



## PRIVATE EQUITY – BRIEF

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## 1. What is Private Equity?

The definition of Private Equity (PE) differs, but broadly, speaking; PE includes the entire asset class of equity investments that are not quoted on stock markets.<sup>1</sup> Either PE funds invest in private companies that are not publicly traded or in companies that are listed on the stock exchange to take them private. Although commonly referred to as private equity, investments include equity, quasi-equity and debt securities. The purpose of private equity is to help investors generate a positive return on investment in the short term, around four to seven years though it can stretch to ten years.

PE funds are usually closed-end investment vehicles, which means that there is a limited window to raise funds and once this window has expired no further funds can be raised. While PE funds can take on different structures in different jurisdictions, the majority are formed as Limited Liability Partnerships (LLP) across the world.

Under LLP, there are two categories of partners: general partners and limited partners. General partners are responsible for managing the PE fund, meaning that they make the investment decisions and manage the investments to create a return for the investors. General partners have unlimited liability for the fund's debts and obligations. Their capital contribution to the PE fund is usually small. Limited partners, which are the investors in the PE fund, contribute capital to the PE fund and have limited liability up to the amount of capital they have contributed. They do not take an active role in the fund's management or the investment decisions.

### 1.1 Angel Investing

Angel investing is a type of funding where a high net worth individual known as an angel investor (also known as a private investor, seed investor or angel funder) provides financial backing for small startups or entrepreneurs, typically in exchange for ownership equity in the company. Angel investors can only invest equity; as the businesses they are targeting are so early-stage that they're not suitable for debt. They tend to be entrepreneurs or people with extensive experience in the business world. However, angel investment is about more than just money. Angel investors offer mentoring and support, and businesses that receive investment generally benefit from the investor's time, skills, contacts and business knowledge.

### 1.2 How would the Ugandan Economy benefit from Angel Investing?

Entrepreneurs play a pivotal role in driving economic development, by starting businesses that contribute to the local economy, creating jobs, and developing solutions that make people's lives better. Entrepreneurs need capital to fuel the growth that contributes to that economic development. That's where angel investors come in. Angel investors provide funding, business management experience, skills and contacts to the entrepreneur. They

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<sup>1</sup> CFA Institute. (2018). *Private Equity Valuation*

can, therefore, be a good source of smart and patient capital. In many countries, they constitute the second-largest source of external funding in newly established ventures, after family and friends. They are increasingly important as providers of risk capital and contributors to economic growth and technological advances.

Angel investors support a much wider range of innovation than PE funds as they traditionally invest locally and in a wider range of sectors than PE funds. This means there is broader investment coverage both in terms of industry sectors and geography (angels live everywhere, not only in areas where PE funds have offices, which tend to be concentrated in a few technology or science hubs). However, it also means that angel investors can also be involved in companies that are not necessarily technology intensive or high growth.

## 2. Benefits of Private Equity

PE funds are typically positioned to offer companies in the capital-intensive and relatively risky sectors more capital than any other type of investor.<sup>2</sup> This is because PE funds find it relatively easy to access financing given the high-expected return due to the level of risk involved.<sup>3</sup> Given the capital-intensive nature of some of the sectors in Uganda such as oil and gas, agro-processing, and manufacturing, PE funds would help meet the capital needs in the sectors.

PE funds usually come on board with expertise to help a business grow and achieve its targets. A good PE fund will help a business to assess every aspect of its operations to determine where the company can cut costs, maximize value, and help with the proper execution of the business plan. The ability to leverage a PE fund's vast industry knowledge, operational expertise and investment experience can be transformative for a business.

Depending on the type, PE funds are good at reaching and helping fast growing smaller and mid-sized companies, which make a large contribution to job growth.<sup>4</sup> Other PE firms concentrate on larger, better established companies, helping them grow and target new markets which leads to economic growth, higher employment and often higher exports or import-substitution.

## 3. Private Equity Investment in Uganda

With no regulatory body for Private Equity funds in Uganda currently in place, there are only a few bodies like the African Private Equity and Venture Capital Association (AVCA)

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<sup>2</sup> Rhett Power. (2017). *The Power of Partnering With a Private Equity Firm*. Available at <https://www.inc.com/rhett-power/the-power-of-partnering-with-a-private-equity-firm.html>

<sup>3</sup> <https://www.financierworldwide.com/private-equity-in-the-energy-sector/#.XHPWmjgzblU>

<sup>4</sup> David Wilton. (2013). The Benefits of Private Equity Investment. *International Finance Corporation*

and the East Africa Venture Capital Association (EAVCA) that offer information on PE investment in Africa, East Africa and specifically Uganda.

Between 2015 to 2020, Uganda received 11 percent (USD 308 million) of the USD 2.8 billion earmarked for PE investment in East Africa.<sup>5</sup> While Uganda has seen a steady raise in PE investment, there was a drop between 2015 – 2020 from 15% to 11%, while Kenya continues to be the dominant investment destination for PE funds in East Africa.

**Table 1: Private Equity Investment in Uganda Between 2012 and 2020**

| Year        | Amount (USD) | Percentage out of investment in East Africa |
|-------------|--------------|---|
| 2012 – 2017 | 144 million  | 6%  |
| 2013 – 2018 | 264 million  | 11%   |
| 2014 – 2019 | 360 million  | 15%   |
| 2015 – 2020 | 308 million  | 11%   |

*Source: African Private Equity and Venture Capital Association. 2017, 2018, 2019, and 2020 Annual African Private Equity Data Tracker.*

Between 2010 and 2019, the energy and natural resource’s sector has seen the most deal activity in recent years (15 deals), most of which related to Uganda’s oil and gas exploration blocks, followed closely by the financial services (13 deals), Telecommunications, Media and Technology (TMT) (10 deals) sectors, Agribusiness (6 deals), and Manufacturing (6 deals).<sup>6</sup>

#### 4. Challenges facing the Private Equity Sector

##### *Double taxation of PE funds*

PE funds are currently subjected to double taxation as per the breakdown below:

- Fund Manager (General Partner) – Withholding tax on management fees at 6% if the Fund Manager is resident in Uganda and 15% if the Fund Manager is a non-resident.
- Investors (Limited Partners) – Withholding tax on dividends from the fund at 15%
- Private Equity Fund – Corporate tax on income at 30%; Withholding tax on dividends from investee companies at 15%; and Capital Gains Tax on disposal of interest in investees at 30%
- Investee Companies – Corporate tax on income at 30%

<sup>5</sup> African Private Equity and Venture Capital Association. (March 2021). *2020 Annual African Private Equity Data Tracker*.

<sup>6</sup> East Africa Venture Capital Association. (June 2019). *Private Equity Sector Survey of East Africa for the period 2017 to 2018*

### *Lack of an appropriate registration vehicles for PE funds*

There is currently lack of an appropriate legal structure for PE funds to register with the Companies Act being the main legislative structure. Globally, PE funds are established as Limited Liability Partnerships (LLPs), which creates specific tax advantages in that partnerships are not taxed. While the Partnership Act is in place, there is some uncertainty about its appropriateness for PE fund formation and no PE fund has been established as a partnership in Uganda.

### *Lack of investment ready companies*

Many Ugandan businesses are family owned and are therefore not willing to share ownership with PE firms and benefit from the expertise PE firms have to offer in the management of companies. Few of the businesses are aware about PE funding, and are often not investment ready due to a lack of professionalization of many businesses with for example the majority of companies not keeping proper books of account

## **5. Interventions to address the Challenges**

- a) Government should create a tax transparent status for private equity funds by removing additional layers of taxation. PE funds should be registered with the Capital Markets Authority (CMA) in order to qualify for the following tax proposals:
  - Exempt PE funds from 30% corporate tax (as PE funds are pass-through vehicles).
  - Reduce the Withholding tax rate on dividend payments from investee companies to PE funds from 15% to 10%, similar to that paid on listed company dividends
  - Reduce the stamp duty rate on the transfer of shares of investee companies receiving or that have received PE financing from 1.5% to 1%
  - Exempt PE funds from Capital Gains tax as a result of disposal of interest in investee companies
- b) Review of the Partnership Act to determine how appropriate the Act is for the formation of PE funds. The review could result in an amendment of the Act.
- c) CMA in partnership with the European Union, and Financial Sector Deepening Africa have set up a Deal Flow Facility (DFF) to get companies investment ready. Established in 2021, the DFF will offer technical assistance and match making initiatives set up to address the persistent gap in accessing growth capital for emerging businesses in Uganda.

