to optimise shareholder value;

Change the group structure	
Change the business model	
Change the business strategy	
Changes to the management team	
Sell off non-core assets to ensure better asset usage	

2. When considering an investment opportunity, I sometimes insist on

Appointing a new CEO or CFO	
Appointing the external auditors	
Chairing the audit & risk committee	
None of the above	

3. In order to optimise the capital structure, I will generally recommend to

Take up additional debt to improve ROE	
Restructure existing debt to improve cash flow and liquidity	
Take up additional debt to declare a special cash dividend	
Expand the existing capital structure by an optimum mix of debt and equity to increase the asset base to generate revenue growth	

4. My preferred exist strategy is generally via

An Initial Public Offering	
Disposing of the equity interest to another investor	
Disposing of the assets to any buyer in the open market	
Disposal via a Management Buyout	
Disposal via absorption by another company in which the Fund I am involved with is invested	

5. The competence of the incumbent management team is best analysed when considering

Demonstratable track record (have achieved key performance objectives in the past and present)	
Number of years' experience (number of years involved in the specific business)	
Connectedness/value of connections (the extent to which the person is well known and respected in the industry)	
Academic qualifications (holds academic qualifications which are considered to be relevant to the job position)	

6. The competitive advantage stemming from complying with BEE codes is

Being able to negotiate better terms of trade	
Being able to charge a premium price for the product manufactured	
Favourable relationship with labour unions	
Opportunities to benefit from Government contracts and initiatives	
Ensuring statutory compliance (permits, licences and other consents to conduct business)	

7. When looking holistically at investment opportunities, the following are key considerations

As a General Partner, I have specialised sector insights	
Alignment of the target company with other portfolio companies	
The willingness of the target company to accept outside shareholders	
Growth prospects of the target company	
Ability to restructure the balance sheet of the target company	
Early identification of a likely exit strategy	
The predictability to superior financial returns	
The competence of the management team of the target company	
The BEE status pre-and-post the investment	
The position of the primary product/service in the market	

Section E – Considering Private Equity investment: getting your input

This section comprised of three questions where you are asked to provide a short description

1. When considering an investment opportunity, my preferred measure of financial return is (please specify, e.g. Return on equity, Internal rate of return etc.)

2. The typical fee structure of my investment portfolio is (for example 2/20)

3. The typical performance hurdle rate is ____ before any distributions are made to the GP

<<< End >>>

Thank you for your participation