



# SARONA

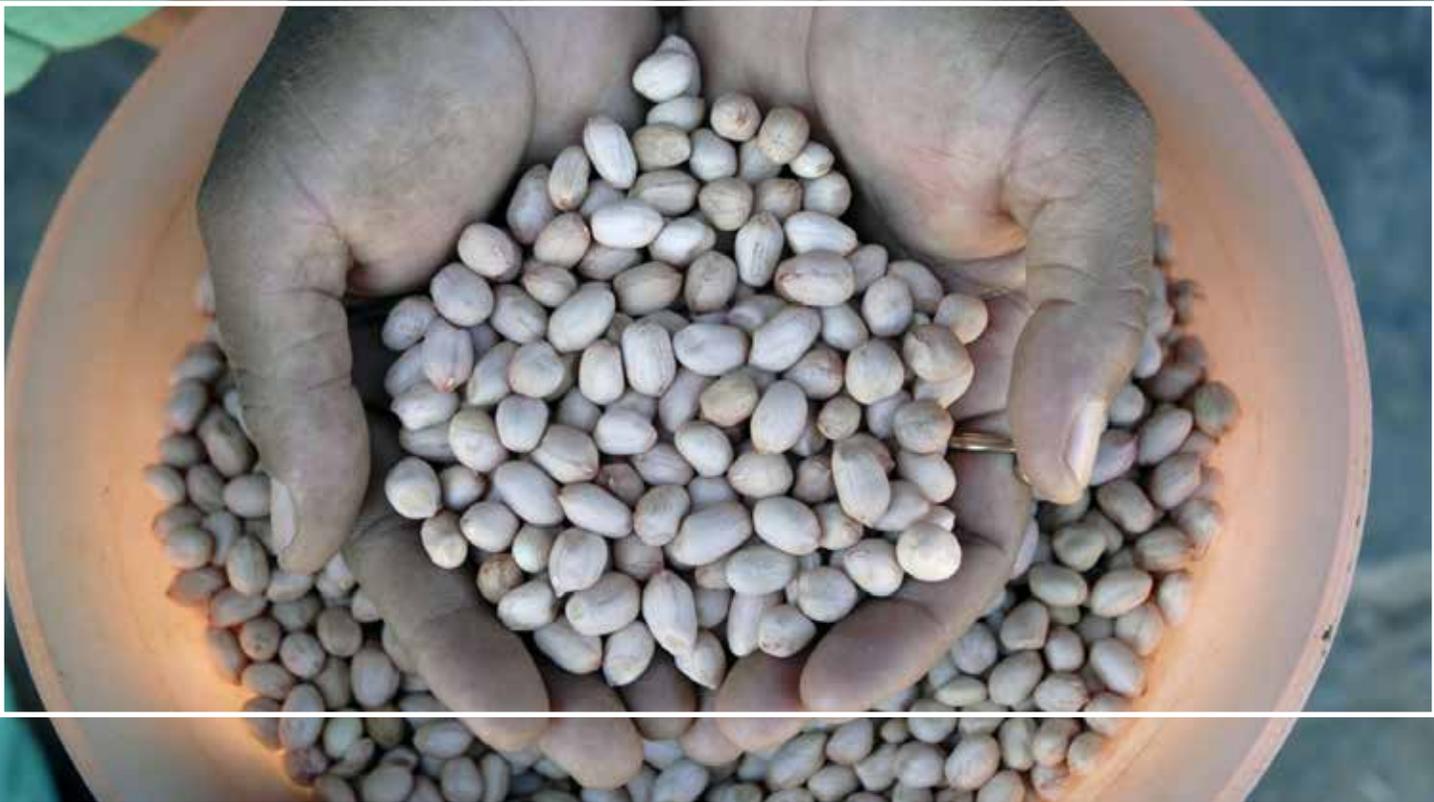
# 2019

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## GLOBAL INVESTORS SURVEY

Limited Partner Perspectives on  
Private Credit and Trade Finance  
in Frontier & Emerging Markets





# About Sarona

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With a rich history stretching back to 1953, Sarona has extensive experience investing in Frontier and Emerging Markets. Our ambition is to use this experience to deliver top-quartile returns by investing in funds and companies that benefit local communities and the environment. We focus on small to mid-market companies providing goods and services to meet the growing needs of the rising middle class in these markets.

Sarona invests in private companies in Frontier and Emerging Markets, targeting strong financial returns while simultaneously upholding positive ethical, social and environmental values. Our firm, based in Canada and the Netherlands, is a leader in innovative development finance, working with private and public partners to structure blended finance vehicles that achieve both financial goals and the Sustainable Development Goals (SDGs).

Sarona's mandates include direct and fund investment strategies focused on both credit and growth equity for private companies. Sarona believes that applying ethical, social and environmental values to each investment decision builds a better world for current and future generations. We further believe that such values help generate strong financial returns. Sarona works to increase the positive outcomes and reduce any negative consequences of its investments. We

measure and report on the social and environmental impacts of our investments and engage actively in international collaborative initiatives with: the Global Impact Investing Initiative (GIIN), United Nations Principles for Responsible Investing (PRI), GRI, World Economic Forum, United Nations (UN) and B Lab. With the right partners and strategy, growing highly successful and profitable companies can have a significant developmental impact. This is what drives us: building a diversified portfolio of funds and companies to deliver Growth that Matters.

To learn more about Sarona, visit [saronafund.com](http://saronafund.com).

## **Contributor**

David Webb, Emerging Markets Development Partners LLP

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# Executive summary

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In February and March 2019, Emerging Markets Development Partners (EMDP), in partnership with Sarona Asset Management, undertook a survey of 46 individuals from 39 different firms to uncover how much Limited Partner (LP) interest there is in investing in Frontier and Emerging Markets (F&EM) private credit. The market research was conducted in the context of gauging investor appetite for a proposed security offering, the Sarona Trade Finance Fund (STFF), a to-be-launched global pooled investment fund that will invest in, or lend to, trade finance intermediaries that engage primarily in providing trade finance credit to small and medium sized businesses (SMEs) in F&EM.

This study aims to reveal the general views of LPs with respect to investing in F&EM private credit. In connection with measuring investor demand, EMDP sought to distill LP preferences with respect to the specific STFF strategy,

positive impact priorities, return expectations, liquidity, geographic focus and preferred product features. In addition, the research sought to provide market feedback on the influence of the STFF potentially partnering with Global Affairs Canada, and specifically, proposed levels of loss protection and return enhancement at the fund level that would influence LP investment decision-making.

Institutions participating in the survey include diversified asset managers, fund of funds, pension funds, insurers, endowments, foundations, banks, development finance institutions (DFIs), private market advisors and family offices. These LPs are headquartered in six different countries which include Canada, the United States, the United Kingdom, the Netherlands, Switzerland, and Austria. In total, these institutions operate in over 50 countries with over C\$6 trillion in assets under supervision.

## Survey definitions

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**SME Trade Finance:** Short-term financing for SMEs of up to 3-years duration, but generally under 365 days, commonly secured by cash flows, raw materials, movable assets, inventory, accounts receivable or other difficult-to-collateralize assets. The purpose of this financing is to enable SMEs to trade, both domestically and across borders.

**Trade Finance Intermediaries:** Pooled investment funds or non-bank financial institutions that engage primarily in trade finance related credit with SMEs.

**Commercial Investor:** An investor that does not include positive impact performance as a factor in investment decision-making and is focused purely on commercial risks and returns.

**Impact Investor:** An investor that includes positive impact performance as a factor in investment decision-making, in addition to commercial risks and returns. Examples of impact themes include financial inclusion, education, environmental stewardship, employment, gender equality and empowerment, healthcare, development of capital markets infrastructure, and corruption reduction.

**Frontier and Emerging Markets:** ODA-eligible countries as defined by the latest OECD DAC list (2018-2020). Broadly defined, frontier market countries are less developed than emerging market countries.

**Limited Partners (LPs):** Investors in funds.

**Development Finance Institutions (DFIs):** Independent, government backed or multilateral financial institutions that promote private sector development in developing countries.

**Small and Medium Sized Enterprises (SMEs):** Companies with less than 500 employees.

**Return Enhancement:** A potential STFF product feature whereby Global Affairs Canada would share a portion of the profits generated from their fund investment with other investors.

**Hurdle Rate:** The rate of return that must be exceeded before the fund manager may apply performance fees.

**Redemption Gate:** A restriction on fund redemptions for a certain period of time.

# Top 5 survey key findings

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The 5 most important findings of the survey are:

- 1.** 74% of LP respondents expressed a moderate to high interest in investment allocations to private credit in F&EM (56% high interest, 18% moderate, 26% low or no interest).
- 2.** 69% of LP respondents expressed a moderate to high interest in investment allocations to SME trade finance in F&EM (46% high interest, 23% moderate, 31% low interest or not currently on their radar).
- 3.** A 1% return enhancement in addition to a target net return of 6% would significantly influence the decisions of a minimum of 23% of LP respondents to invest in the STFF security offering. A 2% return enhancement would significantly influence a minimum of 43% of LP respondents to invest in the STFF.
- 4.** 39% of LPs believed the inclusion of a loss protection feature to the fund offering would significantly influence their decision to invest and 97% of respondents believed loss protection would influence their decision to invest to some degree. With respect to specific loss protection levels required to influence LP investment behaviour: 7% of respondents indicated that any level of loss protection would influence their investment decision, a cumulative 28% of LPs indicated that a loss protection of 5% - 10% of fund equity would influence their investment decision, while a cumulative 59% of respondents indicated that a loss protection guarantee of 10% or greater would influence their decision to invest. 41% of respondents could not estimate a specific level of loss protection that would influence their investment decision based on the information provided.
- 5.** 66% of respondents believed the weighting of the fund portfolio exposure to frontier markets versus emerging markets should be determined by market factors and the investment opportunities available in the market.



# Survey methodology and LP respondent group

In February and March 2019, EMDP surveyed 46 representatives from 39 different institutions to gather their views on investing in private credit in frontier and emerging markets, and specifically, SME-focused trade finance. The market research took the form of an online survey delivered by email as well as phone interviews.

Institutions participating in the survey include diversified asset managers, fund of funds, pension funds, insurers, endowments, foundations, banks, development finance institutions, private market advisors and family offices.

In cases where multiple responses were received from one institution, these responses were aggregated and recorded as one answer.

Figure 1: Respondents by Institution Type

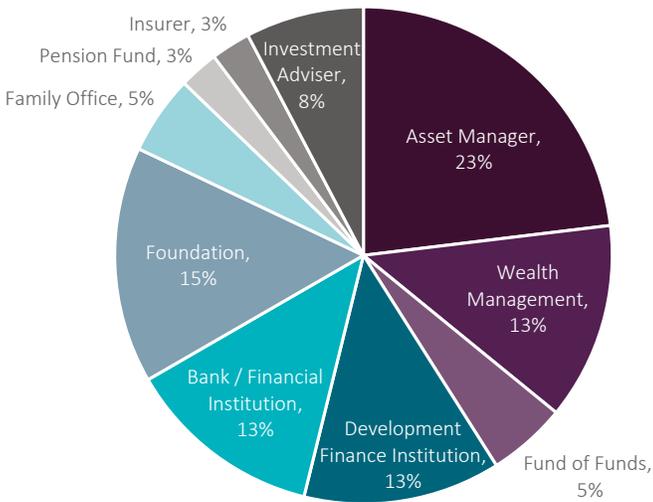
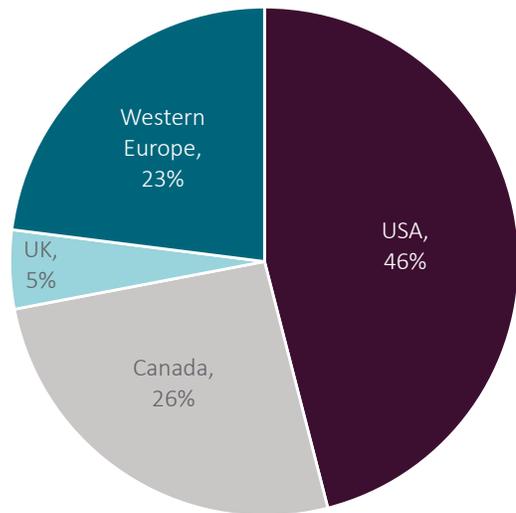


Figure 2: Respondents by Headquarters Region



## LP Respondent Group Investment Focus

Of the total participating LP firms, 15% classify as Commercial Investors, 59% classify as Impact Investors, and 26% offer a mix of commercial and impact-focused offerings to their investors and clients.

62% of participating LPs indicated a high interest for investing in frontier and emerging markets, 28% had a moderate level of interest, and 10% had little or no focus on F&EM. In addition, 90% of respondents had some portfolio exposure to F&EM, with allocations to F&EM ranging from a small percentage of total assets to all assets.

Figure 3: LP Respondents by Investment Focus

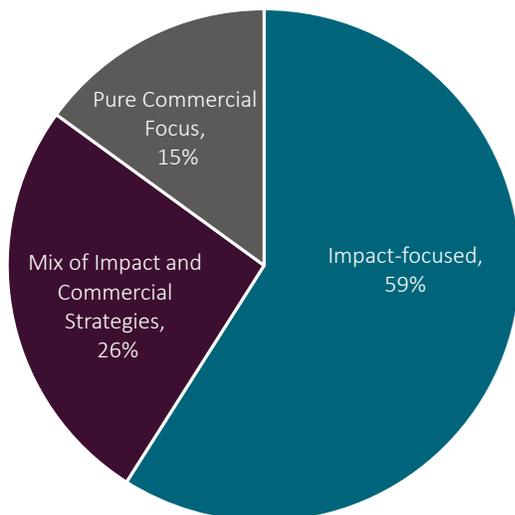
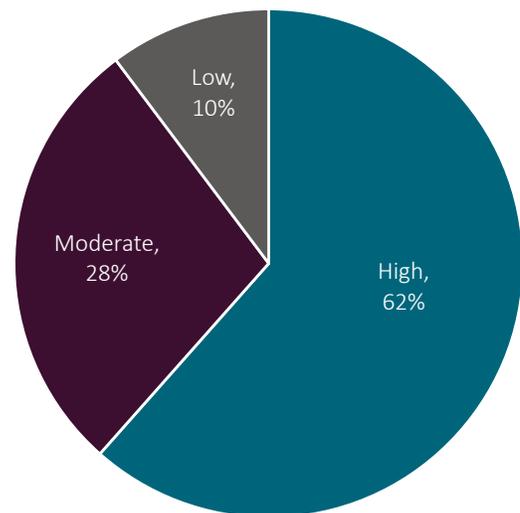


Figure 4: LP Respondents by Interest in Frontier and Emerging Markets



# LP interest in private credit in Frontier and Emerging Markets is high and growing

Based on the survey market research, LP interest in private credit strategies in F&EM is significant. 56% of LPs expressed a high interest in private credit investment allocations in F&EM, 18% expressed moderate interest and 26% expressed low or no interest. With respect to SME trade finance in F&EM, 46% of participants expressed a high interest for investment allocations, 23% expressed a moderate interest, while 31% indicated either a low interest or that this was not an asset class currently on their radar.

Feedback collected during LP interviews identified an expanding interest in F&EM private credit within individual

firms. The stated reasons for this growing interest ranged greatly across the survey participants. Contributing factors that were mentioned were the large SME funding gap in F&EM and the positive impact potential of reducing such a gap, the higher liquidity of private credit and trade finance compared with traditional private equity fund offerings, the self-liquidating nature of debt compared to more complicated private equity exits, the current income of debt, and the decreased risk due to debt seniority to equity in the capital structure. The majority of LPs prefer hard currency lending and any direct exposure to local currencies to be hedged.

Figure 5: LP Interest in Private Credit Exposure in F&EM

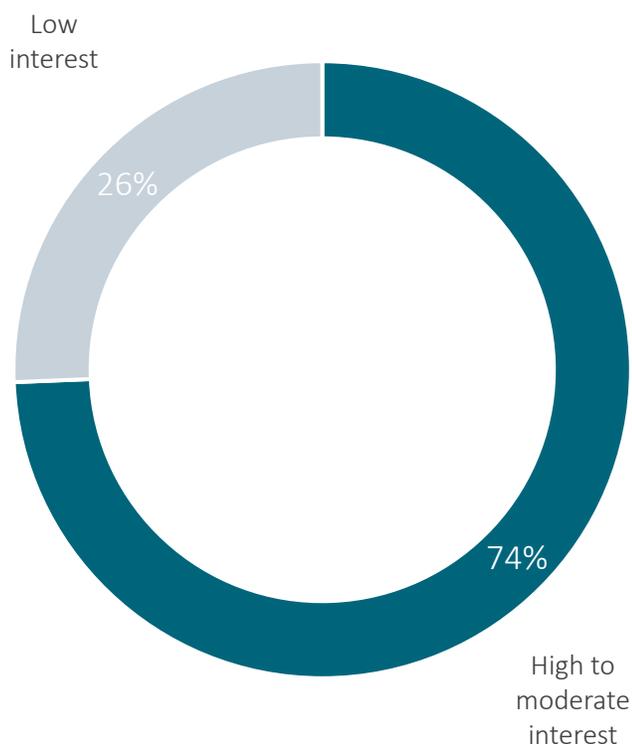
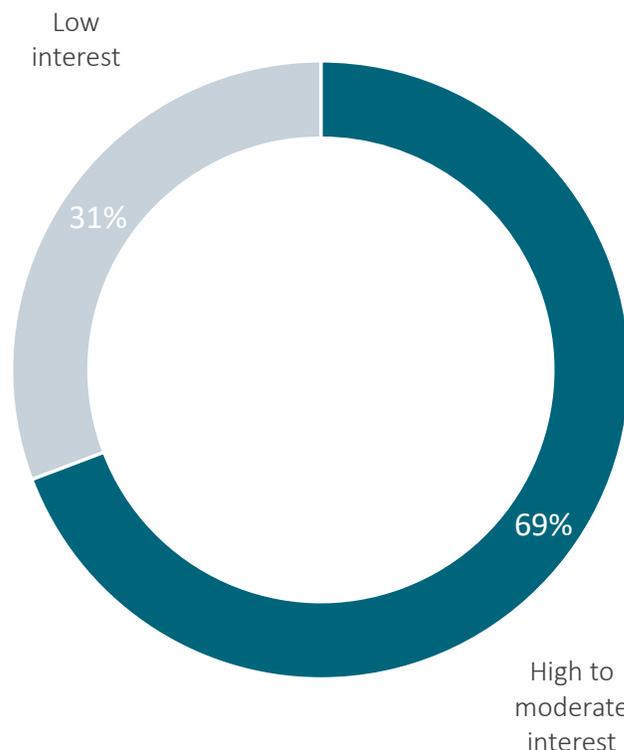


Figure 6: LP Interest in SME Trade Finance Exposure in F&EM





During the course of the interviews, LPs described SME trade finance in F&EM as:

***“Very interesting to us.”***

– Asset Manager

***“Our interest is very high.”***

– DFI

***“An area where we see huge growth potential. Current demands are not met.”***

– Fund of Funds

***“Huge interest in credit, which is a huge gap in the impact market more broadly.”***

– Bank

***“The beauty of a fund like this is it’s scalable.”***

– Fund of Funds

***“LPs seem to like to see the shorter-term transactions.”***

– Advisor

***“Something that is on our radar.”***

– Foundation

***“An area of growing interest.”***

– DFI

## Other Recent Limited Partner Surveys on Private Credit in F&EM

A 2018 study published by the Emerging Markets Private Equity Association (EMPEA) also found LP interest in private credit in frontier and emerging markets to be growing<sup>1</sup>. According to the EMPEA report:

*The percentage of LPs who plan to begin or expand investing in private credit has increased from 40% in 2016 to 47% in this year’s survey. EMPEA’s fundraising totals mirror this increase in investor interest in credit strategies, with EM private credit fundraising in 2017 surpassing all previous years on record.*

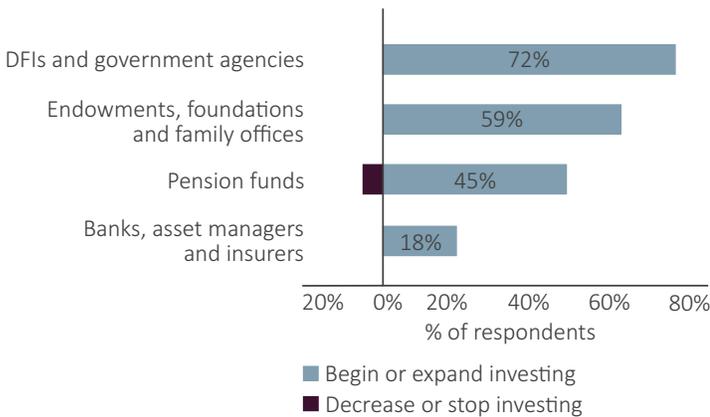
*Reflecting the strong growth in fundraising for EM venture capital and EM private credit documented in EMPEA’s Industry Statistics, the percentage of LPs planning to begin or expand investing via funds employing these strategies has*

*increased over the last two years.*



<sup>1</sup> “Global Limited Partners Survey: Investors’ Views of Private Equity in Emerging Markets 2018”. Emerging Markets Private Equity Association (EMPEA). 2018.

Figure 7: Planned Changes to EM Private Credit Investment Plans by Institution Type (EMPEA Survey)

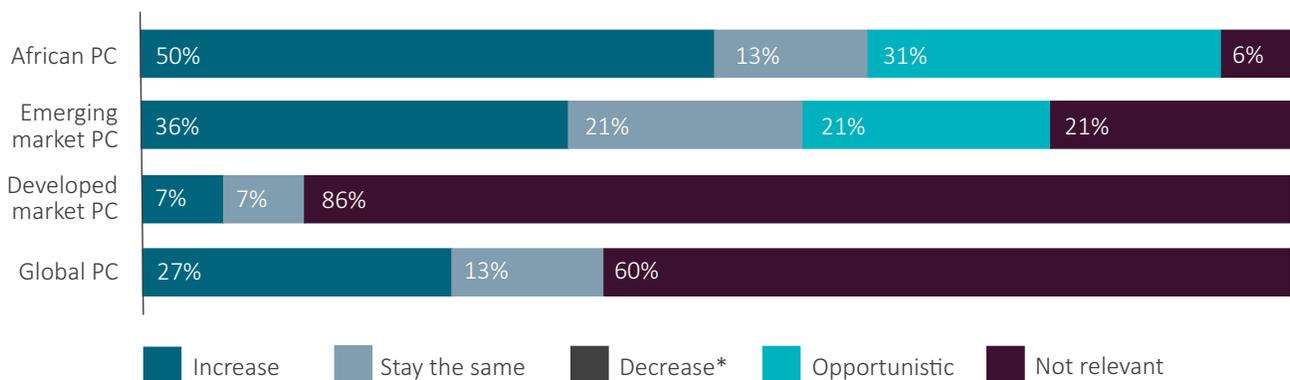


Source: "Global Limited Partners Survey: Investors' Views of Private Equity in Emerging Markets 2018". Emerging Markets Private Equity Association (EMPEA). 2018.

The 2018 Annual Limited Partners Survey published by the African Private Equity and Venture Capital Association (AVCA) surveyed a group of institutional investors to gain their perspectives on investing in private credit in Africa. According to the AVCA report, "50% of question respondents plan to increase their allocation to African private credit over the next three years" and "36% of respondents plan to increase their allocations [in private credit funds in other emerging and frontier markets] over the next three years"<sup>2</sup>.



Figure 8: LPs' Plans for Their Private Credit (PC) Allocations over the Next Three Years (AVCA Survey)



\*Decrease' was not selected by any of the respondents

Source: "Private Credit Strategies in Africa: Exploring the Market's View". African Private Equity and Venture Capital Association (AVCA). February 2019.

<sup>2</sup> "Private Credit Strategies in Africa: Exploring the Market's View". African Private Equity and Venture Capital Association. February 2019.

# Volatility, liquidity and returns are all central factors in LP investment decision-making

## Volatility

100% of respondents preferred low to moderate volatility versus high volatility for the proposed STFF security offering. During the interviews, numerous firms stated that a loss protection feature could significantly reduce the perceived volatility of the fund strategy.

## Liquidity

The importance of liquidity varied by institution type. DFIs, insurers and pension funds preferred less-liquid vehicles, though were not averse to investing in more liquid structures. 84% of respondents indicated they would be comfortable with an initial one-year, soft lock-up period. A soft-lockup is defined as a period during which investors can redeem their investment but are charged a small early redemption fee, generally between 1% and 3% of the amount being redeemed.

29% of LP respondents indicated a preference for quarterly redemptions or “as liquid as possible”, though 67% of firms preferring quarterly redemptions noted they could still consider up to annual redemptions for this type of strategy. 16% of respondents preferred semi-annual redemptions, 19% preferred annual redemptions, and 16% indicated that liquidity was not a high priority for them. 23% of respondents stressed that the liquidity of the fund, taking into account the redemption frequency, redemption notice

period, and redemption gate, should match the liquidity of the underlying investments. Numerous respondents noted that it would be a red flag if the fund offered higher liquidity than was achievable.

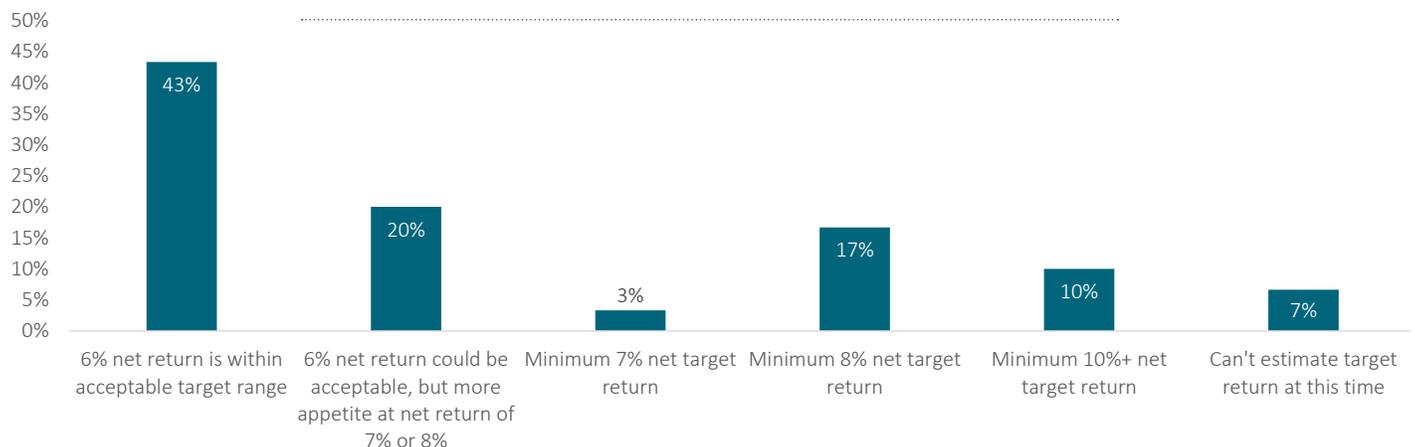
Liquidity had a strong influence on LP investment decision-making with respect to the suitability of the product. In numerous cases, F&EM investors noted the advantages of higher liquidity in private credit and trade finance in comparison with traditional F&EM private equity offerings.

On the topic of current income for the security offering, 56% of respondents indicated they had no strong preference for a distributing share class versus an accumulating and reinvesting share class. 16% preferred an accumulating product, 16% preferred a distributing product, and 12% preferred to have the option to choose.

## Returns

Generally, LPs believed that less liquid and more volatile strategies should have higher target returns. This supports market fundamentals and was evident when comparing the security offering to other offerings or benchmarks in the market. Interestingly, certain Impact Investors stated that they could support lower risk-adjusted returns with increased focus on higher risk (less developed) frontier markets versus lower risk (more developed) emerging markets.

Figure 9: LP Return Expectations for STFF Security Offering



A total of 63% of LP respondents expressed some level of interest for the STFF security offering with a target net return of 6%, based on a high-level description of the fund. This group of 63% of respondents can be divided into two sub-groups: the first, consisting of 43% of respondents, indicated that a net return of 6% generally matched their expected return for such a strategy. The second sub-group, representing 20% of respondents, indicated that a 6% net return could be acceptable but that it is towards the bottom of their return threshold and they would have greater appetite at 7% or 8% net return. Certain firms from the second sub-group noted during the course of the interviews: “We would prefer 7%-8%”, “6% is right on the edge, 8% would be better”, “6% is in

the ball park, a little higher would be better”, and “6% would be the bottom threshold”.

3% of LPs required a minimum of 7% net returns for the proposed offering, 17% of LPs required 8% net returns, and 10% required net returns of 10% or greater. 7% of respondents stated that they could not determine a target return expectation without receiving further details on the portfolio and underlying structures.

Most participants noted that any returns expectations would be subject to further details and diligence.

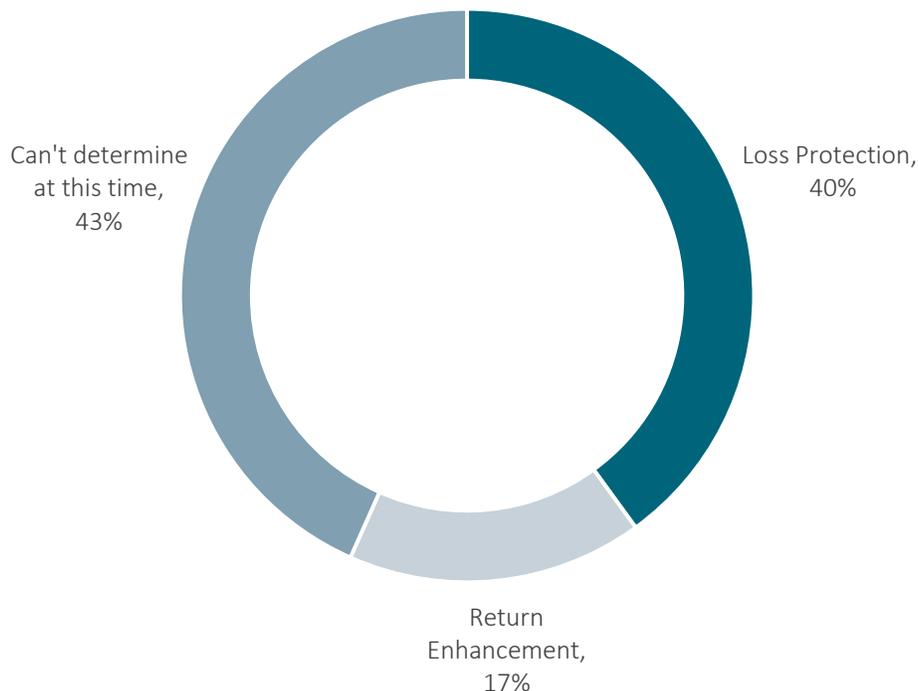


# Loss protection and return enhancement features significantly increase interest from all types of LPs

Unsurprisingly, all participants had a positive reaction to the STFF potentially offering loss protection and/or return enhancement. In certain cases, the addition of a loss protection and/or return enhancement feature at the fund level moved an LPs' appetite for the proposed STFF security offering from low to potentially of interest.

40% of LPs indicated that, conceptually and "all things being equal", if they had to choose loss protection or return enhancement, they would choose loss protection. 17% elected for return enhancement, and the remaining 43% required additional information on the fund and levels of loss protection and return enhancement to make an accurate determination.

Figure 10: "All things being equal, would you prefer to receive loss protection or return enhancement in such a strategy?"

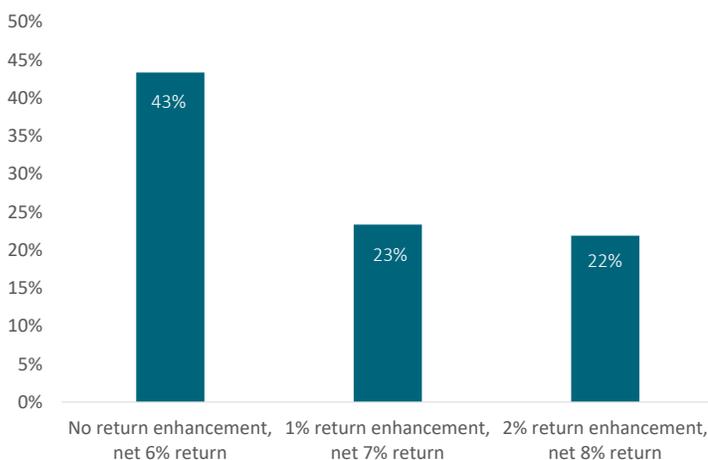


97% of respondents indicated that some level of return enhancement and/or loss protection would influence their investment decision to some degree. 42% of LPs thought that a return enhancement feature at the fund level would significantly influence their decision to invest in a security offering, while 39% thought that loss protection feature would significantly influence their decision to invest. A further 55% of respondents thought return enhancement would influence their investment decision to some degree, while 58% thought that loss protection would move their investment decision-making needle by some amount.

### Return Enhancement

With respect to the level of return enhancement that would influence investment decisions, 23% of LPs either thought a 6% net return was the bottom limit for returns they would expect for such a fund offering or had a minimum target return expectation of net 7%. Thus, a return enhancement of 1% in addition to the 6% target return of the fund would move roughly 23% of respondents into a comfortable range from a target return perspective. 22% of LPs either had a return expectation of net 8% or thought that a return enhancement of 2% would influence their investment decision. Therefore, a 2% return enhancement contributing to an all-in 8% net return would influence an incremental 43% of LP respondents' decision to invest in the proposed security offering and satisfy 89% of LP respondents' target return expectations (excluding the 7% of respondents who declined to provide a target return). These estimates were based on a moderate to low volatility investment strategy.

Figure 11: Effect of Return Enhancement on LP Investment Decisions



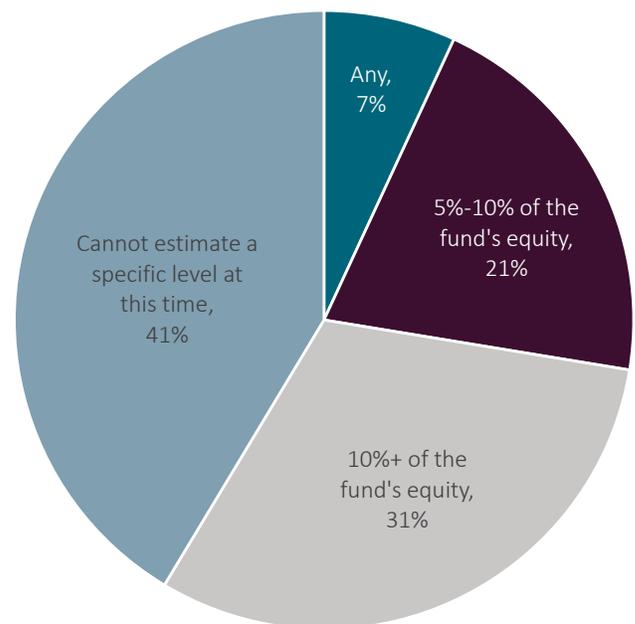
It should be noted that Figure 11 likely underestimates the effect of return enhancement on LP investment decisions, as it does not take into account the increased LP propensity to invest in the STFF within the group of 43% of LP respondents who indicated that a net 6% return was generally acceptable. LPs expressed a difficulty in providing further levels of

specificity with respect to their return expectations without performing due diligence and assessing the risks and positive impact potential of the STFF.

### Loss Protection

41% of LPs could not estimate a minimum level of loss protection that would influence their investment decision-making. As noted above, 39% of LPs believed the inclusion of a loss protection feature to the fund offering would significantly influence their decision to invest and 97% of respondents believed a loss protection feature would influence their investment appetite in some way. 7% of respondents indicated that any level of loss protection would influence their investment decision-making, a cumulative 28% of respondents indicated that a loss protection guaranteeing 5%- 10% of fund equity would influence their decision, and a cumulative 59% of LPs indicated loss protection of 10% or greater would influence their investment decision.

Figure 12: “What minimum level of first-loss protection would influence your decision to invest in the fund?”



Some LPs noted that in other investment vehicles that included a loss protection feature that they had assessed in the market, the guaranteed levels ranged from 10%- 50% of the fund's equity.

Numerous LPs declared that loss protection would bring the benefits of reducing volatility and risk, which would contribute to their overall appetite for the fund offering. In addition, certain LPs expressed a significant increase in their level of comfort for investing in a fund with a sovereign entity providing some level of loss protection.

# Positive impact focus and impact priorities vary greatly across LPs

15% of survey participants classify as Commercial Investors, 59% classify as Impact Investors, and 26% offer a mix of commercial and impact-focused offerings to their investors and clients.

The majority of Impact Investors from the survey group had broad impact mandates across social and environmental themes, with almost all including financial inclusion in F&EM as one of their impact goals. When asked the question, “Is the social and environmental impact of the strategy attractive?”, each LP classified as an Impact Investor (59% of respondents) and those that offer certain impact products to their investors and clients (26% of respondents) affirmed that the positive social and environmental impact objectives of the fund strategy was an attractive feature. Certain Commercial Investors noted that social and environmental impact was “good to have” or “always good”, but that these factors are currently not considered as part of their investment mandate.

10% of total LP respondents and 17% of Impact Investor respondents identified gender empowerment and gender

equality as a prioritized impact theme. Of those respondents who included positive social impact in their investment decision-making, many include gender-related themes as a part of their broader social impact strategy.

All development finance institutions surveyed include positive impact as a central part of their investment theses.

With respect to the STFF providing Technical Assistance (TA) to the SMEs receiving trade finance credit from the fund’s investee trade finance intermediaries, the majority of respondents had no strong opinion on the topic. Unsurprisingly, Commercial Investors were not interested in whether the strategy provided TA. Within the remainder of respondents, most noted that TA was not a priority but that in general they would like to see as much positive impact as possible at the trade finance intermediary investee level as well as the underlying SME level. 3% of LPs thought that TA for the trade finance intermediaries was important for market deepening.

One third of Commercial Investors surveyed or interviewed noted that impact-related investments are increasingly being raised by clients as an asset class of interest:

***“This is increasingly being requested by clients and is increasingly on people’s radar.”***

– UK-based Private Wealth Manager

***“This is an expanding area for us.”***

– US-based Bank



# Majority of participants want geographic focus to be determined by market factors, while certain Impact Investors indicate preference for frontier market exposure

Whether LP respondents expressed an appetite for more exposure to frontier markets than emerging and whether increased frontier market exposure should be accompanied by increased returns, generally depended on whether the LP was an Impact or Commercial Investor. For certain Impact Investors, increased frontier market exposure was interpreted as increasing the impact performance of the product, and thus they would accept a lower commercial return for such a strategy in exchange for the increased positive impact. For Commercial Investors, an increased weighting of frontier markets over emerging markets was interpreted as increasing the portfolio risk of the strategy and should be matched with higher returns.

Figure 13: “What is your optimal mix of investment allocation between emerging (later-stage development) and frontier (earlier-stage development) markets?”

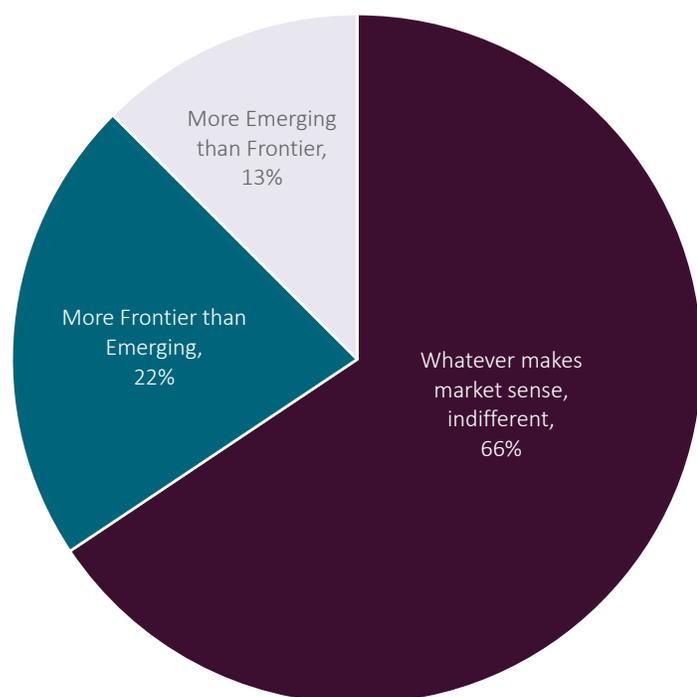


Figure 14: Ranking of F&EM Geographic Regions by Investment Interest



Two thirds of LP respondents thought that the STFF weighting of portfolio exposure to frontier markets versus emerging markets should be determined by market factors and the investment opportunities available in the market. 22% of LPs had more appetite for frontier markets than emerging, and 13% had more appetite for emerging than frontier.

With respect to geographic focus, Emerging Asia and Sub-Saharan Africa were in the top spots for investment exposure appetite within F&EM.



# Majority of LPs are most familiar with investing in limited partnership funds, are comfortable with funds under US\$50 million, and generally agnostic to country of fund domicile

Most survey participants had more experience in investing through Limited Partner and General Partner (LP/GP) fund structures in comparison to corporate structures, while the majority had no opinion or preference on the topic.

70% of respondents were comfortable investing in funds with minimum total assets under management of US\$50 million.

Figure 15: “What is your preference: Limited Partnership (LP/GP) structure or Corporate structure for the fund?”

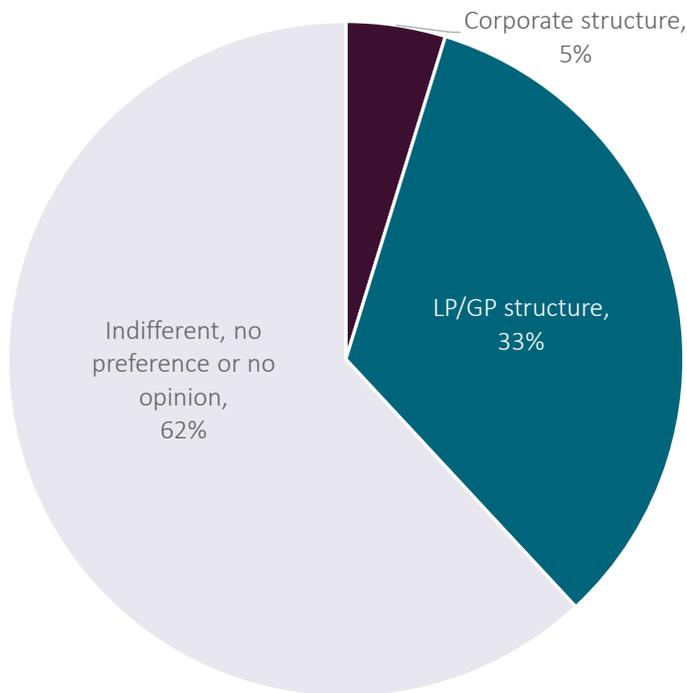
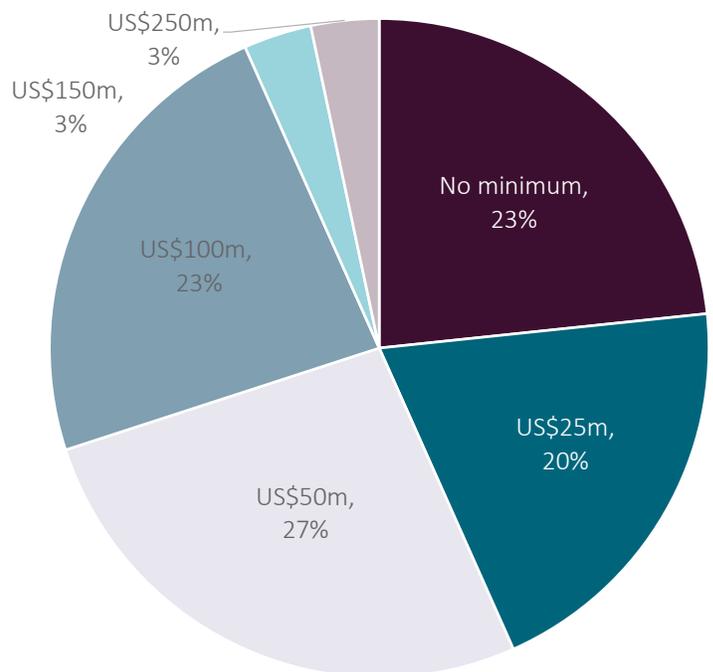


Figure 16: “What is the minimum size of a fund for you to consider an investment?”



With respect to the location of the fund domicile, there was not a strong preference for one jurisdiction over another. 92% of respondents either had no opinion on their preferred location of fund domicile or no preference. Numerous US-based LPs mentioned the need for a US-based feeder fund to facilitate investments from US sources, noting their familiarity with Delaware-domiciled feeder funds. Certain European asset managers expressed a growing preference from their European clients for funds domiciled in Luxembourg, while also noting that other clients preferred Cayman Islands. Throughout the course of the interviews, Luxembourg, Cayman Islands, and Mauritius were the most mentioned fund domicile jurisdictions.

# LPs want management fees of 1% - 1.25% and performance fees of 10% in excess of a hurdle rate

75% of respondents thought a 1%- 1.25% management fee was fair for this type of security offering, while 25% thought 1.5%- 1.75% was a reasonable management fee.

92% of respondents expected some level of performance fees. 50% of respondents thought a 10% performance fee was fair for such a strategy, 33% thought a 5% performance fee was fair, and 8% thought a 15% performance fee was fair.

Figure 17: “What is a fair management fee for such a global pooled investment fund?”

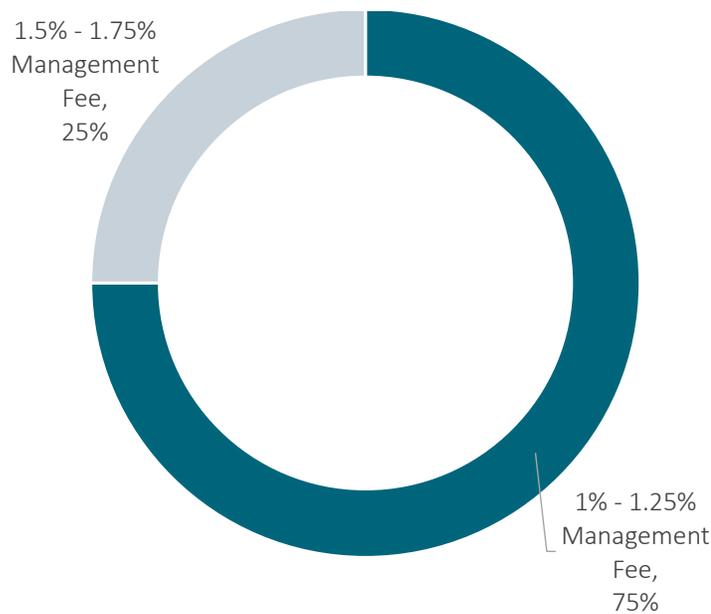
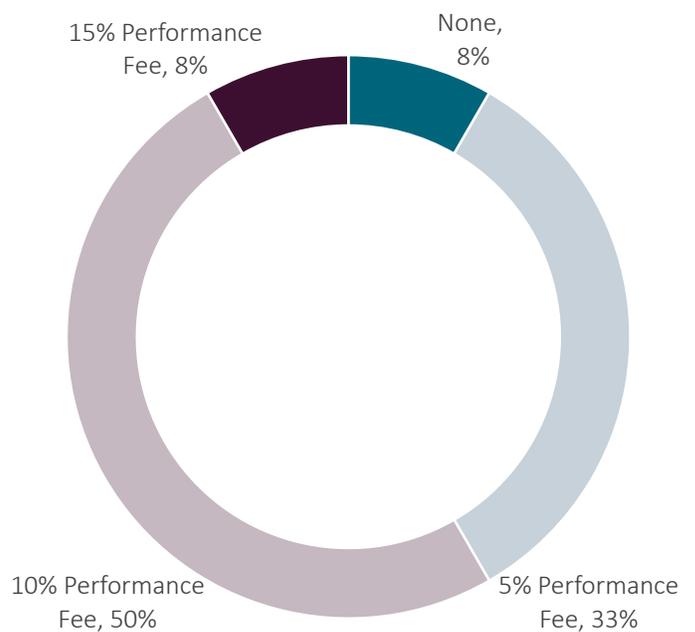


Figure 18: “What is a fair performance fee for such a global pooled investment fund?”



There was a general preference among the survey participants for having a hurdle rate applied to the performance fees of the fund. 86% of respondents indicated a preference for some level of hurdle rate. 50% of respondents thought it was an advantage for a fund to have a hurdle rate but could not specify a hurdle rate that they would apply to this specific fund offering. The mean hurdle rate from respondents who provided a specific desired level was a 3.8% hurdle rate.



sarona@saronafund.com  
+1 519 883 7557  
55 Victoria Street North, Unit K  
Kitchener, Ontario N2H 5B7  
Canada

SARONA

europe@saronafund.com  
+31 20 798 13 11  
Claude Debussylaan 46  
Amsterdam 1082 MD  
The Netherlands

Canada 

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