



Promoting Venture Capital Business in Egypt

FINAL REPORT

**Prepared By: Jo Anne Heywood Miller
Financial Services Volunteer Corps**



July 2-6, 2006



**Egypt/Canada
Small and Medium Enterprise Policy Development Project**



Canadian International Development Agency (CIDA)



International Development Research Centre (IDRC)



Financial Services Volunteer Corps (FSVC)

Executive Summary

The Venture Capital/Private Equity Industry in Egypt is still in its early stages with 13 Egyptian-registered VC firms. There are several VC and Private Equity firms that are operating in Egypt, but are registered elsewhere and there is a focus on the Middle East and North Africa region. The Financial Services Volunteer Corps has co-sponsored a project to promote the Venture Capital Business in Egypt and to support the growth of Small and Medium Size Enterprises (SMEs) as a way of stimulating economic growth and development. During the period July 2-6, 2006, I had the opportunity to interview seven Venture Capital/Private Equity companies, one VC/PE Association, the head of the Cairo-Alexandria Stock Exchange, and the Vice Chair of the Capital Market Authority in the Ministry of Investment as well as participate in an all-day roundtable that included these same constituencies as well as representatives of the Ministry of Finance, USAID, IMC/European Commission and some other VC firms. The focus of the Roundtable was to review the original 2004 study of the issues with the VC industry in the context of the SMEs, the work of the VC committee that has been established by the Ministry of Finance to work the issue of establishing a venture capital company/ fund for SMEs and to discuss the previously identified constraints from the Legal side as well as the VC supply and demand perspectives. The result of these activities is to help the VC committee focus on the most critical issues to address in order to encourage the growth of Venture Capital/Entrepreneurship in Egypt, in addition to the possible formation of a fund to support SMEs.

Although there were many opinions/concerns expressed during the interviews there was a consensus that the **legal and regulatory environment** is a major impediment to the growth of VC/PE industry. Enforcement of Intellectual Property Rights (IPR), structuring of VC funds, shareholder rights and other deal terms need to be brought in line with the laws and regulations of major financial centers including British Virgin Islands(BVI), Luxemburg, Bahrain, Dubai as well as the US and UK. It is recommended that the VC committee ensure that a review of the actual laws and regulations of these countries occurs, propose changes to existing Egyptian laws and regulations and ensure that there is a lobby for those legal changes, recognizing that the VC Committee is not an operating entity.

A second area of consensus is around the **human capital** requirement for better trained/experienced management teams for portfolio companies at all stages, especially those that are in a major growth or turnaround phase. The scarcest management resource seems to be experienced Chief Financial Officers. Conversations around the management topic opened up the whole issue of Egyptian higher education. It is recommended that the VC committee be expanded to include a representative from the Ministry of Higher Education and Scientific Research. I also suggest that the management training programs of the multinational corporations that have major operations in Egypt be surveyed to see if any might be available to non-employees as a way of further stimulating the growth and development of SMEs. The VC committee should ensure that this work is accomplished.

Other recommendations based on the interviews and my previous experience would be to 1) Nurture/encourage those VCs/Associations who are seeking to encourage entrepreneurship in Egypt and also to increase deal flow as they hold business plan competitions or venture conferences. Encouraging entrepreneurship is critical to growing the VC industry. Without entrepreneurs there is no need for a VC industry. 2) Ensure that there is an effective communication channel among the VC/Private Equity firms and between the entrepreneurs and the VC/Private equity companies; 3) Review and recommend potential changes in the tax laws as a way to provide greater incentives for R&D as well as Venture Capital investment; 4) Consider organizing an SME incubator in conjunction with the creation of an

SME-focused fund. While there is currently an IT-focused incubator, ensuring that the services of an incubator are offered to ALL SMEs I believe would be very helpful; 5) Set numeric goals for the next 5 years in terms of amount of money to be invested in VC deals, number of companies funded, number of exits, etc that are aggressive, but attainable. The VC committee should then ensure that there is an entity that can track and publish the statistics on a regular basis; 6) Work with the Cairo Alexandria Stock Exchange (CASE) to find a suitable 'pilot' company to be listed on their new secondary market. This would be to ensure that a suitable company and listing agent are identified to meet the requirements of CASE for a successful initial listing on the just-created secondary market.

Roundtable Issues

The Roundtable on Promoting Venture Capital in Egypt was set up as one of several parallel activities of the sponsoring organizations to encourage the growth and financing of Small and Medium Size Enterprises. Three major topics were covered that had been previously identified as constraints to the growth of the Egyptian Venture Capital Industry – Legal and Regulatory Issues, VC Supply Side (low number of Venture Capitalists and exit/liquidity opportunities) and VC Demand Side (where are the entrepreneurs and business opportunities?). It was a full day of discussion held on July 2, 2006.

One of the first items addressed at the conference was the question - 'what is Venture Capital and how does it differ from Private Equity'? As a working definition, we agreed that Venture Capital is a component of Private Equity, usually representing the early stage, high-risk, high-reward financing that start-up enterprises utilize to launch and grow their businesses. All phases of private equity financing are important to the growth and development of SMEs, but early stage money is the focus. Venture Capital/Private Equity is part of an ecosystem that is centered on entrepreneurs and also includes the sources of funds (limited partners, other investors), universities, government research laboratories, banks, experienced managers as well as a long list of various service providers. Entrepreneurs and good business ideas are critical to the Venture Capital industry. While entrepreneurs can find alternative sources of funding, VCs make their money from finding entrepreneurs with good ideas and investing risk capital.

Venture Capital/Private Equity is increasingly a global industry with the recognition that entrepreneurs and excellent business ideas exist all over the world. Many US VC firms have recently launched offices in China and India. New Enterprise Associates, one of the oldest US Venture Capital firms has just raised a new fund of over \$2Billion to allow expansion into China and India. Intel Capital has announced a focus on the Middle East and is co-sponsoring the July 12th Business Plan competition with IDEAVELOPERS in Cairo. Venture Capital is also local and each region must focus on those industries that are strong in their own area. For example, Spokane, Washington in the US has been able to sustain a local VC/entrepreneurial focus on biotech based on the strength of local research hospitals and universities. As the VC/PE industry in Egypt moves forward, it needs to focus on those business opportunities that are locally strong.

If the local legal and regulatory environment is not supportive, venture capitalists will establish funds and operate in other regions. This seems to be occurring in Egypt. At least some of concerns about the supply side of Egyptian venture capital can be attributed the current legal/regulatory situation. A VC/PE industry also needs liquidity/exit opportunities in order to thrive. There was considerable conversation during the roundtable about the need in Egypt for a second capital market to allow small companies to

list. The Cairo-Alexandria Stock Exchange (CASE) is ready to launch such a secondary market, so a first Egyptian IPO may be within sight. There are other markets around the world and of course mergers/acquisitions remain the largest exit opportunity for the global VC/PE industry.

Action Plan

The two key areas recommended for action by the VC Committee are: 1) the legal and regulatory environment and 2) human capital improvement.

Enforcement of Intellectual Property Rights (IPR), structuring of VC funds, shareholder rights and other deal terms need to be brought in line with the laws and regulations of major financial centers including British Virgin Islands(BVI), Luxemburg, Bahrain, Dubai as well as the US and UK. It is recommended that the VC committee ensure that a review of the actual laws and regulations of these countries occurs, propose changes to existing Egyptian laws and regulations and ensure that there is a lobby for those legal changes, recognizing that the VC Committee is not an operating entity. The Capital Market Authority is working in these areas and the VC committee should verify that the CMA has reviewed the laws and regulations of the major global financial centers and have proposed appropriate changes. It is also recommended that the VC committee work with one of the fledgling VC/PE Associations, such as the Arab Private Equity Association to provide a focused lobbying effort.

There is a strong human capital requirement for better trained/experienced management teams for portfolio companies at all stages, especially those that are in a major growth or turnaround phase. This is an action that can improve the demand side of venture capital. The scarcest management resource seems to be experienced Chief Financial Officers. While CFOs can be imported with the appropriate incentive packages, special training for those with financial and accounting degrees should also be considered. Conversations around the management topic opened up the whole issue of Egyptian higher education and how the existing university education can be strengthened. It is recommended that the VC committee be expanded to include a representative from the Ministry of Higher Education and Scientific Research to ensure that these issues of higher education are covered in the future actions. As a way of improving the specific management training, I suggest that the management training programs of the multinational corporations that have major operations in Egypt be surveyed to see if any might be available to non-employees as a way of further stimulating the growth and development of SMEs. The VC committee should ensure that this work is accomplished. The multi-nationals represent a resource that at least IDEAVELOPERS has started to tap.

Other recommendations for action based on the interviews and my previous experience would be to 1) Nurture/encourage those VCs/Associations who are seeking to encourage entrepreneurship in Egypt and also to increase deal flow as they hold business plan competitions or venture conferences. Encouraging entrepreneurship is critical to growing the VC industry. Without entrepreneurs there is no need for a VC industry. In the US, VC associations, such as the National Venture Capital Association and the Angel Capital Association have helped the industry to grow, been the lobbying arm (for better tax treatment of options for example) and have been the focus of data on the industry . 2) Ensure that there is an effective communication channel among the VC/Private Equity firms and between the entrepreneurs and the VC/Private equity companies. The VC/PE Associations can also fill this need as can others who use the web to inform and communicate. In the US there are numerous non-profit groups of entrepreneurs and early stage ‘angel’ investors that run meetings and venture conferences as well as provide regular

communication; 3) Review and recommend potential changes in the tax laws as a way to provide greater incentives for R&D as well as Venture Capital investment. As the CMA reviews and introduces new regulations and legal structures, tax incentives may be next on the list to encourage new entrepreneurs and VCs; 4) Consider organizing an SME incubator in conjunction with the creation of an SME-focused fund. While there is currently an IT-focused incubator, ensuring that the services of an incubator are offered to ALL SMEs I believe would be very helpful. Incubators/business accelerators can take many forms. In the US these range from public/private/university partnerships to for-profit businesses. The most successful models have focused on services to entrepreneurs and costly labs for biotech start-ups ; 5) Set numeric goals for the next 5 years in terms of amount of money to be invested in VC deals, number of companies funded, number of exits, etc that are aggressive, but attainable. The VC committee should then ensure that there is an entity that can track and publish the statistics on a regular basis. Again, this is an area that the VC associations could fill. In the US a number of accounting firms and legal firms as well as the news media that service the entrepreneurial/VC community provide periodic tracking and publishing of statistics; 6) Work with the Cairo Alexandria Stock Exchange (CASE) to find a suitable 'pilot' company to be listed on their new secondary market. This would be to ensure that a suitable company and listing agent are identified to meet the requirements of CASE for a successful initial listing on the just-created secondary market. There is strong interest on all sides in having this first listing be successful. The VC/PE Associations could be considered as sources for recommending a first listing company, but the VC Committee may need to work directly with the later stage PE firms to identify an appropriate pilot company for listing.

Conclusions

Although the VC/Private Equity industry is still very young in Egypt, I was very encouraged by the strength openness and enthusiasm of the participants that I met with. They have found ways to establish funds in Egypt, the Middle Eastern North Africa region, or elsewhere, to fund companies and find exits that are sufficiently attractive to their principals and shareholders. I was also very pleased to see a little early stage work starting with an upcoming Business Plan Competition with co-sponsorship from as established a VC firm as Intel Capital. I look forward to the further development of both entrepreneurs and VCs in Egypt over the next several years.