POLICY BRIEF

Creating an enabling environment for private equity funds in Uganda

Policy proposals for public policymakers

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KEY MESSAGES

- Private equity could be a significant driver for private sector growth, providing a source of long-term financing and growth expertise to Ugandan companies – thus resolving two of their main constraints to growth.
- Local investors, such as the National Social Security Fund (NSSF), are keen to invest in Ugandan private equity funds.
- The current legal, regulatory and tax environment, however, prevents the emergence of a local private equity industry, with only one private equity fund domiciled in Uganda.
- This report makes recommendations to address the following major public policy bottlenecks for private equity funds seeking to domicile in Uganda: (i) the lack of appropriate vehicles to register as, (ii) the double taxation of private equity funds, and (iii) the need for light-touch regulations specific to private equity funds.

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INTRODUCTION

Access to capital is widely understood to be one of the biggest constraints to business growth in Uganda. However, the private equity industry that could provide this much-needed growth capital is itself constrained by ineffective government policies, which this policy paper aims to address. Private equity would provide not only capital for companies to grow, but also expertise, which represents another big challenge faced by companies.

"Private equity investments have a considerable impact in terms of productivity, skills development, job creation, and social impact, as it includes the transfer and exchange of know-how, access to a broader network, and not merely the flow of capital."

Into Africa, Private Equity: Nurturing Africa, 2019

Although there is substantial demand from local investors to invest in Uganda private equity, and therefore in Ugandan companies, this segment of the market remains underdeveloped. This is because Uganda's laws and regulations have not been designed with private equity in mind, which has hampered the development of the industry in Uganda. Yet, there are concrete policy changes that would have a substantial impact on the industry. Therefore, ***this report is intended for public policymakers and concentrates on strategic regulatory and policy reforms with substantial potential development impact that have the overarching goal of encouraging more private equity funds to domicile[1] and source investments in Uganda***.

This is important as private equity has the potential to have a substantial impact on private sector growth and job creation by providing an alternative source of financing that is much better suited than bank lending for high-growth potential Ugandan companies.

Summary of the identified reform proposals

1. Create adequate vehicles private equity funds can register as

Company or partnership structures can be used as vehicles for private equity funds. Most private equity funds globally are registered as partnerships. The Ugandan Partnership Act, however, remains untested and commercial funds are not willing to incur the cost of checking whether the Act creates appropriate vehicles for private equity funds. The Partnership Act should be reviewed to assess its appropriateness and result in either a guide for private equity funds to use or amendments to the Act.

Furthermore, the Capital Markets Authority Act (or CMA Act) stipulates that private equity funds[2] are registered as a company in Uganda and therefore does not give the option for private equity funds to use a partnership as their vehicle. Therefore, the CMA Act should be amended to allow private equity funds to register as either a partnership or a company.

2. Remove double taxation on private equity funds

Because Ugandan private equity funds are taxed as normal corporate entities, they face double taxation on their investments, making them unattractive for investors. For example, because the Yield Fund creates an additional layer of taxation, investors face a 65 per cent effective tax rate on their investments from corporate tax and withholding tax on dividends. As this additional layer of taxation for private equity funds disincentivizes their use, it should be removed by creating a tax transparent status for private equity funds that are licensed by the Capital Markets Authority.

[1] Domiciling means that the fund is registered as an entity in Uganda under the Partnership Act or the Companies Act.

[2] Referred to as registered venture capital funds under the CMA Act 2016.

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3. Create private equity-specific regulations

Currently there are no private equity-specific regulations, which creates uncertainty and reduces trust in the industry. The industry itself is requesting regulations for private equity fund managers and private equity funds in order to help the industry develop and generate trust in the private equity industry. Therefore, the Capital Markets Authority should develop private equity-specific licensing regulations.

4. Allow pension funds to temporarily invest in foreign private equity funds that invest only in East African companies

The above reforms will take time to be implemented and there is already appetite on the part of Ugandan pension funds, especially NSSF, to invest in Ugandan companies through private equity funds now. However, pension funds are restricted to investing only in East African Community assets, which means that, for example, NSSF would not be allowed to invest in a private equity fund that is domiciled abroad, even if the fund only invests in Ugandan companies. Therefore, the Uganda Retirement Benefits Regulatory Authority (URBRA) should temporarily[3] amend its investment guidelines to allow pension funds to invest in foreign domiciled private equity funds that invest only in East African Community companies.

Note: This report does not address the challenges faced by foreign private equity funds in investing in Ugandan companies. These and other challenges faced by the private equity industry – such as the general business environment, the entrepreneurial ecosystem and the investment-readiness of companies – will be addressed in subsequent reports.

3 Until the above-mentioned reforms have taken effect.

THE POTENTIAL IMPACT OF PRIVATE EQUITY ON THE UGANDAN ECONOMY

Private equity funds invest in high-growth-potential companies

Private equity invests in private companies (rather than companies listed on the stock exchange) through debt, quasi-equity[4] and equity investments. One of the main vehicles for private equity investments is private equity funds, which pool the funds of multiple investors such as pension funds, development finance institutions or high net worth individuals. These funds are typically managed by private equity fund managers, who manage all aspects of fund operation from investment to divestment.

There are a variety of private equity fund investment strategies, including investing in specific sectors (e.g., agriculture or manufacturing) or in companies at a particular stage of development (e.g., start-ups or small and medium-sized enterprises [SMEs]).

SME growth creates employment and economic growth

With a growing population, Uganda requires exponential employment growth opportunities, which the private sector, for many reasons, struggles to provide. Access to finance is key among these challenges as lack of finance holds back the growth of SMEs, limiting employment opportunities, tax payments and economic growth.

Bank finance is of limited help to high-growth-potential SMEs

Regulation and limited credit risk appetite limit what banks can offer SMEs, particularly in terms of long-term financing.[5] ***Private equity offers a potential alternative source of flexible, long-term financing better suited to growth-oriented Ugandan companies***.

Private equity funds help high-growth-potential SMEs grow faster

Private equity funds usually have notable "capital-plus" strategies where capital investments are complemented with hands-on management expertise, helping investee companies' grow, improve operations and meet tax and registration requirements.

Private equity funds have a strong interest in helping companies to grow as much as possible, as this allows private equity funds to sell their stakes in the investee companies at a higher profit when they exit.[6] As a result, many private equity funds that operate in Uganda combine their investments with technical assistance facilities that provide their investee companies with the expertise they need to succeed.

Note: Private equity investors require their investee companies to be fully compliant with their regulatory and tax obligations. This is because private equity funds are regulated entities themselves and the risk of regulatory action against their investee companies could have substantially negative impacts on their profits, as well as their reputation.

Therefore, the potential access to private equity financing would encourage more companies to formalize and pay their taxes, which has been one of the major challenges faced by the government.

[4] Quasi-equity means that the capital has both debt and equity elements (e.g. a convertible note, which is considered debt until it converts to equity).

[5] Banks have high collateral and other requirements that most SMEs cannot meet and the interest rates that banks charge for SME loans are above 20 per cent as banks perceive SMEs as risky. Furthermore, loans are usually too short-term to allow a good return on investment before the loan needs to be repaid.

[6] This is different from banks, whose profits are fixed by the interest rates they charge. Banks are mainly interested in whether companies can pay back their debt, rather than in their growth.

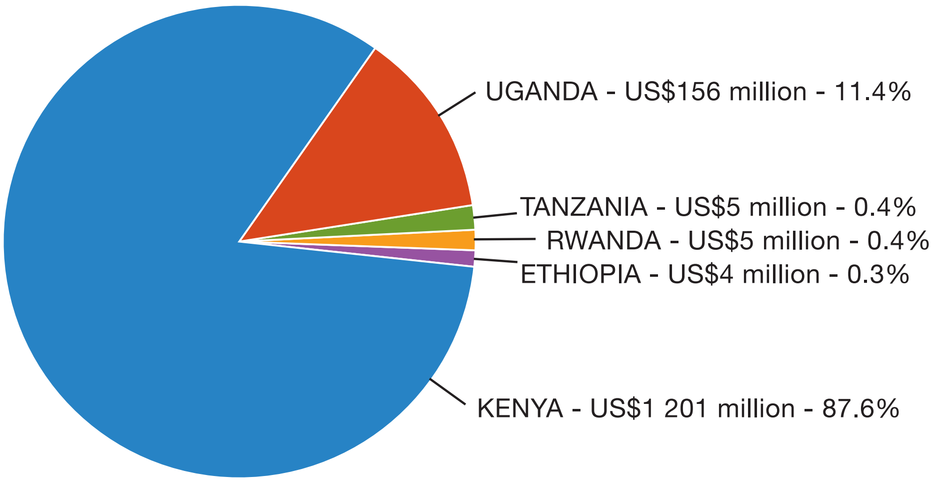
TRENDS IN PRIVATE EQUITY

Current investments from private equity in Uganda are extremely limited in number relative to need and opportunity available, according to the consultancy firm BSpace.[7] With one private equity fund domiciled in Uganda, the Yield Fund, and only 78 private equity deals between 2010 and the first half of 2019, the Uganda equity market is notably underdeveloped.[8]

A negligible fraction of global private equity funds is invested in Uganda. Of the US$6.4 trillion of private equity funds raised globally between 2007 and 2018, 0.5 per cent (US$33.1 billion) was earmarked for Africa, with 0.09 per cent (US$3.3 billion) for East Africa. Even within East Africa, Uganda receives only a small proportion of private equity investments, attracting only 11 per cent of the US$1.4 billion invested between 2017 and 2018 – primarily in health care and agribusiness.[9]

However, interest in Ugandan private equity is growing, on the part of both foreign investors and Ugandan investors, which is an opportunity that should be fully harnessed in order to improve access to finance and expertise for Ugandan companies. It also raises the question about what reforms are necessary to grow the private equity industry in Uganda.

Figure 1
Private equity investments in East Africa by country between 2017 and 2018



Source: KPMG and EAVCA, Private Equity Sector Survey 2017 and 2018, June 2019

THE YIELD FUND, ITS EXPERIENCE AND REFORM PROPOSALS

The Yield Fund is a private equity fund that invests in small and growing agribusinesses in Uganda along the agricultural value chain. Unlike many private equity funds, the Yield Fund has an impact-first mandate, meaning that it can take risks that commercial funds may not be able to, such as domiciling in Uganda under the current regulatory framework. Managed by Pearl Capital Partners, the fund was launched in 2017 with an initial investment of EUR 12 million from the National Social Security Fund (NSSF, the only Ugandan pension fund investing in a private equity fund) and the European Union, through the International Fund for Agricultural Development (IFAD). The Yield Fund grew to EUR 20 million in 2019 through investments by the Open Society Foundations and Finn Church Aid Investments.

[7] BSpace, Mapping the Impact investment Space in Uganda, 2016. BSpace was looking specifically at venture capital and impact investing, which are sub-sets of private equity.

[8] KPMG and EAVCA, Private Equity Sector Survey 2017 and 2018, June 2019.

[9] KPMG and EAVCA, Private Equity Sector Survey 2017 and 2018, June 2019.

The Yield Fund offers long-term capital investments through equity, quasi-equity, and debt instruments that allow investee companies to focus on growth, which short-term debt does not allow. Recognizing the need to support the growth of investee companies, the Yield Fund develops a business development support plan for each company.[10] This ensures investee companies have the tools and expertise for their growth ambitions while meeting tax and registration requirements,[11] which allows for a profitable sale of investments by the Fund.

While the Yield Fund has been successful in its approach, it has confronted numerous challenges as well, especially with respect to government policies, as described below. The assessment of these challenges offers valuable lessons for overcoming bottlenecks in the development of a more dynamic private equity industry in Uganda.

There are other challenges the Yield Fund and the private equity industry face, such as the lack of investment-ready companies. However, as this report is aimed at public policymakers and what policy changes would have concrete effects on growing a local private equity industry, these challenges will be discussed in future reports.

CHALLENGE I – LACK OF APPROPRIATE VEHICLES FOR PRIVATE EQUITY FUNDS

Uganda lacks appropriate legal entities for private equity funds to register as under the Partnership Act or the Companies Act in Uganda.

Private equity funds pool multiple investors' capital to invest in private companies (see figure 2). ***The pooling of capital allows individual investors to diversify their risk (i.e. to hold smaller investments in multiple companies). Pooling also allows investors to employ dedicated professional fund managers. Private equity funds should therefore be seen as "pass-through entities"*** that channel investor funding into multiple companies as opposed to a single business.

Therefore, private equity funds are different from normal companies that sell products or offer a service. The management of the fund is a service; however, this is offered by a separate entity, a fund manager that is hired by the private equity fund and paid a fee for its services.[12]

Most private equity funds globally are established as limited liability partnerships (LLPs), which, in addition to management benefits, creates specific tax advantages in that partnerships themselves are not taxed. Rather, the partners (i.e. the investors) are taxed on income gained from the partnership based on their individual tax status. This avoids double taxation. (See Challenge II below.) The partnership structure also limits investor liability[13] to their fund investment, while the fund manager[14] carries liability.

Most private equity funds operating in East Africa are domiciled in Mauritius, where they are structured as companies rather than partnerships. The Mauritian Companies Act offers significant flexibility in this respect and allows the creation of private equity vehicles as companies.[15] The Ugandan Companies Act, by contrast, does not offer this flexibility.

10 The European Union funds the Business Development Support Facility, implemented by IFAD for companies that the Yield Fund invests in.

11 Private equity funds require investee companies to fully comply with their tax and regulatory requirements before they invest in them because they are regulated entities and do not want to bear the risk of legal action against an investee company due to a lack of regulatory compliance. Building a private equity industry in Uganda would encourage more companies to formalize and pay their taxes.

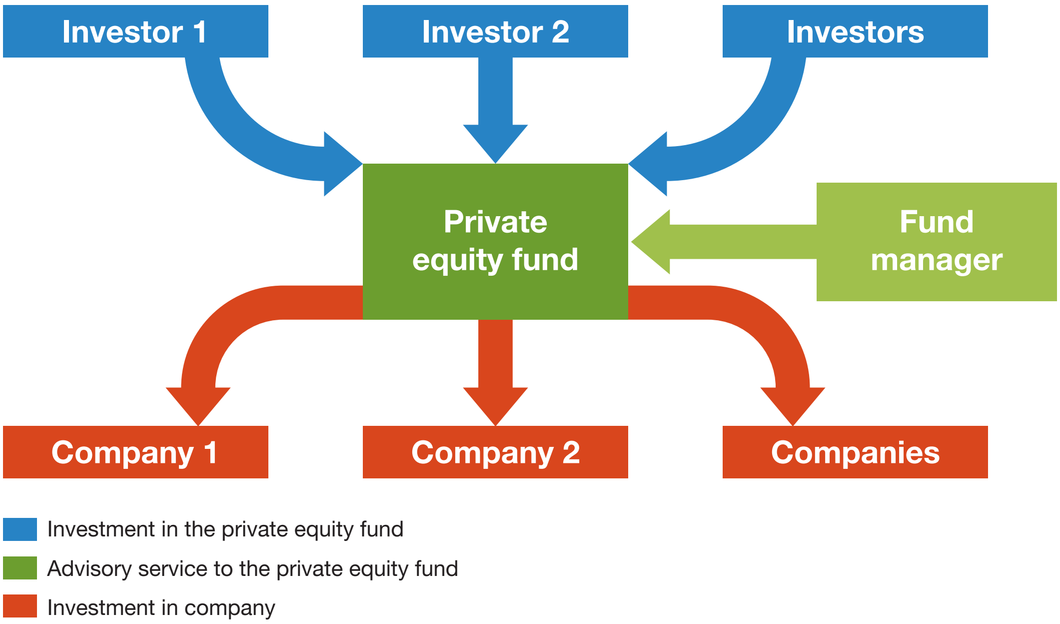
12 The fund manager usually also holds an investment in the private equity fund and its revenue is linked to the return of the fund (carried interest) to align its incentives with those of the other investors to ensure the fund manager works to maximize the return of the fund.

13 The investors in the fund are called limited partners, meaning their liability is limited to their investment.

14 The fund manager is called the general partner and carries liability, although this is usually limited to the capital of the fund manager, which is usually a limited liability company.

15 In addition to a low-tax regime, Mauritius offers a stable regulatory environment and access to high-quality services needed for the management of a private equity fund.

Figure 2
Typical structure of a private equity fund



The Yield Fund was set up as a limited liability company (or LLC) under the Companies Act 2012 because the Partnership Act 2010 had not been operationalized at the time.

This created various challenges as the Companies Act was designed with normal companies in mind and not private equity funds. As a result, the Yield Fund does not enjoy the incorporation and tax benefits of being a "pass-through entity".

Although the Ugandan Partnership Act is now operational, there is some degree of uncertainty about its utility for private equity fund formation and no private equity fund has been established as a partnership in Uganda yet. Furthermore, the CMA Act 2016 stipulates that private equity funds[16] need be registered as companies for the CMA to have the mandate to license them. As private equity funds should be licensed and regulated by the CMA (see Challenge III), it is recommended that the CMA Act be amended in order to allow private equity funds to use partnerships as a vehicle.

There were additional challenges with respect to the set-up of the Yield Fund under the Ugandan Companies Act (challenges that also apply to the Partnership Act), which resulted in several large investors declining to invest – even though they liked the Yield Fund's investment strategy. These challenges included the fact that under Ugandan law: (i) no advisory boards that sit in between the board of directors and the shareholder[17] are allowed, and (ii) no automatic liquidation of the entity after a pre-specified time period[18] is allowed – both of which are common practice in other countries.

RECOMMENDATION I

Appropriate legal structures for private equity funds could be created under the Companies Act and/or under the Partnership Act. ***As limited liability partnerships are the most widely used structure for private equity funds globally, adapting the Partnership Act would probably offer the most attractive means to private equity funds.***

[16] Referred to as registered venture capital funds under the CMA Act 2016.

[17] Directors have significant liability under the Companies Act, which is also a deterrent for foreign investors as they cannot exert enough control and do not have a trusted local professional who can sit on the board on their behalf.

[18] Private equity funds usually operate for a fixed period of time (usually 7-15 years) and then return the investment plus profits to their investors. As the time frame of the operation of the private equity fund is known already when it is set up, private equity funds require an easy liquidation process, which is not possible in Uganda and therefore significantly increases the regulatory burden and costs for the private equity fund.

There is currently disagreement within the industry over whether the current Partnership Act is appropriate for the formation of private equity funds as no one has tested it yet. Therefore, a review of the Partnership Act is required, resulting in either an amendment to the Act or a guide by a reputable law firm to show that the Act is appropriate for the formation of private equity funds.[19]

Furthermore, the CMA Act should be amended to allow for the use of partnerships for private equity funds.[20]

CHALLENGE II – DOUBLE TAXATION OF PRIVATE EQUITY FUNDS

Private equity funds face an additional layer of taxation, making them unattractive for investors.

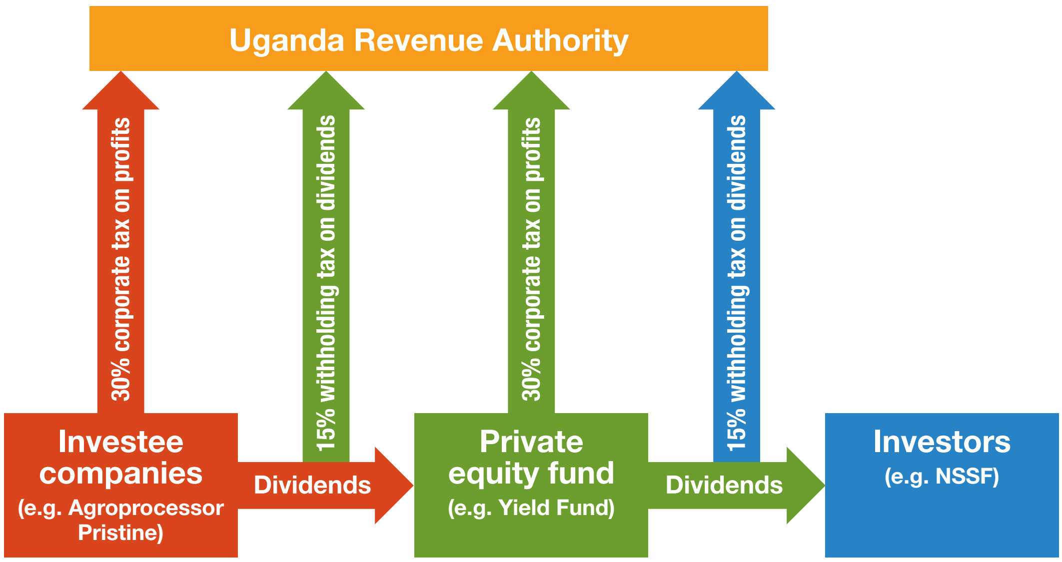
As the Yield Fund was established as a limited liability company, both the company/ fund and its investors are taxed (see figure 3). This leads to the double taxation of private equity funds in Uganda, reducing their attractiveness to investors.

The European Union insisted on a Ugandan domicile as a means of encouraging the development of a local private equity industry. Unfortunately, the limited liability company was the only available regulatory vehicle at the time, which, as noted, does not encourage the creation of Ugandan-based private equity funds. Indeed, no commercial investor considered investing in the Yield Fund, primarily because of the issue of double taxation.

Figure 3 shows how both the private equity fund and the investors are taxed on their investment income, creating an additional layer of taxation and therefore making the use of private equity funds unattractive.

Pristine Foods Ltd is an agroprocessor SME that the Yield Fund has invested in through equity. Imagine Pristine makes UGX 100 million[21] in profits, and under the current tax regime, Pristine would pay 30 per cent, or UGX 30 million, in corporate tax to URA. Pristine decides to distribute the remaining UGX 70 million as dividends to its shareholders (e.g., the Yield

Figure 3
Example of corporate and dividend taxes paid by private equity investors[22]



19 It is important to create confidence in the Partnership Act and develop a guide on how to use it to establish private equity funds in Uganda as the cost of testing the act is too high for an individual private equity fund to carry.

20 As the CMA Act is amended, the definition for registered venture capital funds should also be extended to include all types of private equity funds and remove the restriction on the types of financial instruments used by the fund. All private equity funds should be licensed and regulated by the CMA.

21 The profit and dividend amounts are an example for illustrative purposes and do not refer to the actuals.

22 Under a corporate vehicle structure.

Fund),[23] on which it is obliged to withhold 15 per cent of the dividend, or UGX 11million, and pay it to the Uganda Revenue Authority (URA).

Therefore, the Yield Fund receives UGX 59 million in revenue, on which it is obliged to pay 30 per cent, or UGX 18 million, in corporate tax to the URA.[24] The Yield Fund then pays the remaining UGX 42 million of its profits to its own investors, for example to NSSF. The Yield Fund needs to withhold 15 per cent of the dividend, or UGX 6 million, and pay it to the URA.

This leaves investors, such as NSSF, with UGX 35 million in profits from an initial profit of UGX 100 million, while UGX 65 million is paid in taxes to the URA (an effective tax rate of 65 per cent).

Similar double-taxation rates apply to capital gains tax and stamp duty, making private equity funds highly tax inefficient in Uganda, especially compared with tax havens such as Mauritius.

It is unlikely that removing double taxation on private equity funds alone would be sufficient to attract a rush of regional or African private equity funds to domicile in Uganda.[25] However, it would go a long way towards encouraging Ugandan private equity funds that source investments from local investors (for more discussion on investors, see Challenge IV) to domicile in Uganda.

Furthermore, the capital gains tax rate of 30 per cent is high compared with jurisdictions that attract more private equity investments[26] and does not take into account inflation or transaction costs.

For example, if the Yield Fund bought shares in Pristine Food Ltd worth UGX 100 million in 2021[27] and were to sell them in 2031 at UGX 150 million, the Yield Fund would need to pay 30 per cent in capital gains tax on UGX 50 million to the URA, amounting to UGX 15 million. This would leave the Yield Fund with a nominal profit of UGX 35 million. However, assuming a 5 per cent inflation rate per year, the profit is only worth UGX 21 million in today's money. In addition, the Yield Fund would need to pay 1 per cent (UGX 1.5 million) in stamp duty on the value of the transferred shares to the URA as well as transaction costs for the due diligence and the lawyers, which would reduce its profits even further and therefore make the investment unattractive.

Therefore, the high capital gains tax creates a strong disincentive for investors to invest in Ugandan companies, which can partly explain the higher private equity investments in Kenya, which has a capital gains tax of 5 per cent.

RECOMMENDATION II

The Ministry of Finance, Planning and Economic Development should create a tax transparent status for private equity funds by removing additional layers of taxation.[28] In order to close potential tax avoidance loopholes, private equity funds should be licensed by the Capital Markets Authority in order to qualify for the tax transparent status.

As there is currently only one private equity fund domiciled in Uganda, no significant tax loss is expected for the government. Instead, the increased investment in Ugandan companies would lead to higher corporate tax collections.

23 For simplicity, it is assumed that the Yield Fund is the only shareholder, while in reality the Yield Fund is only a minority shareholder. Under the Ugandan tax code, an entity is exempt from dividend tax if it owns more than 25 per cent of the voting shares. However, private equity investors usually hold less than this.

24 This is assuming that there are no expenses – usually the fund manager charges around 3 per cent annually on assets under management.

25 Even after the double taxation has been removed, levels of taxation in Uganda remain high, especially compared with tax havens such as Mauritius. Furthermore, Uganda's fund management services industry remains underdeveloped.

26 Capital gains tax is 5 per cent in Kenya and 0 per cent in Mauritius.

27 This is a fictitious transaction to illustrate an example.

28 A tax transparent status would mean that the private equity fund itself is not liable for tax, but its investee companies and its investors would still be liable for tax. This tax transparent status should be applicable to all CMA-licensed private equity funds no matter what the structure.

CHALLENGE III – LACK OF REGULATORY FRAMEWORK FOR PRIVATE EQUITY

There are no specific regulations for private equity in Uganda even though most countries regulate private equity. International best practice regulations for private equity[29] are specific to the industry and "light-touch" in order for them to be effective, both in terms of protecting investors and financial stability and by allowing private equity funds to operate without excessive regulatory burdens.

In the European Union, for example, private equity is regulated under the Alternative Investment Fund Managers Directive; in the United States, they are regulated under the Dodd-Frank Act.

In Africa, the Mauritius Financial Services Commission regulates private equity via the Securities Act and the Collective Investment Schemes and Closed-end Funds Regulations. Kenya is in the process of developing its own private equity regulations.[30]

Although Kenya's private equity market is more developed than Uganda's, Kenya faces similar challenges. As in Uganda, "in Kenya […] the lack of modern private equity legislation means that the establishment of private equity investors and the investments that they make are governed by a multiplicity of legislation and regulations, but without clear fund structures or a favourable tax regime that private equity investors would obviously prefer."[31]

The Yield Fund is licensed under the Capital Markets Authority Act 2016; however, as noted, there are no licensing regulations for private equity funds. Pearl Capital Partners, the Yield Fund's manager, is licensed under fund manager licensing requirements designed for collective investment scheme fund managers that invest in publicly listed securities, which, for a variety of reasons, is not appropriate for privately held company investments.[32] The absence of specific private equity regulations and the use of irregular regulatory mechanisms creates uncertainty in the industry, so much so that it discourages equity fund formation.

"***Increased regulatory oversight of the asset class also engenders investor confidence***. Institutional investors, particularly in markets where private equity is nascent, are less comfortable investing in an asset class that is unregulated. Thus, more oversight can increase the flow of capital into the asset class from such investors."[33] This was confirmed during interviews with private equity fund managers and investors such as NSSF who are actively requesting private equity-specific regulations.

Uganda should harmonize any equity fund regulations with the developing Kenyan regulatory framework, avoiding costly replication of effort. It should also reduce information barriers to international investors (i.e., facilitating a "two for one" country cost of assessing regulatory considerations).

RECOMMENDATION III

The Ugandan Capital Markets Authority should develop licensing regulations for private equity in coordination with the Kenyan Capital Markets Authority specific to private equity funds and private equity fund managers.

[29] International best practice is for both the private equity fund and the fund manager to be licensed and regulated, with the fund manager facing more onerous regulations than the fund.

[30] Kenya already has venture capital regulations, i.e. for a subset of private equity funds, which give preferential tax treatment for such funds. However, these regulations are highly restrictive and have not been successful in attracting funds to register in Kenya.

[31] Into Africa, Private Equity: Nurturing Africa, 2019.

[32] Collective investment schemes may also invest in other liquid and tradable securities that are not listed on an exchange, but they would not be allowed to invest in private equity.

[33] World Bank, Survey of the Kenyan Private Equity and Venture Capital Landscape, 2018.

CHALLENGE IV – ATTRACTING UGANDAN PENSION FUNDS TO INVEST IN PRIVATE EQUITY FUNDS

An assessment of African equity investment by FSD Africa found that "***African investors such as pension funds […] are pushing for onshore centres because they are becoming increasingly interested in private equity as an asset class and are often prevented by regulation from investing in private equity funds domiciled offshore***."[34]

At the same time, the World Bank asserts that in Kenya "the most promising source of capital for private equity funds should be local domestic institutional investors, especially given their potentially catalytic role in terms of fundraising."[35] While the Kenyan financial market is more developed, the same observation applies for Uganda.

The absence of national private equity fund regulatory frameworks in the face of growing pension fund demand represents a substantial lost opportunity cost. Moreover, while Ugandan pension funds are allowed to invest in East African Community assets, they are not allowed to invest in private equity funds domiciled outside of East Africa, even if these funds invest in only East African companies.[36]

Currently NSSF is the only Ugandan pension fund to invest in a private equity fund. As noted, NSSF invested EUR 2 million (UGX 8.4 billion) in the Yield Fund. This represents but 0.1 per cent of NSSF's UGX 13.2 trillion[37] assets under management and 10 per cent of the Yield Fund's investor capital contributions. Under URBRA's investment guidelines, pension funds in the country are allowed to invest up to 15 per cent of their assets in private equity. ***As pension funds hold UGX 15.9 trillion[38] in assets under management, the pension industry could invest up to UGX 2.4 trillion in private equity, providing much-needed access to finance for Ugandan companies***.

NSSF is interested in making more private equity investments in Uganda given potentially greater returns, portfolio diversification and a mandate to invest in Ugandan companies (particularly in strategic sectors such as agricultural where NSSF struggles to invest in through its other channels). The NSSF Yield Fund investment was a strategic move to kick-start interest in private equity investment in Uganda despite profit-constraining tax structures.[39]

RECOMMENDATION IV

To facilitate more NSSF and other pension fund equity investments in Ugandan companies, tax and regulatory bottlenecks need to be addressed.

As such reforms are likely to take several years to be implemented, URBRA should consider amending its Investment Guidelines to temporarily allow pension funds to invest in foreign domiciled private equity funds that only invest in East Africa. This would increase capital available to high-growth SMEs in Uganda and help familiarize pension funds to private equity without fear of regulatory risks, laying the foundation for faster growth of a domestic private equity industry once the reforms are implemented.

34 FSDAfrica, Conduits of Capital – Onshore Financial Centres and their relevance to African Private Equity, 2015.

35 World Bank, Survey of the Kenyan Private Equity and Venture Capital Landscape, 2018.

36 Pension funds could use feeder funds that are domiciled in Uganda. However, this would add another level of bureaucracy, taxation and costs, causing the returns to be too low for it to be worthwhile. NSSF declined several opportunities to invest in private equity through feeder funds because of this.

37 As at 30 June 2020.

38 URBRA, Investment Snapshot quarter end Sep 2020.

39 Especially compared with the higher risk.

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CONCLUSION

Building a private equity industry in Uganda could have significant impacts on private sector development and job creation in Uganda as it addresses two of the main challenges faced by Ugandan companies: (i) access to growth facilitation finance; and (ii) access to growth management expertise.

Overcoming current policy and regulatory environment constraints is key to sector growth. The Yield Fund generally, and the NSSF investment in the fund more specifically, illustrate the challenges and potential for increased private equity fund formation in Uganda. The development of a suitable and best practice regulatory framework in Kenya provides an opportunity to efficiently harmonize regional equity fund regulatory frameworks to encourage more international investment into private equity in the region and Uganda.

The Government of Kenya is actively working to address these challenges in a similar manner to the recommendations given in this report. Therefore, it is recommended that the Government of Uganda coordinate and harmonize reforms with Kenya, making both countries more attractive for foreign investment in locally domiciled private equity funds.

Recommendations:

1. ***The Uganda Registration Services Bureau should review the Partnership Act 2010 to assess its appropriateness for private equity funds and either produce a guide for the private equity industry on the Partnership Act or, if necessary, amend the Act.***
2. ***The Ministry of Finance, Planning and Economic Development should create a tax transparent status for private equity funds that are licensed by the Capital Markets Authority.***
3. ***The Capital Markets Authority should develop licensing regulations specific to private equity funds and private equity fund managers and amend the CMA Act 2016 to allow for the registration of private equity funds as partnerships.***
4. ***The Uganda Retirement Benefits Regulatory Authority should amend its Investment Guidelines to temporarily allow pension funds to invest in foreign domiciled private equity funds that invest only in East African companies.***

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