ASHESI UNIVERSITY COLLEGE

AN

INVESTIGATION INTO THE FEASIBILITY

OF AN INSTITUTIONALIZED PRIVATE EQUITY SECONDARY MARKET

FOR INVESTORS.

By

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STUDENT'S DECLARATION

I hereby declare that this dissertation is the result of my own original work and that no part of it has been presented for another degree in this university or elsewhere.

Candidate's Signature:..

Candidate's Name:..

Date:...............................

SUPERVISOR'S DECLARATION

I hereby declare that the preparation and presentation of the thesis were supervised in accordance with the guidelines on supervision of thesis laid down by Ashesi University College.

Supervisor's Signature:...

Supervisor's Name:...

Date:.......................................

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ABSTRACT

The development of a private equity secondary market was researched with emphasis on the necessary conditions for the bedrock on which a strong private equity secondary market would prosper. The research looked at the presence of an operational and legal framework, availability of market participants and the possibility of developing a private equity secondary market. The significance of this research is to come up with a platform on which private equity funds could buy and sell private investments from private equity funds and individual investors.

The study concludes that Ghana currently has no operational and legal framework for the development of a private equity secondary market although there are number of private equity investments that can source as transactions for the proposed market. It is advised that policy makers and stakeholders in the private equity industry draw the required framework for the development of a private equity secondary market. It would be beneficial for an increase in investor education to gradually aid the development of the private equity secondary market in Ghana.

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CHAPTER 1

INTRODUCTION

1.0 Background

The finance industry in recent years has seen the materialization of a private equity market. The private equity market globally has grown very huge, and currently has an investment value of an approximately $100 billion (Ernst & Young, 2013). Ghana is fully participating and contributing to the growth of the private equity market in Africa. However one segment of the private equity industry that is nonexistent is a fully fledged institutionalized private equity secondary market.

1.1 Overview

With the recent economic growth and a large youthful population in Ghana and Africa as a whole, the number of start-up companies have increased. The problem of a lack of funding has led to the creation of a local private equity industry more especially in the area of venture capital mainly because of the growth in the number of startup companies in Africa. Private equity has the capacity to contribute greatly to the growth and development of the Ghanaian private sector by providing not only financing options but technical assistance for companies. It drives economic growth, innovation and job creation (Harvard Business School Press, 2001).

Venture Capital in Ghana is still in its incipient stages and started with the 2004 Venture Capital Trust Fund Act. This Act 680 of the Third Parliament of the Fourth Republic of Ghana was the framework used to set up a Trust Fund for Ghanaian PE firms with a seed funding of GHC 22.4 million. An additional GHC 40.2 million was created from the private sector through a Public Private Partnership. A provision of this seed money coupled with the deregulation of venture capital funds made it possible for the VCTF to operate through mediator institutions known as Venture Capital Finance Companies (VCFCs)(Venture Capital Trust Fund, 2001). The aim of these VCFCs is to act as intermediaries between SMEs who want funds for viable business plans and the VTCF. Currently, there are at least five venture capital firms with a number of boutique investment firms also doing principal investing in startup companies bringing the total number to ten.

1.1 Problem Statement

Nine years after the start of private equity in Ghana as a result of the liberalization of the Ghanaian financial sector, the private equity industry has seen its tentacles stretch into areas of healthcare, ICT, real estate, pharmaceuticals, manufacturing, aquaculture and animal farming, agro-processing and education. Even with the availability of funds and impressive returns on investments, a limited number of options for exiting before the end of the contract or making capital gains has made the venture capital industry in Ghana a place for only high risk takers. Investors that have invested in private equity in Ghana do not have the privilege of liquidity and the freedom to rebalance and diversify their portfolios.

This study aims to find out whether the conditions in Ghana are suitable enough for the development of a private equity secondary market. Investors and other market participants always want a way to manage risks and make a profit. The presence of an institutionalized private equity secondary market will provide a window of opportunity to mitigate their risks and gain profits in the short run. This study seeks to find the conditions that will lead to the development of a private equity secondary market in a Ghanaian context.

1.3 Research Objective

The objectives of this study revolves around how a private equity secondary market can be established in Ghana. The purpose of this research is to:

Analyze the possibility of developing a private equity secondary market in Ghana.

Analyze the necessary conditions for the development of a private equity secondary market.

Make recommendations for the establishment of a private equity secondary market.

1.4 Research Questions

The research questions that are relevant to this study are:

Is there an operational & legal framework for developing a private equity secondary market?

Are there participants that are willing to be involved in the use of this established market?

Does the existing private equity market have a solid foundation for developing a private equity secondary market?

1.5 Data Collection

The data that was collected for this study was mainly from primary sources. Most of them were obtained through questionnaires and interviews of officials from private equity firms, the Securities and Exchange Commission (SEC) and investee companies.

1.6 Structure of the Paper

The structure of this paper is as follows:

The introduction encapsulates the background of the study, the objectives of the study, research questions, methods of data collection and the outline of the study.

The second chapter reviews previous literature on the state of private equity in Ghana and Africa as a whole. It will evaluate and analyze the literature critically to give the reader a clear view of the global and local PE industry with a focus on secondary markets. Gaps identified in the literature are addressed in this chapter.

The third is a review of the methodology which includes the data collection methods, the types of data, limitations of the method and the sample size that was used.

The fourth chapter was a presentation of the analysis of information gathered from the study and will discuss the possibility of developing a Ghanaian PE secondary market.

The last chapter discusses the main results of the previous chapters. The results from the study will inform the necessary measurements to be taken to make the development of a secondary PE market viable in Ghana.

CHAPTER 2
LITERATURE REVIEW

The development of a private equity secondary market parallel is analogous to the evolution of a secondary market for any other asset class. The Stock Exchange is the largest and most advanced secondary market in the world. Evidence has shown that with the maturation of every primary market, a secondary market has developed alongside to provide lenders and initial investors the opportunity to liquidate and diversify their portfolio freely (Sealey and Lutyens, 2008).The size of most secondary markets are driven by the growth and size of their respective primary markets and with the current growth of number of participants, overall volume and transactions in the primary private equity market in Ghana, the need for a secondary market will arise. On the global front, the volume of transactions in the private equity secondary market has increased from an estimated $1.5 billion in 1998 to $22 billion in 2010 (Cogent, 2011).

2.1 What is Private Equity?

“Private equity is the investment of equity capital in private companies.” A classic private equity deal calls for an investor to buy a stake or shares in companies that are not listed on the stock exchange with the expectation of an increase in the value of the said stake (Snow, 2007). This is normally done to provide funds for expansion either through acquisition or growth. Most investors tend to use a fund structure rather than investing directly into the businesses, this allows for efficient use of capital and helps mitigate risk through diversification.

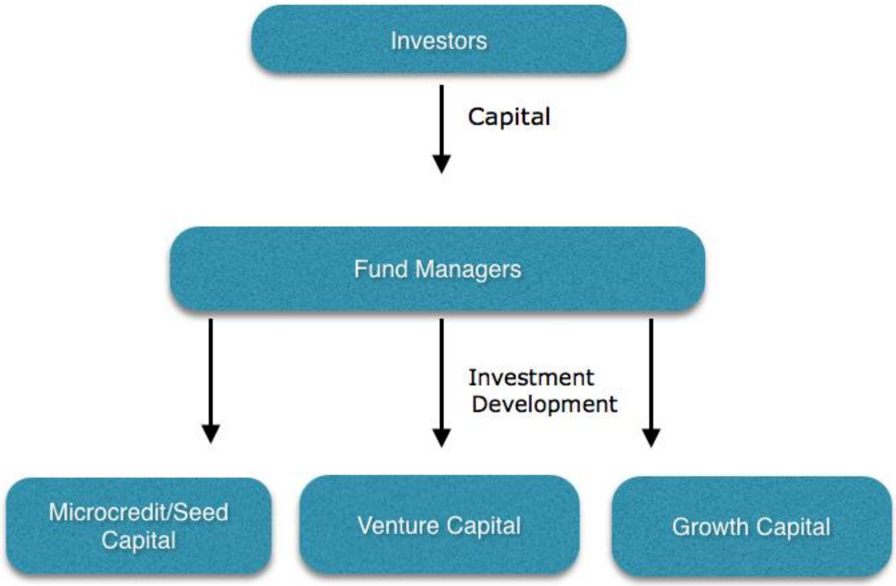

Figure 1. Structure of Private Equity Industry[1]

2.1.1 Investors

Most private equity investments are made by angel investors, private equity firms and venture capital firms. Each of these investors have their own set of goals, preferences and strategies of investment. They provide working capital to the company of interest for the firm to be able to undergo certain projects such as new product development, restructuring of the firm and ownership (Privco, 2013). An angel investor usually contributes more than cash to a company. They always have expertise or knowledge in the required industry which they are able input to improve

[1] Private Equity in Africa for Ghana Policymakers & Regulators

the management of the company. Investors in private equity firms, known as limited partners have a limited liability according to the structure of the partnership. Limited partners provide money for general partners to use.

2.1.2 Fund Managers

Fund managers are usually known as general partners. They are basically the managers of the private equity firm therefore making them responsible for investment decisions. General partners are paid with a management fee within 1-2% of the invested capital and also receive a carried interest or performance fee (Cartier, 2011). General partners have unlimited liability for the obligations and debts of the partnership. They are responsible for raising funds from Limited Partners, looking for and executing investments, management and monitoring these investments and lastly generating returns by exiting.

2.1.3 Microcredit/Seed Capital

Seed capital or microcredit capital is money an investor uses to buy part of a business. This investment is usually done in the early stages with the intention of supporting the business until a point where it can create its own revenue streams. Usually sought from friends and family, angel investors and crowd-funding, this injection of capital pays for initial operations like product development and market research (Hollow, 2013).

2.1.4 Venture Capital

"Venture capital is a long term investment." Venture capital is a subset of private equity that refers to equity investments made into a business entity for the launch, development or expansion of the business. The emphasis of venture capital is on entrepreneurial initiatives instead of mature businesses (EVCA, 2007).

2.1.5 Growth Capital

Growth capital is equity financing that aid outstanding companies improve their growth rate. Provision of capital and operational support are ways by which growth capital investors help companies achieve full market-value potential, revenue and profit. Growth capital unlike venture capital focuses on fast growing business with proven revenue generating models (Summit Partners, 2010).

2.2 Structure of Private Equity Secondary Market

Private equity as an asset class is used because of its diversification and return potential. However, private equity investors face complexities that are not usually found in public markets. Issues like illiquidity, diversification management, high minimums and the "j-curve"[2] effect add a level of complexity to managing a portfolio of the private equity asset class. These complexities can be reduced without forgoing the diversification and performance targets investors are seeking with private equity investment. One method that can be used to mitigate the challenges stated is the release of secondary funds in a portfolio (Cotton, 2010).

"Secondary investments - the transfer of an interest in a private equity fund from one investor to another." (Triago, 2010)

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[2]J-Curve: A reference to the initial downward slope of a line graph charting a fund's value as it moves from year to year followed by, hopefully, a steady rise in value.

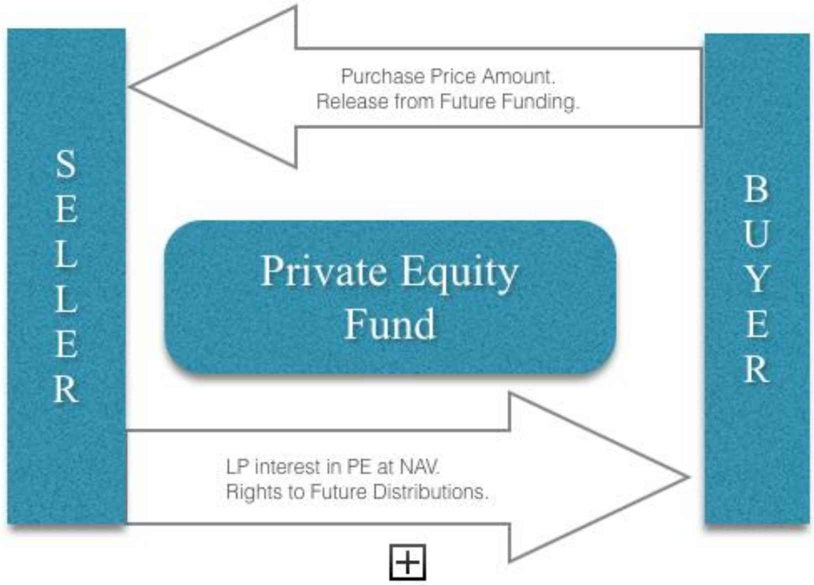

Figure 2. Basic Secondary Transaction in Private Equity [3]

In a basic secondary transaction, the limited partner sells in his interest in the PE at a net asset value and his rights of future distribution of return to the buyer. The buyer in exchange gives him the purchase amount and releases the seller from the obligation of future funding (Ibid, 2010). Most secondary transactions require the consent of the General partner of the fund, this makes it advantageous for people who have good relationships with their General Partners (Cherney, 2009). The benefits of such transactions include:

- Opportunity to sell illiquid assets

[3] The Benefits of Secondary Funds in a Private Equity Portfolio

- Reduce managerial fees and overhead costs
- Reallocation of assets as investments evolve
- Quicker returns on investment

According to Lüchinger and Schnyder, the development and success of a private equity secondary market is hinged on the premise that without participants there can be no market. For our local PE industry to sustain the establishment of a secondary market for the transfer of private equity, it should have the following requirements:

- Proactive source of transactions
- Thorough analysis of underlying assets
- Execution excellence

The current state of the economic and financial sector has created the need for a secondary market to evolve from the private equity industry. The volume of secondary transactions have increased from mid-2007, this increase in deal volume was started by people looking for the need to liquidate their holdings in private equity firms.

2.3 Participants in a Private Equity Secondary Market

Every secondary market has three main active participants. They are the advisers, buyers and sellers.

2.3.1 Advisers

Transactions between buyers and sellers in the secondary market require the services of financial advisers to increase transaction and also understand the risks associated with the transfer of rights to the underlying asset. The expertise of legal advisers are also needed in order to draft documents like the Purchase and Sale agreement and also to analyze the limited partnership agreement of the fund. It is recommended that the service of an adviser be sought since it helps achieve high returns and efficient management of issues such as valuation, portfolio analysis and legal. Advisers usually charge a fee based on each transaction and its characteristics (Tichelen, 2010).

2.3.2 Buyers

Buyers in a private equity secondary market are grouped into two, traditional and non-traditional buyers. This classification is done based on their ability and methods of investments. Traditional buyers are funds of funds dedicated to buying asset classes in the secondary market. Non-traditional are institutional investors from diverse sources of funding like pension funds, endowments and foundations. According to research done by Probitas Partners, 50% of institutional investors purchase directly from funds and 10% purchase from companies that are in the secondary market (Ibid, 2010).

2.3.3 Sellers

The secondary market contains two types of sellers: Limited Partners (Fund investors) and General partners (Fund managers). Limited partners tend to be financial institutions such as banks, pension funds, insurance companies and wealthy individuals represent a third to a half of secondary transactions. Fund managers also play the role of sellers in the market, where they are able to sell a direct interest in a portfolio company, a fund interests, part or whole of the portfolio fund they are managing (Ibid, 2010).

Future of Private Equity Secondary Market

Private equity industries around the world have found the need to develop a secondary market most importantly after the 2008 financial crisis. Countries such as the United States, Sweden and Denmark have developed trading platforms such as SecondaryNet and Palico to offer services to General partners, Limited partners, fund of funds and gatekeepers. With its benefits to both GPs and LPs the secondary market is key to the survival of private equity industry, it is a system that can be used to mitigate risks and maximize profits for all investors in private equity and investee companies (Austin, 2009).

Chapter Summary

Private equity in Ghana and Africa is growing, with different funds coming up, the number of investors and investees are growing by the day. Ghana's private equity industry albeit young is approaching a point where secondary sale of private equity shares is being noticed and is not only being used as a method of exit by funds and investors but also a way to diversify their portfolio.

The global secondary private equity market had an investment value of $59 billion in 2009, with the number of participants increasing every year. As private equity funds deal with issues of liquidity, the economic environment contains the right factors for the continuous evolution of the secondary markets to utilize the purchase opportunities available. The market for private equity will continue to grow more complex and involve new transaction methods and structures and is expected to be commonplace in the private equity industry (Austin, 2009).

The secondary market is an area that requires a special attention in both legal and finance areas as participants of the market will have to deal with issues such as valuation and transfer of rights. Ghana has two of the requirements (Proactive source of transactions and thorough analysis of underlying assets) needed for the development of private equity secondary market i.e. (Owusu-Adjei, 2010). The focus then should be placed on execution excellence which would require a regulatory and operational framework to fully institutionalize the secondary market. This will help the private equity industry to survive and thrive in the future.

CHAPTER THREE
RESEARCH METHODOLOGY

The objectives of this study is to analyze the possibility of developing a private equity secondary market in Ghana and analyze the requisite conditions necessary for the development of a private equity secondary market. Based on these objectives, this chapter discusses the research tools, instrumentation and the methods of data collection used by the researcher to meet these objectives. This chapter spells out the types of data and their sources, sample size, questionnaire design and the chapter concludes with a discussion on the limitations of the data collection. Prior studies examined by the researcher on developing a private equity secondary market mostly used interview questionnaire, or solely interviews for their data collection.

3.1 Type and Source of Data

This researcher relied mostly on primary data. The primary data was obtained from two main sources- institutional investors and the Securities and Exchange Commission (SEC). The institutional investors comprised of only private equity funds and investment firms which are participants in the private equity secondary market. Primary data was collected from the institutional investors through the use of interview questionnaires. Primary data was also obtained from the Securities and Exchange Commission (SEC), the regulatory body for the Ghanaian securities market, with the aid of an interview guide. The interview guide provided the structure for the interview which aided the researcher in obtaining data from a qualified representative of the SEC. The researcher chose the number of data sources based on the assumption that the size will not affect the operational consistency of the study. The interview questionnaires contained both close and open ended questions which are directly addressed to the objectives of the study.

3.1.2 Sample Size

The unit of analysis for this study was institutional investors- brokerages, investment firms and the Securities Exchange Commission (SEC), in the city of Accra, Ghana. The non-probability sampling technique was used in this study. The convenience sampling and purposive sampling was used. Convenience sampling assumes a homogenous population where one person is not much different from the other. The researcher chose this sampling technique because it is inexpensive, simple and it chooses the groups that are easiest to reach. Another rationale behind the researcher's decision in using convenience sampling is because institutional investors are a homogenous population, and are mostly exposed to the same knowledge base, thereby reducing the bias in the sampling method. A sample size of 15 were choosing initially, however there was a response rate of 5 companies.

Purposive sampling selection was used for the officials at the SEC because they possess the necessary information that would enhance this research. One of the research questions of this study is, is there a legal framework for the development of the private equity secondary market? The answer to this question can only be obtained from the SEC because they are the regulatory body for the Ghanaian securities market. So the decision to use purposive sampling is valid because the target group is specifically chosen due to the information they possess.

Names of Institutional Investors to be Sampled (Participants)

Oasis Capital Ghana Limited

Gold Venture Capital

Merson Capital

Ghana Capital Partners

Venture Capital Trust Fund

3.1.3 Mode of Data Collection

Data collection methods for this study included the use of interview questionnaires and personal interviews. Interview questionnaires were filled in by the institutional investors. The researcher after selecting the institutional investors using the convenience sampling method, visited their various offices to administer the interview questionnaires.

An interview guide was used for structuring the interactions during the personal interview with the personnel from SEC. The information obtained was recorded with the use of an MP3 player and was transcribed by the researcher for the purpose of analysis. Data for the research was collected over a two week period as it was convenient for the institutional investors. The data from the personal interview was collected in one day from the SEC.

The researcher decided to use interview questionnaires because it is easier to administer and is best suited for the type of research embarked on.

3.1.4 Questionnaire Design

The designed questionnaires administered to the institutional investors were straightforward and unambiguous. It consisted of open ended and closed ended questions. The basis for using both types of questions is to as much as possible extract both subjective and objective answers to the questions asked. The open ended questions was asked at the end of the questionnaire in an attempt not to deter the respondents. The closed ended questions will have a range of response categories for the respondents to pick from. The interview questionnaire is aimed at exploring the level of awareness of private equity secondary market and the level of acceptance and willingness of establishing a private equity secondary market.

3.2 Methods of Analysis

The analytical methods used for this study will twofold, firstly the use of Microsoft Excel was used for the analyses of the questionnaire of the study while content analysis was used for the interview part of the study. Emphasis is placed on the frequency and percentages at which certain trends occurred during the analyses of the quantitative data, then the researcher explained the trends and phenomenon which occurred. The qualitative data collated through interviews was analyzed based on content by generation of themes and signal keywords which serves as an auxiliary base to explain the research questions.

Limits of research

- Data needed from Venture Capital Trust Fund was difficult to get due to bureaucratic nature of the institution, this affected the period used for data collection.

- Some institutional investors from initial sample were reluctant to give out information concerning their activities. A longer period of data collection could have gone a long way to incorporate more institutional investors.

CHAPTER FOUR

ANALYSIS OF RESEARCH DATA AND RESULTS

The data for this research are presented, analyzed and discussed in this chapter. The chapter begins with data analysis of responses from potential participants of the private equity secondary market. It then continues with a descriptive analysis of the reasons behind why there should or should not be a private equity secondary market, the readiness of the Ghanaian economy for a private equity secondary market and the regulatory and operational framework that are used by participants in the trade of private equity investments.

4.1 Layout of Data

The presented data below was gathered over a 2 week period through interviews and questionnaires from possible participants in the private equity secondary market. Some responses concerning the variables in the questionnaires and interviews were not directly related to the research questions, they however give more information on the conditions that will lead to the development of a private equity secondary market in the Ghanaian economy.

Frequency Tables

Table 4.1		PES		
	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	5	100%	100%	100%
No	0	0%	0%	0%

Table 4.2		CIP		
	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	0	0%	0%	0%
No	5	100%	100%	100%

Where,

PES = Are you familiar with a private equity secondary?

CIP = Is your company involved in any private equity secondary transactions?

Table 4.3		NUD		
Million	Frequency	Percent	Valid Percent	Cumulative Percent
\$1-\$2	1	20%	20%	20%
\$2-\$5	2	40%	40%	60%
\$5 and above	2	40%	40%	100%

Table 4.4		PDM		
	Frequency	Percent	Valid Percent	Cumulative Percent
Very Low	1	20%	20%	20%
Medium	1	20%	20%	40%
High	2	40%	40%	80%
Very High	1	20%	20%	100%

Table 4.5		ODM		
	Frequency	**Percent**	**Valid Percent**	**Cumulative Percent**
Yes	5	100%	100%	100%
No	0	0%	0%	0%

Where,

NUD= How many un-exited private equity deals does your company currently have?

PDM= How possible do you think it was to develop a private equity secondary market in Ghana?

ODM= Will you be open to the idea of developing a private equity secondary market?

The results shown above in the table(s) are a summary of statistics and frequency of measured variables that will help the study of data for the research.

4.2 Analysis of Results

With respect to the table(s) above, the frequency table highlights the number of times respondents chose a particular variable. Looking at Table 4.1, it is noticed that PES shows a frequency of 5 and 100 percent output, which suggests that all respondents knew what a private equity secondary was. One of the questions the research sought to answer was if there were any participants ready to be involved in the trade of private equity secondaries. Consequently, there can be no market without participants-buyers, sellers and advisers- who have no knowledge about the market; The study placed emphasis on institutional investors, i.e. private equity funds, although private individual investors can participate in the private equity secondary market. There was a generalization of participants in my research because earlier studies had shown that participants who were usually involved in the market were doing so for various reasons. For this reason, categorization of participants would have proved difficult. The link between my findings and the research question of there being participants willing to be involved cannot be separated, because the want to trade in private equity secondaries cannot be there without being familiar with private equity secondaries.

Table 4.2 is a frequency table that finds out the involvement of the research participants in private equity secondaries. From my findings, it is seen that 0% of the sample size were involved in private equity secondary transactions. The results of this do not directly address the research questions asked in the study but they shed some light on the state of the Ghanaian private equity industry for the development of a private equity secondary market. Though there is a possibility of a difference as a result of the sample size, previous research has shown that prevalence of private equity secondary transactions is next to 0. Later in the research, it was seen that the lack of a private equity secondary market may be responsible for this. Most firms explained that the reason why they had not been involved in any private equity secondary transactions was because they were still in the investing stages and had not reached levels that required exiting. According to Owusu-Adjei (2010), a number of methods can be employed as ways of exiting by private equity firms, a majority of these methods included secondary sale of equity interests. Although research findings show no involvement in private equity secondary transactions based on the sample size it is an indicator of the need for a private equity secondary market to present opportunities to private equity firms.

With reference to table 4.3 NUD, we see the value of un-exited private equity deals among the sample size, invariably showing the value of potential private equity secondary transactions. The ranges of value of portfolio were broken down into groups of $1-$2 million, $2-$5 million and $5 million and above. These categories were represented by 20%, 60% and 20% respectively. A large percentage (60%) of respondents fell between the $2-$5 million range, while $1-$2 million and $5 million and above had 20% of the respondents. Since my study was aimed at finding out if there were conditions necessary for the development of a private equity secondary market, my study unveiled that the condition of a proactive source of transactions was satisfied since, and there was an ample amount of un-exited private equity deals in the industry.

PDM which represented the possibility of developing the private equity secondary market was categorized into very low, medium, high and very high and was represented by 20%, 20%, 40% and 20% respectively. Cumulatively, a higher percentage (80%) belonged to the categories of medium to very high which is indicative of a skew towards the high probability of creating a private equity secondary market. One research question this table sought to answer was if the conditions in Ghana were conducive enough to develop a private equity secondary market, the results of this study is evident that save a working operational & legal framework participants in the private equity industry believed that it was possible to the market. Consequently, Table 4.5, ODM showed that all the respondents were open to the idea of participating in a private equity secondary market.

4.3 Themes from Interview Data

In the analysis of interview data, four relevant themes emerged, these themes were discussed in this section of the chapter. Their relevance in answering the research topic of investigating the feasibility of a private equity secondary market cannot be overemphasized. The themes cut across why participants are interested in the creation of a private equity secondary market, to the operational and legal framework necessary and the readiness of the Ghanaian economy for a private equity secondary market.

4.3.1 Reasons for a Private Equity Secondary Market

From the literature review of this study, reasons-diversification, easy opportunity to exit, reduction of managerial costs, quicker returns on investments were given for the need of a private equity secondary market. The interviews showed that the reasons in the literature review were the same as compared to those of the Ghanaian private equity companies. Respondents stated-:

"The idea of investors receiving some liquidity for the funded investments as wells as a release from remaining unfunded obligations might sound appealing. It creates opportunities for investment banks to explore."

"The private equity secondary market creates an avenue for the trade in P/E where an investor is willing to invest in and diversify his portfolio."

"Developing a private equity secondary market is a way of improving the financial service sector. It would be great to have it established."

"It would enhance exit opportunity prospects/ make the industry more competitive."

"We are looking at involving some of our investments in this market."

The comments above give evidence to the fact that the private equity secondary market was of use to participants. Should the private equity secondary market thrive amongst the private equity funds, individual investors can be allowed to enter the market to benefit from the advantages.

It can also be taken as a good sign that in spite of the nascent stage of the private equity industry, the need for a private equity secondary market is present.

4.3.2 Legal Regulatory Framework

One thing that was identified from the literature review and also a research question was the presence of an operational and legal framework for the trade of private equity secondary. From the interviews, the data shows that there is no standard, legal framework for the trade of private equity secondaries by any of the companies. This might be because they have not yet been involved in any private secondary transaction.

For most respondents, the answers to the question of a present legal regulatory framework were no and continued to say that plans were not being made to create such frameworks. One respondent, in the case of a legal framework, was of the opinion that the main reason why they had not developed their own framework was because the body responsible for the regulation of the private equity industry, the Securities and Exchange Commission (SEC), did not have a legal framework that controlled the private equity industry. Findings from interviews with the SEC show that there is no regulatory framework to guide and control activity in the private equity industry. The lack of this legal regulatory framework is unhealthy for the private equity industry and consequently, the private equity secondary market since it gives the avenue for insider trading, wrong valuation and evasion of tax (Knudson, 2008).

4.3.3 Readiness of Ghanaian Economy

On the issue of whether the Ghanaian economy was ready for the establishment of a private equity secondary market, 4 respondents gave positive answers. They were of the view that the financial sector of Ghana was ready for such a market because the banking sector and other financial services in the industry had created a backbone on which the private equity secondary market could trade and grow. One respondent did not agree however.

Respondents stated:

"Yes. Partly, because all types of private equity funds (real estate, venture capital etc.) can be sold in the market. However, the financial services must have a stronger, stable and sounder backbone, first and foremost."

"Yes, the Ghanaian market is, the fact is, if you don't start you will never know how good it is. I believe that a private equity secondary market can be established in our current economy."

"No. We need to establish a proper legal framework first."

"Yes and No, for the smaller players in the market it still might be difficult for them but with the bigger players it would make things easier."

"I do not know how huge the market is but I believe that the Ghanaian economy can handle the presence of a private equity secondary market."

These responses in relation to the state of the Ghanaian economy and its capacity to start and maintain a private equity secondary market show that the experts and officials in the private equity industry have confidence in the financial services sector. It should however be noted that the conditions of a strong investor confidence must be met alongside educating of people in the industry to adequately keep the market alive.

4.3.4 Operational Framework

Literature according to Lüchinger and Schnyder state execution excellence as factor in the studies show that the presence of an operational framework Most respondents who were interviewed about the presence of an operational framework in their funds concerning private equity secondary revealed that they did not have an operational framework in place and they had no plans of creating one. Respondents said that:

"No, we do not have an operational framework, this is mainly because we are a closed end fund. Should we decide to create our own fund then we will look at creating our operational framework."

"Our company at this point does not have an operational framework for the trading of private equity. We have not considered selling our interests yet but it is something we are definitely going to look into"

The lack of an operational framework for the trade of private equity impedes the development of an institutionalized private equity secondary market. This is because it prevents a streamlined process in the transfer of shares of private companies. The adoption of operational frameworks to fit the specific transactions will improve transparency and aid its growth and development.

4.4 Summary Analysis

The development of a private equity secondary market is dependent on certain conditions that need to be met. A well-structured institutionalized private equity secondary market needs to be developed on a foundation of market participants, a proactive source of transactions and an operational and legal regulatory framework. The private equity industry in Ghana despite its nascent stages, from research, seems to be ready for a secondary market. The lack of an operational and legal regulatory framework however makes it hard for the market to work seamlessly. Regulatory bodies and market participants need to be educated in order to create and develop the secondary market.

CHAPTER FIVE
CONCLUSIONS AND RECOMMENDATIONS

The concluding chapter of this research provides a conclusion to the investigation into the feasibility of a private equity secondary market and the necessary recommendations to develop the market.

Regulatory & Operational Framework for Developing a Private Equity Secondary Market

A regulatory framework alludes to the factors of the development conditions that reinforce a properly functioning market. A regulatory framework provides the parameters within which production and distribution takes place, in this case, buying and selling takes place (Nii K. Sowa, 2007). From interviews and questionnaires, it is revealed that there is no regulatory framework for the establishment of a private equity secondary market in Ghana. In a conversation with an official at the Securities and Exchange Commission, he stated:

"Currently, we do not have any legal framework for private equity let alone a private equity secondary market. This is because private equity and venture capital usually has to do with the money of private individuals. However, we have started discussion on forming a legal and regulatory framework for which the industry can work with."

These comments serve as evidence that there is no regulatory framework in the private equity industry. With focus on a regulatory framework for a private equity secondary market, we will need to tackle issues of valuation, determination of tax basis for deal sourcing and regulations of exiting process.

An agreement of private equity transfer from one investor to another should be subject to approval by an authorized body, their review should pay particular attention to:

1. Anti-trust issues or the monopoly effects on the market
2. The amount of foreign ownership and if it meets the industry limit.
3. Handling issues of confidentiality

Valuation/Pricing

In Ghana, stocks are priced at the market value of the stock given by an accredited appraisal firm. Due to the significance of registered capital in Ghanaian companies, prices of stock to be transferred are usually tethered to the contribution of registered capital by the seller. Methods such as discounted cash flows, liquidation value, P/E multiples and replacement cost (Deng, 2013).

Tax determination of deals

A myriad of issues concerning taxation face the parties involved in a private equity secondary transaction. Ultimately, the goal was to minimize the adverse effects of taxes to the investment and investors. However in Ghana, according to The Venture Capital Trust Fund, (ACT 680), 2004, private equity funds and its transactions are exempted from paying all types of taxes, Value Added Tax (VAT) and National Health Insurance Levy (NHIL). This translates to the fact that secondaries that involve direct private equity investments do not pay tax.

In the future when a more concrete regulatory framework is in place, tax rates can be put on private equity secondaries to increase revenue for the government.

Regulating the Exiting Process

The regulation of private equity secondary market is dependent on the different methods of exiting that are in place. For the purpose of this research, only two methods of exiting and their regulatory methods was recommended.

a. Trade Sale
b. Secondary Buyout

Trade Sale

As an exit method used commonly in the private equity industry; it is a process where fund sells shares it has in a particular company to a trade buyer, usually someone in the same industry. Some regulations can be put on the trade sale method of exiting, to control the process and prevent abuse of loopholes. To prevent issues of monopolies that can arise from trade sales and promote local involvement, in the case of a foreign individual/company being the buyer purchasing stock in a Ghanaian firm, the buyer must employ the use of a special purpose vehicle (SPV) which was moved to the Ghana Alternative Exchange within a year of attaining revenue necessary for (floating). If the share of the company is targeted by a local individual/company, the new company formed can stay private.

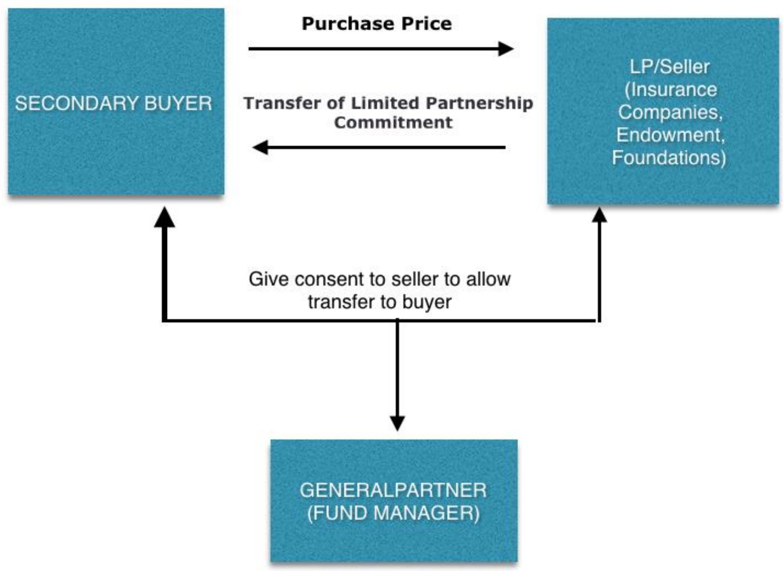

Fig. 3 Framework of Trade Sale[4]

Secondary Buyout

A secondary buyout is an exit strategy that involves to private equity funds. It is the sale of private-equity owned companies to another private equity firm. Secondary buyouts is most likely to be the method employed by private equities to acquire and release interests in companies. Secondary buyouts give rise to opportunity of attractive investments to private equity firms that have huge capital and opportunity to add value to a similar asset being held by another private equity firm. The process of secondary buyouts can go on forever with a continuous addition

[4] The Private Equity Secondaries Market, 2008

of value to the target company. Secondary buyouts made in the early life of the investment tend to have higher returns. I suggest that targets of secondary buyouts remain private since returns are as high as returns earned through public listing (Degeorge, 2009).

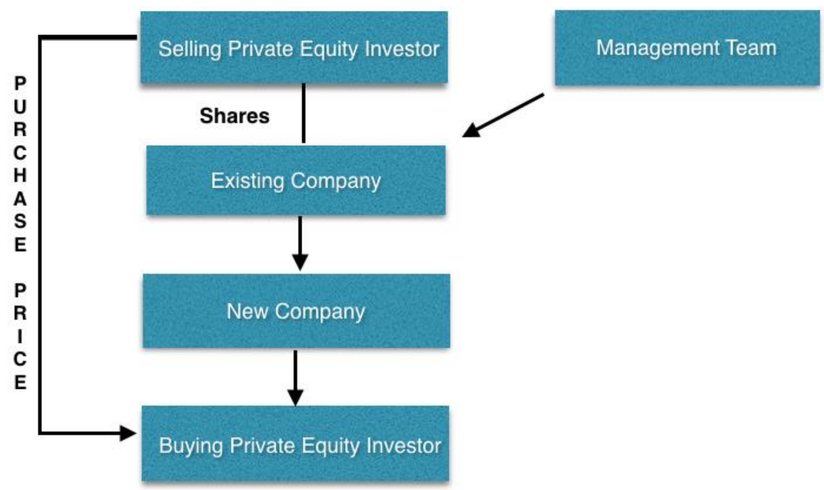

Fig. 4 Framework for Secondary Buyout.[5]

Process

As stated earlier, the development of a private equity secondary market is necessary due to a large number of potential transactions. A buy-out/transfer of private equity involves three steps.

1. Equity/Shares
2. Acquisition

[5] Secondary buyouts and the maturity of the private equity industry

3. Financing

Equity/Shares

This is an agreement between the new company and the the target relating to the action of making or agreeing to make an advance payment in order to receive for shares.

Acquisition

It is when interest expressed by the new company in the acquisition of the target is approved by the target.

Financing

This step involves negotiations and discussions between the new company and financiers for the acquisition of the target.

Provision of Business Information Memo

The first step is for the target company to provide information on the business. This information will contain the background of the target (vision and mission), financial records and past performance as well as projected performance after the introduction of extra funds. The presentation of this document should be done in the initial stages of the transaction.

The owners of the new company will choose their own accountants and auditors to review the business information if they decide to,however the review can be carried out themselves. This review is needed so as to challenge, recalculate and test the feasibility of projections. The transaction will be taken further after if the investment presents agreeable returns.

Provision of Equity Term Sheet

After the owners of the new company have agreed to continue with the process, a term sheet is drafted. A term sheet is “a document that outlines a potential agreement between an investor and a company. The investor agrees to invest private equity in the company in return for preferred stock” (DocStoc Inc, 2013). The term sheet will contain an exclusivity and confidentiality provision granting the new company a period of time where the target company and its management decide to not negotiate with other potential investors concerning the transaction. This might help transactions in the private equity industry maintain a sense of privacy.

Performance of Due Diligence

The next step is for the buyers of the target company to perform due diligence on the target company. Due diligence is a further step to measure the attractiveness of the opportunity. This process will involve reporting on the target company’s financial reports, it’s assets and properties, insurance schemes and macroeconomic conditions of the industry in which the target company operates in. Negotiations will take place during the period of due diligence.

Swap of Contracts

The climax of the buy-out/transfer process is the exchange or swap of contracts with respect to all the three steps of the transaction.

Transfer of Equity/ Debt

Depending on what the buyer uses to fund the transaction, different lines of actions need to take place. Should the buyer use equity, an agreement binding all parties will be signed and interests are sold to buyer, money however will not be given to the sellers till the completion of the transaction, this is a measure to keep in check fraudulent issues. The agreement will have to specify that save the transfer of payments for equity, the agreement is completed. In the case of debt financing for the target company, a bank debt facility will have to be signed and swapped between all parties. The bank will provide the financing upon completion and presence of necessary conditions as stated above.

Acquisition

The signing of the agreement of acquisition of the target company by the new company takes place after issues of financing have be sorted out. The agreement will bind both parties from the date that it will be signed. The agreement will contain a warranty on the date of acquisition and completion. A disclosure letter will be attached to the agreements to qualify the warranties.

Completion

After all pending conditions have been fulfilled, the process will start and management of the new company will transfer payment (debt or equity) to the owners and management of Target Company, acquisition is then complete.

After Completion

This stage of the process will involve transfer of remaining documents, authentication of transfer of assets occur and tax duties are fulfilled, the transfer of intellectual and real property also take place depending on earlier negotiations (Ashurst LLP ,2013).

Conclusion

The aim of the research was fulfilled as the feasibility of developing the private equity secondary market in Ghana was analyzed. Notably, the research has shown that there is currently no legal and operational framework that will allow for a development of a private equity secondary market. The study also revealed that the Securities and Exchange Commission is at the moment, working on a legal regulatory framework that will make the development of a private equity secondary market possible in Ghana.

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APPENDIX

INTERVIEW QUESTIONNAIRE

1. Please state your occupation: …………………………………………………………………..

2. What do you understand a private equity secondary to be?
   ……
   ………………………………………………………………………………..

3. Are you familiar with a private equity secondary?
   Yes/No

4. Is your company involved in any private equity secondary transactions?
   Yes/No

5. If yes to Question 4, How many transactions?
   a. $1m -$2m b. $2m-5m, c.$5m and above

6. How many un-exited private equity deals, do you currently have?
   a. $1m -$2m b. $2m-5m, c.$5m and above

7. How possible do you think it will be to develop a private equity secondary market in Ghana?
   a. Very Low b. Low c. Medium d. High e. Very High

8. Will you be open to the idea of developing a private equity secondary market?
   Yes/No

9. What are your reasons?

Research Interview Guide

Thesis Topic: AN INVESTIGATION INTO THE FEASIBILITY OF AN INSTITUTIONALIZED PRIVATE EQUITY SECONDARY MARKET FOR INVESTORS.

The interview is for academic purposes only. Your response is important and will aid the purpose of this academic research.

Date: ____.

Q1. Is there a legal framework present in your company for the trading of private equity secondaries? If not, why and are plans being made to create a legal framework?

………
………
………
……………………………………

Q2. Is the Ghanaian economy ready for the development of a private equity secondary market?
………
………
………
……………………………………

Q3. Is there an operational framework present in your company for the trading of private equity secondaries? If not, why and are plans being made to create an operational framework?
………
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