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WAHA CAPITAL

VIEWS

Corporate Fundraising In The Middle East: The Journey To Maturity

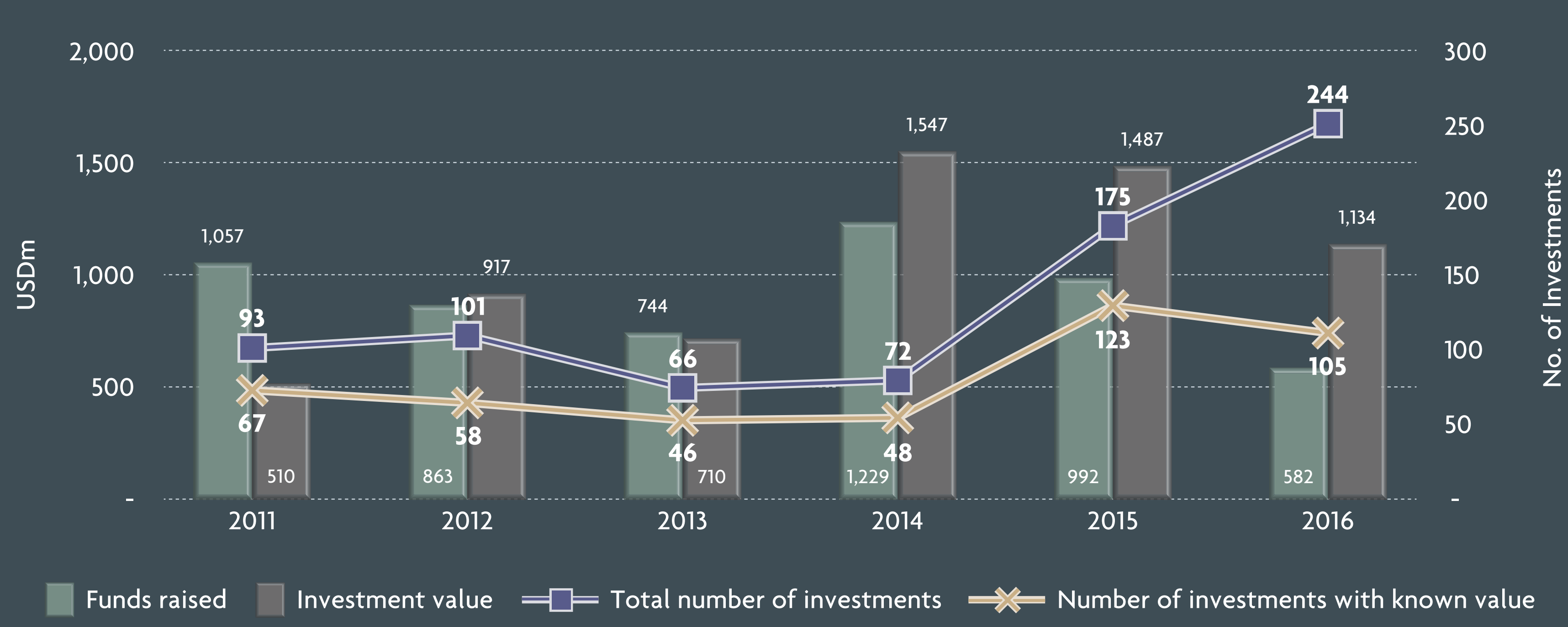
A Commentary By Waha Capital

For all its economic challenges, one issue the Middle East generally doesn't face is a shortage of capital. The region is home to three of the world's five largest sovereign wealth funds¹ and over 400,000 high net worth individuals, with an estimated combined fortune in excess of US\$2 trillion.² Banks, too, are well capitalised and have few problems accessing liquidity overall.³

However it's clear that this capital doesn't necessarily flow efficiently to the private sector, and that many worthwhile companies find it hard to access funding, particularly in the early growth stages. Government and private investment is still concentrated heavily in 'traditional' industries like energy, real estate and infrastructure. Banks are often reluctant to lend, with finance rejection rates reportedly running as high as 75% in some GCC markets, and just 2% of the region's bank lending going to SMEs.⁴

Private equity would seem a natural way to address this shortfall, and indeed it's an option more firms are exploring. The number of disclosed private equity investments in the Middle East and North Africa (MENA) climbed steadily from 66 in 2013 to 244 in 2016, according to the MENA Private Equity Association (MENAPEA).⁵ But this growth has to be put in perspective. The total value of such investment has actually been on the decline. Private equity remains a limited presence in the region and there are obstacles that have prevented it from playing the role in corporate fundraising it does elsewhere.

FUNDS RAISED AND INVESTMENTS COMPLETED



Source: Thomson Reuters and Deloitte

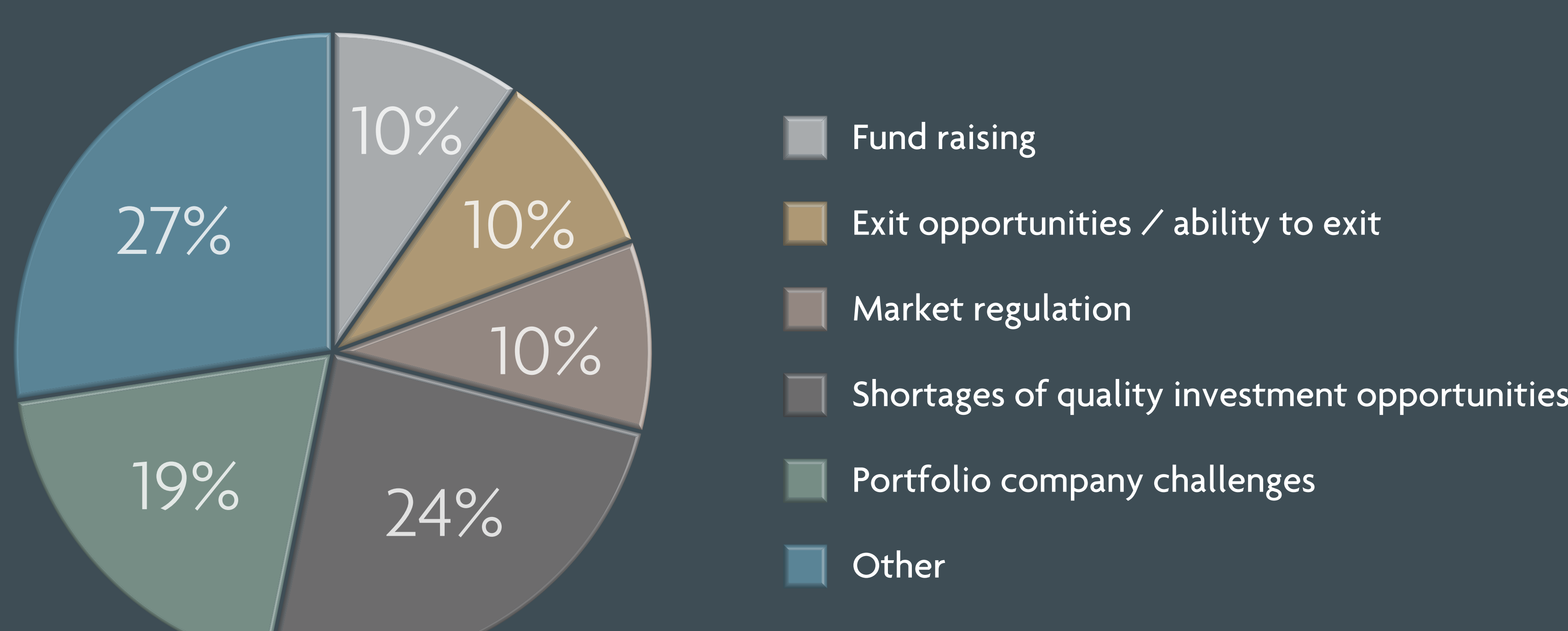
THE PRIVATE EQUITY DILEMMA

First, the relatively short history of private equity and venture capital in Middle East means the industry is still building credibility with potential investors and target companies alike, leaving the region locked in what MENAPEA has called a "challenging game of catch-up" with the more established West. Even in the UAE, where it is most active, venture capital investment accounts for only around 0.03% of GDP, versus 0.3% in the United States.⁶

The shortage of quality potential investments has been cited as one of the biggest challenges facing the regional private equity industry.⁷ This is in part because many of the region's best assets remain firmly in family or government hands, but there is also a lack of awareness around some investment opportunities. Relatively little-known, but highly competitive firms may fail to capture the attention of investors that could support their fundraising needs due to limited personal or industry networks.

The policy environment also needs to be considered. Many MENA markets maintain some form of restrictions on foreign investment or ownership, which complicate efforts to raise capital internationally. Harsh or unclear bankruptcy laws can also contribute to apprehension around business failures for investors and entrepreneurs alike.

CHALLENGES AND BARRIERS



DAWN OF A NEW CYCLE

At the same time, we're confident that some of these barriers are on the verge of being overcome. Over the past year we've witnessed some of the region's first major private investment success stories. High-profile deals like Amazon's \$580 million purchase of online retailer Souq.com will increase investor focus on the region and provide a much-needed boost of confidence in the private equity fundraising model among investors and target firms.⁸

The region's young population is also highly conducive to private equity's long-term development. In the MENAPEA study 65% of those polled cited the region's favourable demographics as its key strength relative to the growth of the private equity market. Demographic trends and the changing habits of young, digitally native consumers will create a wealth of investment opportunities in sectors like healthcare and e-commerce.

Last but not least, policymakers are becoming more proactive in addressing the corporate fundraising problem. The Central Bank of the UAE is looking to encourage private equity and new methods such as crowdfunding to plug the corporate financing gap.⁹ More governments and family offices are exploring private equity themselves or setting up venture capital-style operations; Abu Dhabi's Mubadala Investment Company, for example, recently established a venture capital arm.¹⁰ In the past these entities tended to focus their investments abroad, but the emergence of more promising young firms and robust economic growth are likely to return their attention to home.

In essence, corporate fundraising may previously have been facing a 'chicken and egg' situation. Without a proven track record it's hard for private equity funds and companies to raise capital, but without capital they won't necessarily have a chance to develop a track record. Now, however, we stand on the cusp of a virtuous circle. More positive deals will attract more funds to private equity and ultimately to more companies, producing more success stories that fuel future waves of investment, and easing the fundraising pinch. For companies and investors alike, identifying the right opportunities and forging genuine partnerships will be critical to keeping this circle in motion in the years ahead.

1 <https://www.swfinstitute.org/sovereign-wealth-fund-rankings/>
 2 <https://www.businesswire.com/news/home/20170523005737/en/Middle-East-2017-Wealth-Report-Approximately-410000>
 3 <http://www.arabianbusiness.com/industries/banking-finance/382230-capitalisation-keeps-gcc-banks-strong-says-sp>
 4 <https://www.entrepreneur.com/article/286019>
 5 http://www.menapea.com/research-association.php?fileid=11th_MENAPEA_AnnualVCReport_2016.pdf
 6 <https://www.forbesmiddleeast.com/en/challenges-persist-in-raising-venture-funds-in-the-middle-east/>
 7 http://www.menapea.com/research-association.php?fileid=11th_MENAPEA_AnnualVCReport_2016.pdf
 8 <http://www.arabianbusiness.com/377503-how-significant-is-the-amazon-souqcom-deal-really>
 9 <https://www.thenational.ae/business/banking/uae-central-bank-looks-to-private-equity-to-plug-sme-funding-gap-1.677934>
 10 <https://www.thenational.ae/business/technology/mubadala-s-new-venture-capital-arm-is-a-feather-in-its-cap-1.668441>