

# Impacts of the COVID-19 Crisis on Private Equity Funds in Emerging Markets





The role traditionally played by Private Equity Fund (PE Fund) investments in supporting private sector development in Emerging Markets (EMs) is being challenged by the COVID-19 pandemic. This note assesses how PE Funds in EMs may evolve as a result of the COVID-19 crisis, focusing in particular on the Growth Equity and Venture Capital (VC) asset classes. Growth Equity funds, which focus on accelerating investees' growth through operational enhancements, account for a significant share of PE Fund investments in several developing regions, while VC funds are a fast-growing vehicle in certain EMs and present specific opportunities related to technology and digitization in the context of the COVID-19 crisis.

This note also discusses how selected “megatrends” may impact these two asset classes in the medium term, along with opportunities for the industry and for enhanced DFI support. The intended audience for this note is international development practitioners, private equity professionals in emerging markets, and capital market analysts.



- **PE Funds are being hit by the reduction in activity and growth prospects of their portfolio companies.** The combination of demand shocks reducing income availability and supply shocks disrupting global value chains is impacting entire business lines and sectors, including light manufacturing and urban consumer businesses, which represent a large share of the investments of Growth Equity funds. PE Fund Managers' (FMs) priority is currently to shore up portfolio companies by using the funds' cash reserves where possible and by providing hands-on operational support.
- **In the short term, PE Funds' returns will take a hit as a result of significant write-downs in portfolio companies' valuations, exchange rate volatility, and challenges in exiting investments.** The financial performance of the asset class in EMs has suffered, while overall PE market volumes in EMs are expected to contract.
- **Fundraising in EMs is expected to become more challenging in the next two to three years, especially for funds targeting small and midsize companies.** These funds will struggle to survive, while larger and more established funds will be less impacted but still need DFI support. The composition of the Limited Partner (LP) base in EMs will shift, with international institutional investors being constrained in their asset allocations to EMs. The life cycle of funds will see a lengthening in light of longer fundraising cycles and longer investee holding periods due to challenges in achieving exits.
- **Against a context of scarce VC funding in most EMs, these trends will be magnified for VC funds due to the nature of investees and investors:** Start-up investees need significantly more hand-holding and access to follow-on funding, while less-institutionalized VC investors may step back owing to high perceived risk.
- **The crisis will also bring opportunities for PE FMs.** The PE Funds business model is well suited to help navigate companies out of economic crises, and FMs can become partners in rebuilding sectors and economies through reducing equity funding gaps and leveraging their strategic and operational know-how to support structural changes across businesses.
- **FMs also have an opportunity to pivot and ride a number of megatrends that are expected to emerge post-COVID-19.** These include shifts in global supply chains toward localization of strategic sectors and diversification of the supply base for products with complex value chains, an acceleration in digital transformation (increased digital adoption by businesses, uptake of digital platforms and innovative digital business models, rise in the digital urban consumer), and an increased appetite for impact-oriented investments (with a focus on businesses related to COVID-19 response and resilience and with regard to the expected reduction in public sector funding going forward). In the medium term, VC funds will benefit from opportunities to leverage technology and pivot business models.
- **FMs also have an opportunity to better leverage DFIs' support:** In addition to providing funding to support fundraising at a time of negative fluctuations in the economic cycle, DFIs can scale direct investments into investee companies, mobilize third-party capital, and support regulatory change.

# Private Equity Funds in EMs before COVID-19



The PE Funds sector covers a number of investment strategies. The main types are Buyout,<sup>1</sup> Growth Equity, and VC funds.<sup>2</sup> This note will focus on Growth Equity funds and VC funds, which account for an important share of investments in the sector for those DFIs that operate in this space. As Growth Equity funds tend to invest across multiple sectors, a number of megatrends affecting specific industries are described later on. Growth Equity funds typically focus on small and midsize companies seeking capital and knowledge to grow and professionalize.

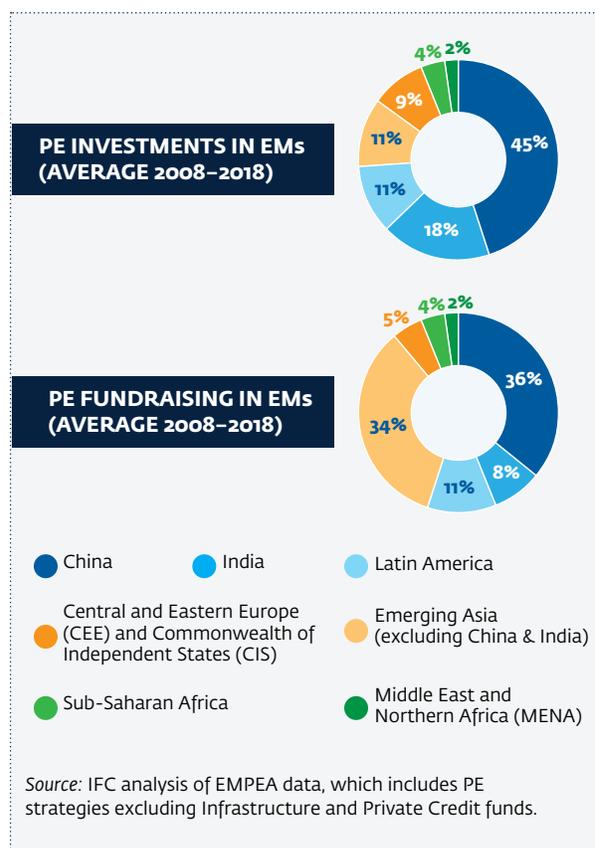
**Compared to developed markets, the scale of PE in EMs remains limited, and is mostly concentrated in Asia.** Only 23 percent of PE global fundraising went to EMs in 2018, even though EMs represent 60 percent of global GDP. About 85 percent of PE capital raised in EMs goes to Emerging Asia, with China and India accounting for 38 percent and 8 percent, respectively.<sup>3</sup> In the 10 years prior to the COVID-19 pandemic, PE in EMs had seen positive trends in aggregate, mainly driven by Asia. In all EMs, over the period 2008–2018, the total PE activity grew from about US\$24 billion to about US\$53 billion annually, with an increase in total PE fundraising from about US\$58 billion to about US\$75 billion annually. Activity in Asia, and in particular in China, drove the growth observed over the past 10 years.<sup>4</sup>

**Growth PE represents a significant share of PE activity in EMs.** In EMs, over the 2014 to 2018 period, the cumulative investments in Growth Equity accounted for about 34 percent of total PE investments, followed by Buyout and Venture Capital investments.<sup>5</sup> Buyout investments are largely concentrated in Asia (in China in particular), and to some extent in the Central and Eastern Europe (CEE) and Commonwealth of Independent States (CIS) region, while they remain marginal in Sub-Saharan Africa (SSA) and in the Middle East and Northern Africa (MENA). In most regions, Growth Equity funds are the most prominent type of PE (although other types of Private Capital investments also play an important role).

**The level of dry powder—cash reserves that FMs have available—is relatively high in EMs.** In line with a trend observed globally, FMs in EMs entered the COVID-19 crisis counting on up to US\$400 billion<sup>6</sup> of available capital at the

end of 2019. An analysis based on the International Finance Corporation (IFC) portfolio suggests that, in relative terms, dry powder is distributed homogeneously across most of the regions.

**FIGURE 1.** Investment and fundraising trends in EMs, based on annual average volumes 2008–2018



1 Leveraged Buyout funds invest in more mature businesses, usually taking a controlling interest. The purchase is financed through debt, which is collateralized by the target firm's operations and assets.  
 2 The broader Private Capital asset class also includes Infrastructure funds and Private Credit funds; other categories of Private Equity may include private investments in public equity (PIPE) and secondary buyout/portfolio investments.  
 3 Emerging Markets Private Equity Association (EMPEA) database based on EMPEA 2018 release. Regional funds and allocation to other Emerging Asia market funds make up the rest of the Emerging Asia investments.  
 4 EMPEA database.  
 5 International Finance Corporation (IFC) analysis of EMPEA data.  
 6 IFC analysis of Preqin data. The definition of Private Equity used by Preqin may include asset classes that, in this note, are considered in the broader category of Private Capital; the estimate of dry powder in EMs is based on data by primary geographic focus and includes Asia and rest of the world (global volumes excluding North America and Europe).

# Expected changes to the Private Equity sector post-COVID-19



**PE Funds are being hit by the reduction in activity and future growth prospects of their investee companies.** The COVID-19 crisis is affecting the short-term (within one year) and medium-term (within two to three years) growth prospects of funds' portfolio companies, which are generally experiencing negative impacts on revenues, costs, and profitability. Further, these businesses might find it hard to service debt, and heightened risk aversion could lead to climbing borrowing costs, bankruptcies, and defaults.<sup>7</sup> The combination of demand shocks reducing income availability and supply shocks disrupting global value chains is impacting entire business lines and sectors.<sup>8</sup> Light manufacturing and urban consumer businesses, which represent a large share of the investment of Growth Equity funds, are examples of sectors affected in numerous markets. This situation marks a contrast to the experience FMs had during the Global Financial Crisis, when availability of credit was an issue but the fundamentals of economic growth that characterized EMs, and the underlying growth prospects of investee companies, did not substantially deteriorate.

**FMs' short-term priority is to ensure the survival of portfolio companies by providing them with hands-on operational support and working capital.** Discussions with FMs across the IFC portfolio indicate that FMs are currently involved in portfolio management activities to understand the implications of the crisis on investees in terms of liquidity management, cost and revenues, and business continuity along the supply chain. Government support to companies that are experiencing temporary difficulties (for example, through access to loan programs, as seen in developed countries) is often unavailable in emerging markets, hence FMs are stepping in and providing capital to portfolio companies. Interviews conducted by IFC with market participants indicate that, where dry powder is available, this cash can be used by FMs to shore up investees. In cases where FMs are constrained in the support they can provide to investees by capital allocation limits, other types of funding are required, including debt and co-investments with LPs. This approach to shoring up investees is consistent with that taken by the FMs that successfully emerged from the Global Financial Crisis, during which they tended to take a more cautious approach and focused on shoring up existing assets.

**In the short term, the financial performance of the asset class in EMs will deteriorate.** A common sentiment among LPs and General Partners (GPs) in the PE asset class is that PE Funds' returns will take a hit in terms of reduced PE Funds' Distributions to Paid-in-Capital (DPI) and net Internal Rates of Return (IRRs) as a result of the following factors:

- **write-downs in portfolio companies' valuations** in the first quarter of 2020,<sup>9,10</sup> reflecting the portfolio companies' vulnerabilities discussed above;
- **exchange rate volatility**,<sup>11</sup> which can undermine the returns generated by investees in local currencies and impact cash flows available to FMs; and
- **challenges in exiting investments**, as exit processes are delayed (see Table 1) and many deals planned for 2020 will not materialize.

**Overall PE market volumes in EMs are expected to contract over the next two to three years, both in terms of fundraising and levels of activity.** Preliminary evidence shows that EM access to international markets has worsened significantly since March 2020.<sup>12</sup>

7 World Bank. 2020. *Global Economic Prospects June 2020*. Washington, DC: World Bank.

8 Financial Times. 2020. "The Impact of Coronavirus Across Industry and Finance." FT.com, January 27, 2020.

9 Campbell Lutyens. 2020. "LP Sentiment Update: Views on Fundraising and Returns." May.

10 For example, the big five public PE Funds in the US (Apollo, Blackstone, KKR, Ares, and Carlyle), posted valuation markdowns in the range of 8 percent to 22 percent. PitchBook. 2020. "Analysis of Public PE Firm Earnings: Q1 2020." May 11, 2020.

11 Chavez-Dreyfuss, Gertrude. 2020. "Coronavirus' Shadow Looms over Emerging Market Currencies." Reuters.com, March 5, 2020.

12 IFC analysis of Dealogic data.



The combination of these risks and the reduced profitability of the PE EM asset class is already leading to challenges in fundraising, with numerous examples of FMs that are currently fundraising and are considering delays and downward revisions of fund target sizes.<sup>13</sup> With some LPs leaving the market or reducing their commitments,<sup>14</sup> PE volumes in EMs are expected to contract significantly and take time to go back to their pre-COVID-19 level of activity.

Beyond impacts on market activity and financial performance, interviews with market participants and experts indicate that more substantial shifts are expected to occur in the medium term to the EM PE market, and to some of the fundamentals of the FM business models (see Table 1). Among these shifts:

- The composition of LP base in EMs is expected to shift, with the role of DFIs and domestic institutional investors becoming more prominent. A number of global investors will leave the asset class, while local investors are expected to remain, albeit with higher risk aversion.

DFIs' participation is expected to become more important, including in markets that have needed lower DFI support in recent years.

- The entire life cycle of a Fund Manager—from fundraising, to deploying capital, to exiting—will take longer. The delays in fundraising and the lower fund sizes than originally targeted suggest that fundraising cycles will lengthen significantly. Heightened market uncertainty will result in slower and more prudent deployment of capital for investments and in longer holding periods, as exit multiples will suffer.<sup>15</sup> Exit strategies will become more complex and lengthier.
- The number and composition of FMs will change, with the larger and higher quality FMs likely to be less impacted. The more established FMs are expected to be better positioned to absorb some of the shocks, as they have higher portfolio management capabilities, ability to provide strong operational support and capital to investees, and ability to leverage local networks to assess investments.

**TABLE 1.** Elements of the Private Equity business model impacted by COVID-19 and key risk factors

PE ELEMENT	RISK FACTORS
<b>LP composition</b>	<ul style="list-style-type: none"> <li>• Global investors: Further exposure to EM PE constrained by the need to ensure a balance in the ratio between private and public investments in a context where public equity has decreased rapidly in value.</li> <li>• Local investors: Lack of alternatives reduces the likelihood of leaving the asset class.</li> <li>• While some types of LPs may reconsider their investment strategy, as a mitigating factor, DFIs can help compensate for reduced funding.</li> </ul>
<b>Fundraising cycle</b>	<ul style="list-style-type: none"> <li>• Reduction in LP base and longer due diligence time for LPs to consider investment in FMs.</li> <li>• Investors' asset allocation rules posing a limitation for investment in EMs during a crisis in high-risk environments.</li> <li>• Delays and reductions in initial fund target sizes.</li> </ul>
<b>Investment and capital deployment</b>	<ul style="list-style-type: none"> <li>• Slower and more prudent deployment of capital in light of heightened market uncertainty, ranging from the duration of the crisis to implications for unemployment, income, and supply chain disruptions.</li> <li>• Some upside for those funds that have dry powder available to consider buying opportunities from the depressed valuations of good quality assets.</li> </ul>

<sup>13</sup> For instance, a well-established, local PE firm in Turkey which is currently in fundraising phase has halved the target size of its new equity growth fund as a result of a challenging fundraising environment, while the largest PE firm focused on Africa is struggling to get to a first closing on their subsequent fund.

<sup>14</sup> For example, overall LP commitments to EM funds are expected to decline amid the unprecedented global health and economic crisis. EMPEA. 2020. "Global Limited Partners Survey." June.

<sup>15</sup> PitchBook. 2020. "COVID-19's Influence on the US PE Market." March 30, 2020.

PE ELEMENT	RISK FACTORS
<b>Investee holding period</b>	<ul style="list-style-type: none"> <li>• Falling earnings and rising cost of capital lead to declining asset prices, which hurt exit multiples for PE investments.</li> <li>• Lower exit multiples are expected to delay exits and increase holding period.</li> <li>• Impacts more severe on funds that are approaching the end of their life and are looking to exit portfolio investments.</li> </ul>
<b>Investee exits</b>	<ul style="list-style-type: none"> <li>• Exits to other PE funds will be difficult in light of the prudent attitude of FMs on the buy side.</li> <li>• Strategic investors will experience delays or reduce buying, partly because a due diligence process including in-person visits cannot be completed.</li> <li>• Initial Public Offerings (IPOs) reduced due to the latest trends observed in public indices and volatility in the market.</li> </ul>
<b>Composition of Fund Managers</b>	<ul style="list-style-type: none"> <li>• Some global/international FMs will exit EMs. This type of FM had already been declining over the past few years in regions like Africa, and more generally in the mid-market space.</li> <li>• Top-tier domestic FMs are expected to consolidate their position in the market and to raise successive funds in the medium term, albeit at smaller fund sizes; even those that had graduated from DFI support will require further DFI involvement.</li> <li>• Smaller domestic and regional FMs will face the hardest challenges, especially if they had vulnerabilities prior to the crisis. However, this will also be an opportunity for certain FMs to prove themselves, and those that come out on top are likely to be in a position to grow.</li> <li>• See Appendix 1 for a regional overview of these risks.</li> </ul>

Source: IFC analysis based on discussions with Fund Managers and market participants.

**Small and medium enterprises (SME)–focused funds and accelerators will experience performance deterioration and harder fundraising.** SME-focused funds are funds that invest in the smaller end of the market and in frontier regions where availability of private capital is scarce, including early stage VC funds that operate as accelerators and seed funds. These SME funds, which tend to depend heavily on DFI support and grants, have traditionally been operating in a challenging environment. Discussions with market participants indicate that their performance will take a hit in the short term and DFI/donor support will become more selective as a result of heightened risks. Less-institutionalized investors, such as high-net-worth individuals or family offices, are expected to reduce investments in accelerators.

**The negative impacts of COVID-19 are expected to be higher on VC funds in the short term than on Growth Equity funds, but VC funds will benefit from increased appetite for technology-based companies in the medium term.** VC investment levels in EMs stood at about US\$27 billion<sup>16</sup> in 2019, out of which about US\$19 billion was in China and India only, and represent a small share of total global VC investments.<sup>17</sup> In this context, some of the risks discussed above for the Growth Equity funds asset class are magnified: Start-up companies need more hand-holding, availability of the follow-on funding upon which they depend for growth will decrease, and LPs and investors are less institutionalized and present higher flight risks. However, the positive outlook for technology companies is seen by market participants as a potential mitigating factor (see Table 2).

<sup>16</sup> EMPEA database.

<sup>17</sup> Between 2008–2017, excluding China and India, VC flows to EMs were just US\$24 billion, compared to about US\$1 trillion in developed markets. PitchBook database.

**TABLE 2.** VC fund activities impacted by COVID-19 and key risk factors

VC FUND ACTIVITY	RISK FACTORS
<b>Supporting start-ups</b>	<ul style="list-style-type: none"> <li>• VC funds invest in companies that are at earlier stages of the business life cycle. These companies have yet to prove their business model or are in the process of scaling.</li> <li>• These businesses are more cash intensive, often have little or no revenue, and have a higher risk of failure compared to PE growth fund investees, even in ordinary times. In the current environment, these investees will require more hand-holding and operational value add.</li> <li>• A significant share of investees for most VC FMs in EMs will face cash issues. Seed and early stage VC funds will be the most immediately impacted, while the risk of writing off investments is higher.</li> </ul>
<b>Follow-on funding for start-ups</b>	<ul style="list-style-type: none"> <li>• VC funds require follow-on funding from other investors to take companies to the next stage of development. In the current environment, with investors facing travel restrictions that limit the due diligence process, access to follow-on funds is challenging even for good quality companies.</li> <li>• VC FMs are likely to shift from prioritizing new investments to focusing on existing investments; many are providing the additional follow-on funding themselves.</li> <li>• FMs will support portfolio companies currently raising a funding round in several possible ways: by following an external investor who may lower the valuation by a certain amount compared to a pre-COVID-19 scenario; by investing with a consortium of existing investors that take the whole round internally but at a discount; or through providing a bridge loan without setting a valuation, but rather taking a discount to the next external round.</li> </ul>
<b>LPs and fundraising</b>	<ul style="list-style-type: none"> <li>• VC funds are usually backed by less-institutionalized LPs that are not as supportive during a crisis.</li> <li>• In most EMs, VC fundraising primarily comes from high-net-worth individuals or family offices, as most institutional investors view VC as a riskier asset class. Discussions with FMs suggest that managing LPs during this crisis is a critical task that FMs are undertaking.</li> <li>• Over the medium term, there is a risk that high-net-worth individuals and family offices will reduce their exposure to this asset class in EMs if it does not deliver the expected returns. Such LPs are also more likely to default on their commitments.</li> </ul>
<b>Leveraging technology returns</b>	<ul style="list-style-type: none"> <li>• VC investees often provide digital services, platforms, or deep tech solutions, and have the agility to pivot business models to react to the crisis. Some of these businesses are inherently more innovative and tend to see an uptick during a crisis.</li> <li>• VC has the potential to generate a better risk-reward balance for investors and could benefit from increased interest from LPs as they look to diversify their portfolios and invest more in sectors with more exposure to technology and digitization given trends that will emerge post-COVID-19. (See Section on "Opportunities and trends for Private Equity Funds in EMs").</li> </ul>

Source: IFC analysis based on discussions with VC Fund Managers and market participants.

# Opportunities and trends for Private Equity Funds in EMs post-COVID-19



*As in any time of crisis, opportunities will emerge for the industry to transform its business model and to support companies and economies in a different way.*

**Opportunity 1: FMs can leverage their strategic and operational know-how to help companies navigate the crisis and the post-crisis readjustments.** Unlike banks or other financial intermediaries, PE Funds contribute to the growth of industries by providing not just capital, but also operational capabilities to firms. FMs transfer knowledge and best practices that make businesses more innovative and increase dynamism in the wider market. Evidence indicates that industries in which PE Funds have been active have grown more rapidly than other sectors across total production, value added, total wages, or employment.<sup>18</sup> Given the rising uncertainty and impending slowdown in growth in the real sectors, FMs have an opportunity to leverage this know-how to help businesses navigate the post-COVID-19 world. For example, traditional firms are harnessing the power of technology and digitization to deliver better products and improve their overall business

models; FMs can identify and nurture such firms, assisting them in adopting digitization to become more competitive and resilient. FMs can also help companies rethink their growth strategies amid the shifts that are likely in global supply chains.

**Opportunity 2: FMs are well positioned to leverage megatrends in the real sector that COVID-19 has accelerated.** In a context where PE funds' success ultimately depends on investees' performance, FM's ability to understand and harness changes in business models, consumer behavior, and government policy post-COVID-19 will be a key success factor. A number of megatrends are emerging that have a cross-cutting impact on many sectors, and the opportunities associated with these sectors could result in strategic changes and growth potential for FMs.

**TABLE 3.** Post-COVID-19 real sector megatrends and key features

MEGATREND	KEY FEATURES
Shifts in global supply chains toward localization and diversification	<ul style="list-style-type: none"> <li>• Countries could push companies in sectors viewed as strategic such as healthcare, personal protective equipment, food packaging, and so on to bring back production from overseas. For products with complex value chains (for example, products made over several countries), companies will diversify their supplier base so that they have the flexibility and options to source from a broader range of countries.</li> <li>• This trend could naturally benefit countries such as Turkey, Mexico, Vietnam, Bangladesh, Morocco, and others that have built unique capabilities over the years in certain sub-sectors. Even before COVID-19, Chinese manufacturing had begun shifting to Africa to locally manufacture products in the construction value chain. These shifts will likely intensify.</li> </ul>

<sup>18</sup> Shai Bernstein et al. 2010. "Private Equity and Industry Performance." NBER Working Paper 15632. January.

MEGATREND	KEY FEATURES
Acceleration in digital transformation	<ul style="list-style-type: none"> <li>• <b>Increased digital adoption by businesses:</b> In the medium to long term, there will be greater levels of tech absorption as companies seek to digitize certain parts of their operations. Technology will become more important not just for efficiency and competitiveness, but for business continuity and resilience.<sup>19</sup></li> <li>• <b>Rise in digital platforms and innovative digital business models:</b> These models can strengthen supply chains by reducing the role of intermediaries, improve price transparency, and reduce market-wide costs. The demand for models that bring down prices and respond to new challenges is likely to increase as the economy moves toward a recession post-COVID-19.</li> <li>• <b>Rise in the digital urban consumer:</b> The COVID-19 crisis has changed consumer behavior, increasing online food purchases, use of telehealth, and so on. These behaviors are likely to continue in the medium to long term.</li> </ul>
Increased appetite for impact-oriented investments	<ul style="list-style-type: none"> <li>• <b>Focus on businesses that can help respond to COVID-19:</b> Increased interest in sectors such as health and logistics will increase appetite for impact-oriented investments in these areas. Some of this activity has already emerged—for example, BlackRock has launched an impact fund for companies focusing on combating the COVID-19 pandemic.</li> <li>• <b>Increased focus on economic and environmental resilience:</b> Pandemics and climate-change risk share similarities in that they are physical shocks that require collective action. Other key positives for investments in this space include climate action targets, job creation, and the need for economic and environmental resilience.</li> <li>• <b>Increased level of public government debt (long term):</b> As EMS' government debt continues to grow, the funding gap for investments in critical Sustainable Development Goals (SDG) sectors (education, gender, water and sanitation, and so on) will require greater private sector funding.<sup>20</sup></li> </ul>

Source: IFC analysis based on discussions with Fund Managers, market experts, and sector economists.

**Growth-focused funds have opportunities to harness shifts in global supply chains toward localization and diversification.** Businesses and governments will likely have a greater desire to shift their supply chains to be less dependent on a limited number of markets in the wake of the COVID-19 crisis. A vast proportion of Growth Fund investees operate in the manufacturing sector, and as global value chains shift and new hubs emerge, FMs have an opportunity to leverage their experience and react appropriately to these changes. The active and hands-on approach of FMs presents opportunities to assist businesses in entering new markets or shifting their own supplier base to deliver growth.

**Funds that operate in the growth stage have an opportunity to shift toward digital technology, and the late VC growth stage has potential to grow.** An acceleration in digital transformation will likely materialize

through increased digital adoption by businesses, a rise in digital platforms and innovative digital business models, and a rise in the digital urban consumer. Certain verticals will emerge as winners from this increased digitalization in the medium term, such as healthcare, logistics for online purchases (of food, groceries), and payment/lending platforms. The crisis is likely to spark innovative, entrepreneurial ideas for building sustainable infrastructure and scalable essential services, and investors, particularly in the venture space, will be needed to fund these ventures.

**Increased appetite for impact-oriented investments will provide opportunities for Impact funds.** FMs will be increasingly asked to support LPs' appetite for more impactful investments—for example, investments in businesses that can help respond to COVID-19, such as healthcare; in businesses that can support economic and environmental resilience; and, more broadly, to provide

<sup>19</sup> For instance, the majority of LPs are taking climate change and other environmental factors into account when making investment decisions. EMPEA. 2020. "Global Limited Partners Survey." June.

<sup>20</sup> UNCTAD (United Nations Conference on Trade and Development). 2014. *World Investment Report 2014: Investing in the SDGs—An Action Plan*. Geneva: UNCTAD. Financing the SDGs is estimated to require a US\$3.9 trillion investment per year by 2030, and private sector participation will need to increase from 20 percent of investments today to 50 percent of investments. Assuming an average 60/40 ratio of debt and equity, financing the SDG infrastructure investment gap will require US\$360 billion to US\$720 billion in additional annual equity investments across key SDG sectors in developing countries.

private sector funding to the SDGs in the face of an increased level of public government debt. Impact funds were already on the rise pre-COVID-19.<sup>21</sup> A rise in appetite for impact from governments, consumers, and LPs will intensify this trend,<sup>22</sup> with an opportunity to also shift more traditional GPs to think about how they can best deliver impact.

**Opportunity 3: FMs could leverage DFIs' support beyond their LP role—for example, for co-investments, due diligence, and to improve regulatory environments.**

Traditionally, the role of DFIs has been to invest in nascent markets, provide counter-cyclical funding to PE Funds, catalyze more private sector funding, promote impact objectives, and provide technical assistance where required. Most DFIs have strong relationships with the top-tier FMs in each region and these partnerships are likely to continue; some of these FMs had graduated from DFI support and will likely need it again. In addition, much of the mid-market segment, the smaller managers, and the early stage venture funds and accelerators will continue to look to DFIs to sustain them. While this support will continue, there is an opportunity for FMs to leverage a number of other advantages DFIs can offer:

- Accelerating and scaling direct investments in investee companies, which are critical to support growth of the best investees in an environment of equity scarcity for EMs; providing access to working capital loans to investees; and playing a greater role in identifying opportunistic deals.
- Leveraging DFI presence on the ground to facilitate the due diligence process in a context where international FMs may not be able to fully operate locally, and to support further mobilization of other investors.
- Mobilizing third-party capital by providing and encouraging local capital to engage with PE and VC, and by sharing due diligence with interested LPs who may not have the ability to conduct detailed due diligence.
- Connecting FMs and governments to fill funding and capacity gaps to catalyze the strategic transformation of critical industries.
- Increasing industry effort to work with governments to develop policies and legal frameworks that enforce contracts (such as property rights), protect investors, and are compliant with international business standards and practices.

*Growth-focused funds have opportunities to harness shifts in global supply chains toward localization and diversification.*

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<sup>21</sup> Phenix Capital. 2020. "2020 Global Impact Platform Fund Report." March 2020.

<sup>22</sup> IFC. 2020b. Growing Impact—New Insights into the Practice of Impact Investing. Washington, DC: IFC. June.

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## APPENDIX 1. SUMMARY OF PE TRENDS ACROSS REGIONS

The table below summarizes the relative vulnerabilities and strengths of the PE asset class across EM regions (excluding China). The assessment is based on a review of trends currently observed in these regions and discussions with local market participants and analysts.

REGION	VULNERABILITIES	STRENGTHS
<b>Sub-Saharan Africa</b>	<ul style="list-style-type: none"> <li>• The SSA market entered this crisis more vulnerable than most other EMs, with more limited availability of private capital.</li> <li>• Most FMs are closing funds at a smaller size than initially foreseen, and this is expected to continue.</li> <li>• FMs, including the larger ones, who had graduated from DFI support, have come back to request DFI participation in the upcoming fundraising cycles.</li> <li>• Small and mid-market funds appear especially vulnerable in the next fundraising cycle and are at risk of disappearing.</li> <li>• Delayed fundraising cycles and a reduction in PE activity overall are expected over the coming years, shrinking the activity of the PE sector.</li> </ul>	<ul style="list-style-type: none"> <li>• The most established FMs are completing or have recently completed fundraising, albeit at a smaller size than predecessor funds, and are now able to deploy the capital.</li> <li>• These FMs are currently shoring up their existing portfolio investees.</li> <li>• Opportunities exist for established FMs with capital to deploy to find investments at more attractive entry valuations than would have existed six months ago.</li> <li>• Africa may benefit from increased opportunities in the manufacturing sector as a result of shifts in value chain from other regions.</li> </ul>
<b>Latin America</b>	<ul style="list-style-type: none"> <li>• Foreign exchange (FX) market volatility and currency depreciation, especially in Mexico and Brazil, could constrain PE funds' ability to generate positive returns for LPs even when the underlying investees are performing well from an operational perspective.</li> <li>• FMs that operate in the smaller market segment have emerged in recent years: They are at higher risk due to foregone revenues and low financial performance and are expected to struggle to survive.</li> <li>• The potential scale of the COVID-19 outbreak in Brazil and the policy response to the crisis will add to uncertainties.</li> </ul>	<ul style="list-style-type: none"> <li>• Some FMs have completed fundraising, have some dry powder, are well placed to deploy capital to shore up portfolio companies, and could deploy into good quality assets as valuations fall.</li> <li>• The cash availability of larger funds appears relatively robust compared to other EM regions.</li> <li>• The best performing funds are accelerating tech-driven solutions.</li> <li>• There is some internal capacity from FMs to absorb shocks through the domestic banking sectors or local development banks (these are more sophisticated in Brazil and Mexico and Colombia than in other regions).</li> </ul>

REGION	VULNERABILITIES	STRENGTHS
<b>Southeast Asia</b>	<ul style="list-style-type: none"> <li>• Most FMs currently fundraising are experiencing delays, and most of the capital is expected to go to established FMs, which will negatively impact smaller, or SME-focused funds.</li> <li>• Growth PE risks being negatively impacted by weakening consumer demand, as consumer-centric businesses need to pivot rapidly to benefit from the rise in online business and e-commerce.</li> <li>• In frontier markets, some initial attempts to introduce the asset class to Cambodia, Laos, and Myanmar might result in negative outcomes, due to these markets' high reliance on tourism and to the lack of banking infrastructure to provide companies with lifelines.</li> </ul>	<ul style="list-style-type: none"> <li>• VC funds have the opportunity to invest in innovative businesses, provided they have the financing readily available.</li> <li>• Overall, the larger countries in this region appear relatively shielded from market disruption in the medium term, riding the rising trends in VC/technology or consumer-driven businesses, and opportunities at the intersection of PE/VC.</li> <li>• Because the COVID-19 outbreak started in this region, SEA's PE/VC industry might emerge from the crisis sooner and bounce back faster than other regions.</li> </ul>
<b>Central and Eastern Europe (Turkey/Poland)</b>	<ul style="list-style-type: none"> <li>• Established/top-tier FMs have had to reduce fundraising targets sharply in Turkey.</li> <li>• Companies in this region tend to be highly exposed through the global supply chains (Turkey and Poland serve as manufacturing hubs for the European market).</li> <li>• A new fundraising cycle in Poland will be coming up in the next two years and will be impacted by lack of funding.</li> <li>• Nascent markets in South Eastern Europe will struggle to emerge.</li> </ul>	<ul style="list-style-type: none"> <li>• Large and well-governed companies have buffers and are expected to withstand the shock, and larger FMs typically have had relatively diversified portfolios.</li> <li>• Countries in this region will likely benefit from timely DFI and regional institutional support, also through specific financial instruments available in the region.</li> <li>• Turkey stands to benefit from shifts in global supply chains, as it can serve as a key manufacturing hub.</li> </ul>
<b>India</b>	<ul style="list-style-type: none"> <li>• Some FMs are facing delays in both fundraising and deploying capital, with the currently fundraising FMs having to postpone closing the funds.</li> <li>• Risks are accumulating for the many small and midsize FMs that had less dry powder entering the crisis, many of which still rely on DFI funding and are at risk of leaving the market.</li> <li>• As most LPs are in a wait-and-see mode pending the magnitude and duration of the economic crisis, the role of DFIs may increase compared to before the COVID-19 crisis.</li> </ul>	<ul style="list-style-type: none"> <li>• At the larger end of the market, established FMs with fundraising well under way will likely survive and focus on preserving their portfolios.</li> <li>• At the outset of the crisis, the level of dry powder was relatively high, and larger funds are well placed to engage in good buying opportunities as valuations drop for relatively high-quality assets.</li> <li>• The larger end of the market carries out PE deals in Buyout or in VC, and activity at the intersection of PE/VC is rising to take advantage of tech-driven opportunities.</li> </ul>

Source: IFC analysis based on discussions with Fund Managers, market experts, and sector economists.



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