finnfund

A Way to Recovery

Trends and analysis on the impacts of the COVID-19 on markets and businesses in developing countries

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Content

***Cover:** Finnfund's investee Starsight offers solar panels, batteries and more energy efficient cooling and lighting solutions to reduce the use of diesel by its commercial and industrial clients throughout Nigeria. Due to the Covid-19, the company has made special arrangements to protect its employees and contractors. Additional protection measures have been included to their daily routines – also when installing the panels on a rooftop.*
(Photo: Starsight)

Foreword: An unprecedented COVID-19 shock

The COVID-19 pandemic is an unprecedented shock to the world economy. The International Monetary Fund (IMF), projects the worst global recession since the 'Great Depression' a steeper slump than during the Global Financial Crisis, with the global economy expected to contract by 4.9% in 2020. The 'Great Lock-down', or 'a crisis like no other', as the IMF has framed it, will have and is already having profound impacts on lives and livelihoods across the globe.

The pandemic and the imposed containment measures, varying to some extent in scope by jurisdiction, have changed the operational environment of millions of businesses operating globally.

As a development finance institution, we have good visibility to how businesses in emerging and developing markets are affected. While many newspapers are covering the immediate impacts the pandemic has on businesses, for example on industrial companies or on the service sector in the developed world, we now want to give a glimpse on how businesses in the developing world have been impacted.

Businesses in developing markets, obviously, face issues that are very similar to the issues businesses in more developed markets are facing, such as disruptions in supply chains or abrupt changes in the availability of staff or access to finance.

However, as their operating environment is often more challenging to begin with, businesses in developing countries are significantly weaker positioned to face a crisis. Also, their cash-strapped governments are usually not able to provide sufficient support, not even to the most thriving businesses, that are simply victims of the crisis.

In this article, we discuss some of the main channels through which businesses in the developing world feel the impact from COVID-19. We give an overview on how the pandemic has affected businesses in our key industries thus far: sustainable forestry and agriculture, renewable energy, and financial institutions.

"As their operating environment is often more challenging to begin with, businesses in developing countries are significantly weaker positioned to face a crisis."

Most importantly, we argue that for a professional and patient investor, there are still plenty of opportunities in developing markets. Population growth, climate change, urbanisation and digitalisation continue to drive leapfrogging and innovations in many of our target markets, where development finance institutions (DFIs) play a crucial role in supporting healthy businesses.

With the right tools and adequate risk-sharing, our objective is to create markets and attract additional capital into investments that promote the UN Sustainable Development Goals (SDGs) and the 2030 Sustainable Development Agenda.

Minna Kuusisto
Economist, Finnfund

Key impacts of the first months of the COVID-19 pandemic in developing markets

In this Chapter, we present the main impact channels through which developing markets and their businesses are affected by the COVID-19 pandemic. We briefly discuss differences in country-level responses as well as the socio-economic consequences and costs related to lockdowns.

In its newest update, published in late June, the IMF projects the world economy to contract by 4.9%. The figure is 1.9%-points lower than the April forecast. Sub-Saharan Africa is expected to contract by 3.4%, double the contraction foreseen in April, and approximately 7%-points lower than the pre-pandemic forecast.

Developing economies struggle to support their private sector, as their domestic and foreign income falls while health and other expenditure rise.

Development finance institutions can help bridge the financing gap in the private sector, which has been exacerbated by the unprecedented capital flight this spring.

Main impact channels: domestic and global economic activity and financial markets

Three factors contribute to the negative socio-economic impacts caused by the COVID-19 crisis: **a decline in domestic activity, a decline in global economic activity (slower growth and weaker trade) and financial market developments.**

Through a range of channels, these factors imply not only slower economic growth but also rising poverty levels and increasing economic and gender inequality; rising external imbalances and unsustainable debt levels; as well as potentially rising risks to societal and political stability.

The key channels are summarized in **Figure 1** and discussed in further detail below.

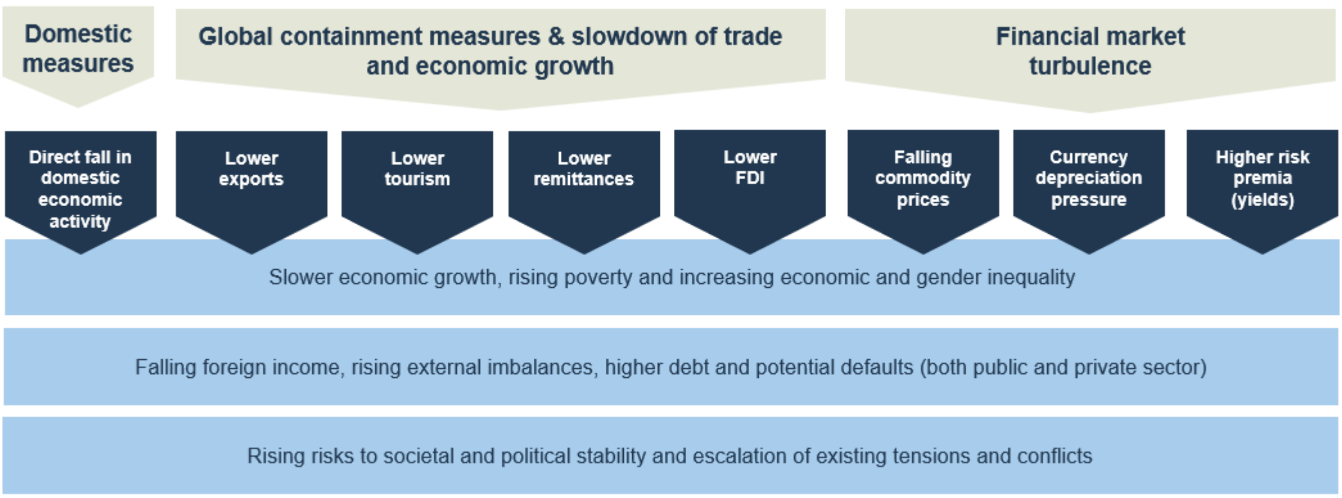


Figure 1. COVID-19 economic impact channels.

Many developing countries reacted fast

A factor that goes often ignored; **many developing countries were very proactive in imposing measures to contain the spread of the virus.**

In South East Asia, Vietnam deployed a low-cost strategy by quickly tracing and isolating people potentially infected. In Sub-Saharan Africa, countries like Kenya and Rwanda acted fast to close their borders and constrain travel, to impose social distancing as well as nationwide lockdowns and curfews as soon as the first cases of COVID-19 were confirmed in March.

For now, it seems that these early measures have been successful in winning more time to prepare the societies for combatting the virus.

While many countries were proactive, some have remained passive and even ignorant. The whole world has seen how poorly Brazil, where the President has been calling the virus 'a little flu', is coping with the crisis. Tanzanian government has imposed very limited containment measures and, instead, the President has appealed to a higher power and encouraged praying as a means of virus mitigation. Tanzania's strategy has caused anxiety amongst its neighbouring countries that are doing their best to contain the virus. South Africa has not been ignorant but was slower to react and is now paying a high price as it remains one of the continental hotspots for the virus.

As of end of June, In Africa, new COVID-19 confirmed cases were rising with more than 10,000 infections recorded daily with the worst continental hotspots in North, West and South Africa (see **Figure 2**).

The number of new infections continues to double every 2-3 weeks in the continent, and Egypt and South Africa alone account for close to 60% of the total active confirmed cases.

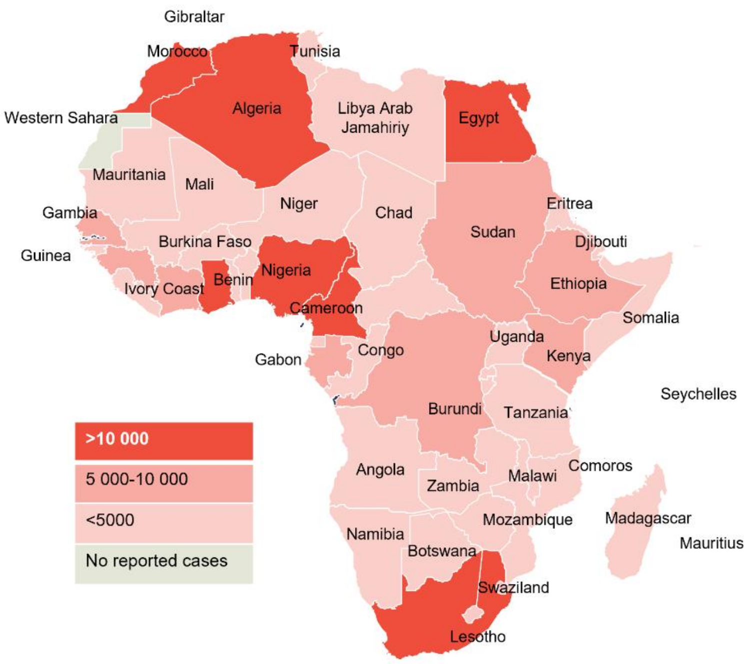


Figure 2. COVID-19 map on Africa, as of June 30 (Africa CDC).

Lockdowns have significant economic and social costs

While the containment measures in the developing world, mostly similar to the ones imposed in the developed world, have been crucial to prep the often-weak health care systems, their **societal costs are a lot higher than in the developed world.**

Much of the formal sector employees work in professions where remote working is not possible, not to mention the plethora of informal workers that go to the market place every day to sell e.g. fruits or used clothes. Lockdowns are leaving these people out of jobs, and often lacking a social security net, without any income.

This will lead to rising poverty and income inequality as people who are better educated and in better jobs to begin with, have a higher chance to continue working and maintain their jobs.

The World Bank has estimated that 49 million people could fall into extreme poverty, marking the first increase in global poverty since 1998 Asian Financial Crisis.[1] For example in Nigeria, a low-middle-income country, five million people could be pushed into extreme poverty, meaning that more than 40% of the population would have to live with a less than 2 dollars a day.

There is a heightened risk that the COVID-19 crisis also leads to setbacks in gender equality. The International Labour Organisation (ILO) warned in late June that some of the modest progress achieved in gender equality in recent decades could be wiped out by the COVID-19 crisis.

According to the ILO, women have been disproportionately affected by the pandemic as they are overrepresented in the most affected sectors, such as hospitality, food sales, and manufacturing. Almost 40% of all employed women work in those sectors, compared with 36.6% of men. Women are also more likely to work in sectors, where there is a high risk of infection (healthcare) or where losing income is likely (esp. domestic work).

“This will lead to rising poverty and income inequality as people who are better educated and in better jobs to begin with, have a higher chance to continue working and maintain their jobs.”

Looking at Finnfund’s key industries, female entrepreneurs constitute a significant share of many microfinanciers’ clientele. Due to lockdowns, many of them are now at risk of losing their livelihoods.

By supporting local financial institutions and microfinanciers who adhere to responsible practices, development finance institutions continue to promote female empowerment at a time, when more and more borrowers are expected to face problems in debt servicing due to the acute crisis.

Falling exports and remittances reduce foreign income and weigh on growth

While domestic economic activity has stalled due to containment measures in many places, **developing markets also feel the impact from the global fall in total demand and trade.**

For example, many countries in Sub-Saharan Africa, depend on the global market for their commodity sales; Zambian copper, Ghanaian gold, Kenyan flowers or tea, Ethiopian or Rwandan coffee, Tanzanian cashews or cocoa from Ivory Coast – not to mention the oil-exporting countries like Nigeria or Angola. Tourism has collapsed as well, affecting countries like Egypt, Morocco, Kenya, Tanzania, Uganda, Rwanda, Ghana and South Africa, as well as the island states of Mauritius and Cabo Verde. In Asia, countries most affected include Cambodia,

[1] Link to World Bank blog: https://blogs.worldbank.org/opendata/impact-covid-19-coronavirus-global-poverty-why-sub-saharan-africa-might-be-region-hardest

Thailand, Vietnam, Nepal and Sri Lanka where tourism is a major employer.

Many countries rely on their foreign income from exports to feed the people – not because these countries could not afford to be more self-sufficient, but because the local agricultural production and value chains are often underdeveloped and inefficient. **Hence, foreign currency is needed to buy food and of course, during the pandemic, also the life-saving medical equipment and testing kits that are produced abroad**.

Exports is not the only factor reducing countries' foreign income. **Falling remittances is another critical one as many developing countries depend on money transfers from people working abroad.**

As the COVID-19 shock is so global and so holistic, the World Bank projects a sharpest decline in remittances in recent history, an annual drop of 20% (see Chart 1). Countries most dependent on remittances include e.g. Nepal (29% of GDP), Lesotho (23%), El Salvador (21%), Honduras (20%) and Liberia (14%).

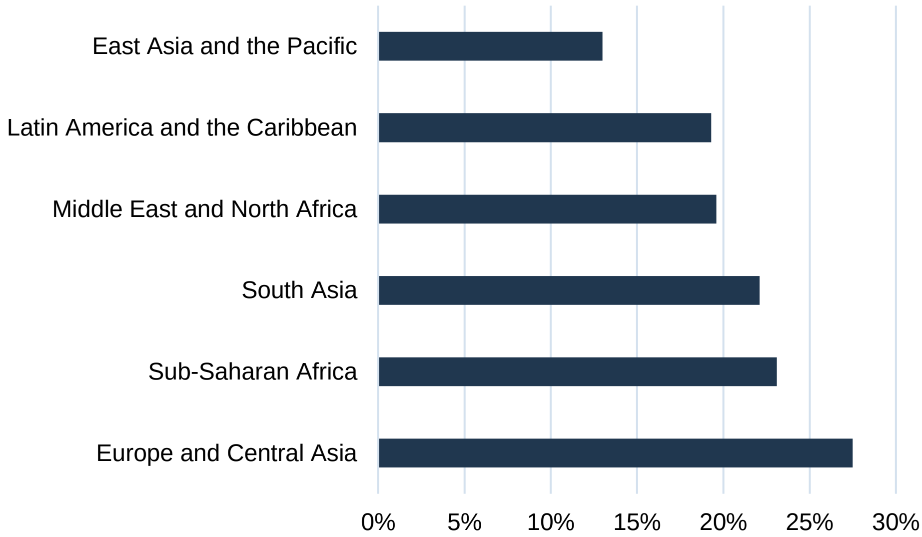


Chart 1 Projected fall in remittances (World Bank)

Banks' capacity to provide credit to private sector deteriorates in a crisis

In the developing world, local banks are often not in the position to provide sufficient credit to local private sector, at least not on feasible terms. Even in normal times, many businesses, albeit commercially viable, lack sufficient collateral to obtain credit from a local bank.

The capacity of the local banking system to provide credit stimulus for their domestic private sector depends on several factors, including the creditworthiness of the borrower but also on the bank's liquidity position and its own access to financing.

As governments are often considered the lenders of last resort to their banking system, a bank's creditworthiness is typically linked to the sovereign. A deterioration in the government's credit rating is, hence, reflected in the perceived credit risk of local banks, so a lower credit rating leads to higher financing costs for the banking sector.

When sovereign credit ratings are cut, banks are even poorer positioned to lend to private sector. Measures such as interest rate cuts or central bank loans can bring some relief but in many developing countries, the room for monetary easing is limited due to already high inflation, currency depreciation pressure or other issues.

As both domestic and foreign income fall, many developing country sovereigns are now struggling with their debt repayments. This has been reflected in many sovereign credit ratings, as illustrated in a summary **Table 1** below.

The most indebted countries like Angola or Mozambique will be particularly strained as well as countries that are at the brink of a default, such as Ecuador or Zambia[2]. Cash-strapped sovereigns cannot afford sufficient stimulus programs to support their private sector, but thanks to financing from e.g. the IMF, the World Bank or regional development banks they could cover the most critical costs for the public sector, such as those related to healthcare or e.g. food security.

In a similar way, development finance institutions' (DFIs) can help bridge the gap between the demand for financing in the private sector and the credit supply of local commercial financial intermediaries.

Summary table of relevant rating actions by Moody's during H1-2020

Rating actions*	Africa	Latin America	Asia
Rating confirmed or changed	Ethiopia downgraded to B2 Zambia downgraded to Ca South Africa downgraded to Ba1 Egypt confirmed at B2 Nigeria confirmed at B2	Suriname downgraded to B3 Ecuador downgraded to Caa3 Argentine downgraded to Ca Bolivia downgraded to B1 Costa Rica downgraded to B2 Nicaragua downgraded to B3 Bahamas downgraded to Ba2	Oman downgraded to Ba2 Lebanon downgraded to Ca India downgraded to Baa3
Rating outlook changed**	Ghana, Kenya, Namibia, Botswana outlooks changed to negative	Trinidad&Tobago, Costa Rica outlook changed to negative	Thailand outlook changed from positive to stable; Mongolia outlook changed to negative
Review for downgrade***	Tunisia, Angola, Ivory Coast, Senega, Cameroon		Pakistan, Sri Lanka, Laos

Rating scale	Investment grade	Speculative grade
	Aaa Aa1 Aa2 Aa3 A1 A2 A3 Baa1 Baa2 Baa3	Ba1 Ba2 Ba3 B1 B2 B3 Caa1 Caa2 Caa3 Ca C

*Excludes some rating actions on small states like Maldives, Mauritius and Belize.
**Rating outlook indicated a direction of the direction, typically in the next 6 months-2 years.
***Review for downgrade indicates an increased likelihood of a rating downgrade in the near future.

Table 1. Summary of key rating actions (Moody's).

Re-pricing of emerging market risk lead to a historical capital flight in March

As uncertainty grows, financial markets change their perception and pricing of risk. Investors rush into so-called safe haven assets, e.g. to the US or German government bonds, while dumping riskier assets such as emerging market equities or bonds.

Pricing higher risk premia for certain financial market products happens for a reason. **The risk associated with e.g. developing country sovereigns and businesses is perceived higher as their capacity to cope with the crisis is considered weaker.**

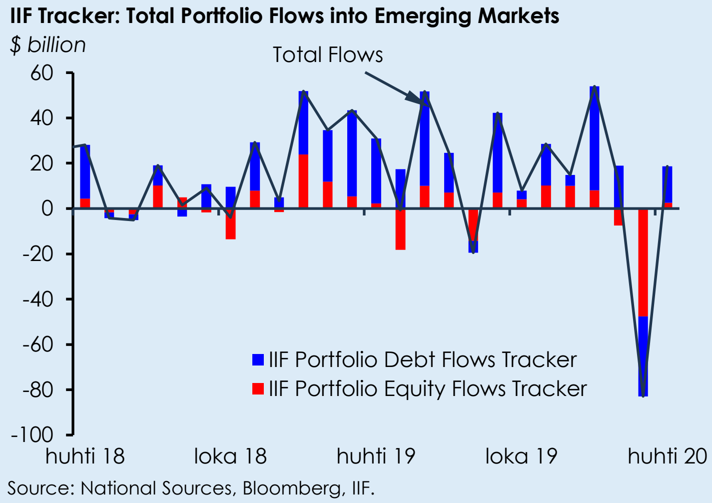
This is what happened in March when the markets panicked about COVID-19. Investors withdrew in masses from emerging markets resulting in a substantial capital flight.

Outflows in March were indeed unprecedented, with investors pulling USD 83billion from EM stocks and bonds in one month[3]. As the two charts (**Chart 2**) below illustrate, the outflows in March were most pronounced in emerging Asia, which makes sense, since Asia was the epicentre of the pandemic at the time.

The situation stabilised in April and the markets were again able to attract around USD 19bn inflows.

[2] Argentine already defaulted in May.

[3] Data source: International Institute of Finance (IIF).



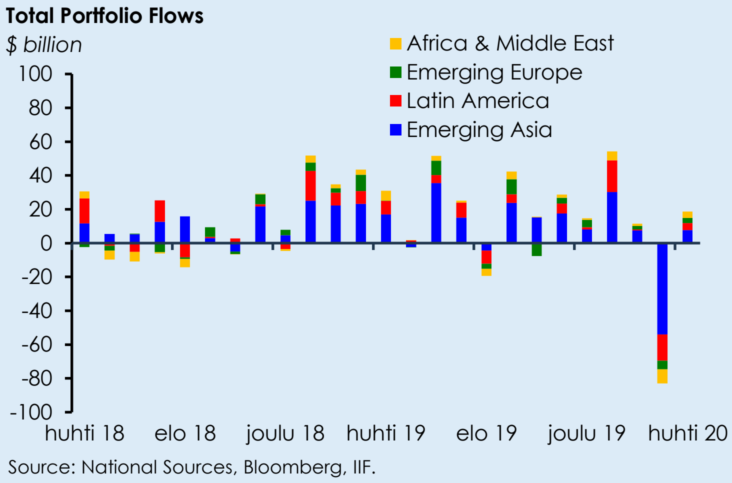


Chart 2 Total portfolio flows into emerging markets (IIF).

The IIF daily and weekly flow data confirms a further stabilisation and net inflows in May-June period, which could be a sign that adverse economic outcomes and weak growth are now largely priced in emerging and developing markets. It also reflects a consensus scenario where the pandemic, globally, is expected to wane in H2 and a massive second wave is avoided.

Looking at flows, however, geographical performance remains highly uneven. While China has been able to attract net inflows since early March, most other countries, where country-level data exists such as Indonesia, India, South Africa and to a lesser extent Vietnam still record net outflows in the same period.

Also, while flows have reverted to the positive territory in the second quarter, the damage on many emerging market assets was real.

Probably the biggest impact was on foreign exchange, as many emerging and developing country currencies have depreciated considerably during the pandemic.

For example, South African rand, Mexican peso, Zambian kwacha, Nigerian naira and Brazilian real remain at 10-30% weaker levels than before the storm. Because of a currency mismatch, with income being mostly in domestic currency while debt service is in hard currency, local currency depreciation negatively affects business margins and debt sustainability.

Unlike in 2007-2008, when food prices rose sharply, the world prices of agricultural commodities have been relatively stable during the pandemic. However, inefficiencies in food value chains may lead to price increases at the local level. Our investee, ETC Group, processes, warehouses and trades agricultural commodities, linking local farmers to global value chains and ensuring more efficient logistics. (Photo: ETC Group)

Falling commodity prices stimulate global economy but weigh on exporters

As global economic activity falters and total demand falls, it is intuitive that commodity prices decline. **Weak market sentiment and general risk aversion tend to push commodity prices further down.** Also, a stronger USD typically weighs on commodity prices, those that are priced in USD.

While commodities in general are sensitive to react to changes in economic outlook or market sentiment, 'commodities' is a broad asset class, and whereas oil and base metal prices often have positive correlation, precious metals tend to react differently, and agricultural commodities follow their own fundamentals.

Thus far, price declines have been most pronounced in oil and industry metals, which reflect expected downturn in e.g. construction and manufacturing. While falling commodity prices weigh on economic growth of commodity exporters, on a more micro level, lower raw material prices also compensate for the negative impact that slower growth has on businesses.

Price declines in industrial metals provide a much-needed cushion for industrial companies that use these raw materials in production. Also, as prices of fossil-based raw materials used for energy production fall, businesses get a boost in the form of lower energy bills. Unlike industrial metals, precious metals like silver, have fully recovered from the March slump, and gold prices have even soared, which is positive for emerging market exporters like Mexico, Ghana and Thailand.

Price swings in agricultural commodities have, thus far, been more limited and it is realistic to assume that staple food prices will fare well but prices of more expensive commodities like cocoa or coffee could suffer declines. Price dynamics could change if food-exporting countries start imposing export restrictions similar to what happened during the Global Financial Crisis. In that case, prices could rise significantly, worsening the already weak outlook for food security in e.g. Sub-Saharan Africa.

Last year, the FAO studied the impacts of economic downturns on food security in Africa, and found that **52 out of the 65 countries that experienced a rise in hunger during recent economic slowdowns are countries that are dependent on primary commodities for export and/or import**[4].

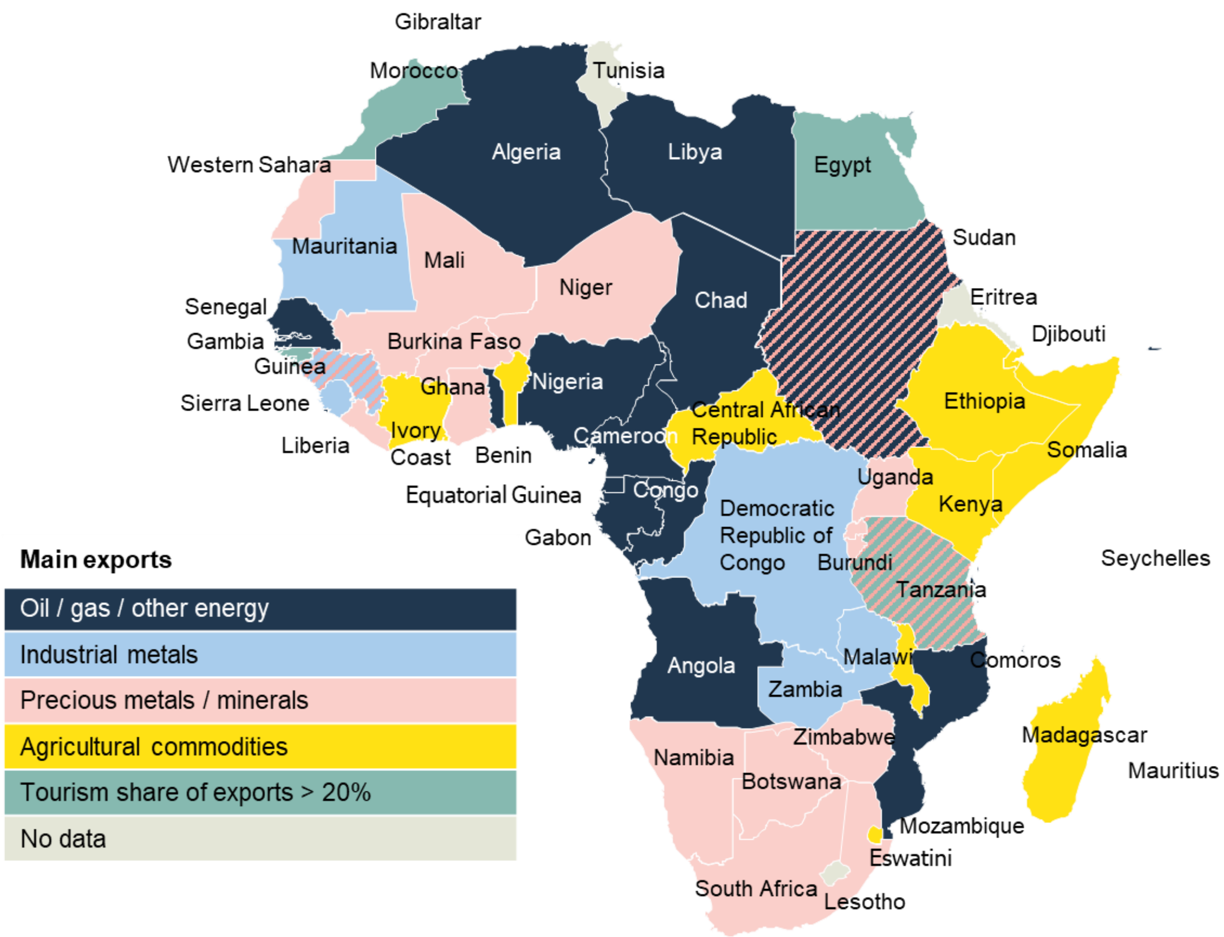


Figure 4. Main exports of countries in Africa (Observatory of Economic Complexity and World Bank).

[4] FAO 2019 Africa Regional Overview of Food Security and Nutrition: http://www.fao.org/3/ca7343en/CA7343EN.pdf

Sectoral impacts & experiences from Finnfund's investees

In this Chapter, we discuss the impacts on Finnfund's four key sectors: sustainable forestry, renewable energy, sustainable agriculture, and financial institutions.

For example, while supply chain disruptions have disproportionately affected the forestry sector, companies in energy sector face a heightened off-taker risk during the pandemic.

Local financial institutions can expect rising payment arrears and non-performing loans as their clients' (borrowers') businesses are disrupted by lockdowns. Agribusinesses also have had to adapt to a new situation and prepare for bottlenecks in supply chains. Simultaneously, agricultural sector entails significant new business opportunities as demand for local agricultural produce is set to increase.

Impacts on sustainable forestry

Sustainable forestry is one of Finnfund's key industries. It helps fight urgent global challenges, such as climate change mitigation and adaptation, deforestation, biodiversity loss, erosion, and water security. In practice, this means e.g. commercial plantations and related industries, such as sawmills, panel & board mills. Our forestry investments contribute to development creating good jobs and improving infrastructure, especially in the rural areas.

The observation that the pandemic has severely disrupted global supply chains can be confirmed by our client businesses in the forestry sector. Unsurprisingly, thus far, the greatest impacts have resulted from lockdowns in Asian countries as that is where the pandemic started. For example, our client businesses have customers in India and even though demand, up to now, has not been significantly affected, there are severe delays as deliveries get stuck at ports. Also, there have been delays in deliveries of key inputs needed both on plantations and processing, such as fertilizers and preservatives.

Supply chain and delivery disruptions have severely affected the revenue of forestry businesses. As the companies' cash reserves dry up, cost-cutting is needed. Unfortunately, that sometimes means that businesses encounter issues in implementing their CSR (corporate social responsibility) or smallholder programs that have great positive development impacts. If these programs are put on hold, many people go out of jobs. For example, the smallholder programs that are currently active amongst Finnfund's clientele, employ more than 17,000 people in Sub-Saharan Africa.

Key impacts:

- **Supply chain disruptions causing bottlenecks in production and delivery delays.**
- **Implementation of CSR and community programs becomes more challenging as cash reserves dry up.**

Impacts on energy sector

The way that developing countries meet their rapidly growing energy demand will be crucial for global efforts to curb climate change. Renewable energy is one of Finnfund's key sectors, and also the largest sector. Finnfund invests in wind, solar, hydro and bio energy, as well as in energy efficiency and storage.

According to the IMF[5], at least 24 developing countries[6] have imposed new subsidies to either support critical energy production or lowered the electricity bills of businesses and households amidst the pandemic-induced economic crisis. Especially in the least developed countries such as Burkina Faso, Chad, Mali, and Democratic Republic of Congo, governments have suspended electricity payments at least for the most vulnerable households. India has also directly supported its electricity distribution company through a liquidity injection.

While it is beneficial especially for the low-income consumers and SMEs (small and medium-sized enterprises) that their energy bills are lowered or exempted, it means that electricity distributors face lower revenues. As they become cash-constrained, their capacity to pay for independent power producers weakens. This is what we have seen across the board in the emerging and developing market space. Government-linked power companies, in many countries, are invoking force majeure clauses and e.g. unilaterally announcing a discount on tariff or simply delaying payments. These types of measures have direct negative impacts on our client businesses many of which are renewable energy producers.

Key impacts:

- **Revenues fall as government-linked off-takers invoke force majeure clauses and unilaterally cut tariffs or delay payments.**

[5] IMF Policy Responses: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19
[6] Including nine countries in Asia-Pacific, five in Latin America, five in West Africa. three in Central Africa, and one in East and North Africa each.

Impacts on financial institutions

Over a third of the world's adult population have limited or no access to official financial services. Most of these people live in Sub-Saharan Africa and Asia. The growth of mobile banking lays the foundation for making official financial services available to all. This mostly benefits people with low income or who live in remote areas or are difficult to reach for other reasons. Access to financial services also empowers women. Credible, reasonably priced financing helps small farmers and entrepreneurs, thus paving the way for economic growth and new jobs. Financial institutions is one of Finnfund's key sectors. Finnfund invests in micro-finance institutions, other financial institutions and fintech companies.

Local financial institutions and micro financiers have been at the epicentre of the discussion regarding sectors most affected by the pandemic. That is because clients of local financial institutions and microfinanciers are typically low-income people who hustle from day-to-day, such as taxi drivers, small-scale entrepreneurs or vendors. With many open-air markets now closed and travel restrictions on, millions of people are losing their livelihoods. As a result, one could expect rising payment arrears and non-performing loans in the microfinance sector.

A study conducted by Innovations for Poverty Action in Pakistan during the pandemic, has studied effects of the pandemic on microfinance borrowers[1]. The study concluded that week-on-week sales and household income both fell by about 90%, and that as a result, 70% of the sample of current microfinance borrowers reported that they could not repay their loans. Loan officers anticipated a repayment rate of just 34% in April.

Amongst our portfolio businesses, we have seen that impacts thus far have been limited. This is partially because many of our client businesses operate in rural areas, where lockdowns have been less strict and, hence, have had less severe impact on livelihoods. In many jurisdictions, local financial institutions have also deployed debt moratoria, allowing their clients extended grace periods or other leeway on repayment schedule, which provides immediate relief to borrowers.

On a more positive note, the pandemic has led to an increasing demand for digital and contactless payment solutions, a factor that could promote leapfrogging in the finance industry in countries and regions, where digital services were still rare before the pandemic. Digitalisation, however, also entails challenges, especially when it comes to gender equality. In many societies, women still have poorer access to e.g. mobile phones, so when banking goes digital, their access to financial services could suffer a setback.

Key impacts:

- **Lockdowns leave small-scale entrepreneurs out of jobs, which could affect their ability to repay micro loans. Payment arrears and non-performing loans are expected to increase.**
- **Digitalisation presents opportunities for the industry, but gender aspects require special consideration.**

Impacts on agriculture

Sustainable agriculture is one of Finnfund's key sectors. Climate change, population growth and urbanisation threaten the food security of millions of people. Many developing countries continue to import food because the productivity and crops of their own agriculture are inadequate. Improving the productivity of agriculture in a sustainable manner creates jobs and raises the income of people dependent on farming. Finnfund invests in the entire value chain of agriculture with the aim of improving primary farm production, particularly in Sub-Saharan Africa.

Sustainable agriculture plays a key role in the current crisis. At the start of the Global Financial Crisis in 2007-2008, a number of countries imposed restrictions on exports of key staples. As a result, according to the FAO[7], in 2008 domestic prices (adjusted for inflation) in a sample of countries were on average 28, 26 and 26 % higher for rice, wheat and maize, respectively, than in 2007. This had a disproportionate negative impact on food security of poor households, who could use 35% or more of their income to buy food.

The International Food Policy Research Institute (IFPRI) has been monitoring food price developments since the 2007-2008 food price crisis, and since the COVID-19 outbreak, their world market prices have been relatively stable. However, as the IFPRI highlights, wholesale and retail prices have nevertheless risen in many developing countries. For example, potato prices in India, the country hosting the world's largest lockdown, have increased 15% since the outbreak started. Similarly, in Uganda, prices of key food items have increased 15%. Evidence compiled through a survey conducted in Ethiopia, highlights a rising risk of food and nutrition insecurity as households report 'much less income' and a shift in food consumption patterns from fruits, meat and dairy towards less-nutritious items.

Finnfund's client agribusinesses operate mostly in agricultural production (e.g. fisheries, poultry, fruits) or in trading or transporting of agricultural products. Especially those that operate in trading and logistics, have had to adapt their operations to take into account the potential volatility in prices. Risks can be mitigated by entering into hedging contracts but also by dynamically adjusting inventories. For those agricultural products, where disruptions in supply chains have been identified, it makes sense to have a higher inventory. On the other hand, if there is a risk that commodity prices will fall significantly, it makes sense to shift to an order-based operating model where inventories are kept at minimum.

Some of Finnfund's client businesses in agriculture have reported negative impacts on business by e.g. as a result from lower sales to restaurants or as a result from local currency depreciation. Whenever inputs are bought from abroad (and paid in foreign currency), but sales are mainly local (income in local currency), local currency depreciation negatively affects company margins. For some businesses, sales have dropped because local marketplaces have been closed down or there is uncertainty around when and how the vendors can operate. Some businesses have altered their product offering to better match the current demand from supermarkets (instead of restaurants).

Key impacts:

- **Commodity price and exchange rate fluctuations affect business margins and require changes in operating models, risk management and warehousing.**
- **By adjusting their product offering, businesses have responded to changes in market dynamics and demand.**

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[7] FAO publication: Key lessons from the world food crisis of 2006-2008. http://www.fao.org/3/i2330e/i2330e04.pdf. Annual average prices are used.

Cross-cutting challenges

Businesses across sectors and geographies could expect rising expenses related to e.g. procurement of protective equipment and other health and safety related investments. Another factor adding to expenses is access to and cost of finance.

As discussed above, capital outflows and re-pricing of risk have affected both the cost of and access to finance of millions of emerging and developing market businesses.

Also, while we have not seen considerable challenges with staff yet, a few businesses are reporting their management staff members being stuck in 'wrong' countries due to travel restrictions, and further staff availability problems could arise as the pandemic evolves.

Finnfund's investee Australis Aquaculture reacted early to the COVID-19 risk in Vietnam. The staff follows the company risk assessment and response plan including the use of protective equipment and regular temperature checks. (Photo: Australis)

Opportunities

While the pandemic is a major setback for economic and societal development across the globe, it does not cancel out megatrends that continue to shape the world we live in.

The pandemic has proven the case for investing in resilience. **The current crisis has revealed the gaps in national healthcare systems and punished the societies where governments have taken a too complacent or even ignorant stance.** In an effort to avoid new epidemics, investments in health, clean water, sanitation and hygiene are needed, especially in areas and regions with fast rates of urbanisation and population growth.

The urgency to combat negative effects arising from e.g. climate change and biodiversity loss has not receded, on the contrary, **this crisis should serve as a reminder of what can happen if societies ignore the continuous warnings by scientists**.

"The pandemic has proven the case for investing in resilience."

The need for increased access to reliable, affordable and clean energy is expected to remain at the top of policymakers' agenda, also in the post-crisis world. The IEA has estimated that in line with SDG 7, in Africa, the number of people gaining access to electricity every year should triple from around 20 million today to over 60 million, with grid extensions and densifications as the least cost options[8].

As electricity demand is set to more than double in Africa by 2040, renewables play a leading

[8] IEA Africa Energy Sector Outlook 2019: https://www.iea.org/reports/africa-energy-outlook-2019

role in meeting this demand. To date, the continent with the richest solar resources in the world has installed less than 1% of the global total solar photovoltaics (PV). As technology costs fall, the resource-rich continent is expected to experience a double-digit growth in deployment of utility-scale and distributed solar PV, and other renewables, across the continent.

Apart from solar, wind power presents significant opportunities in Ethiopia, Kenya, Senegal and South Africa. To meet the increasing electricity demand, a significant scale-up in electricity sector investment in Africa is needed, as the continent currently accounts for a mere 1% of the global power supply investment.

The crisis has forced a digital leap in regions, sectors and organisations that were not at the frontier of digital revolution when the pandemic hit.

The pandemic has given a significant boost to platform economy and digital matchmakers. **In future, businesses operating in, for example, AgriTech or FinTech have great potential to leverage innovations made and practices taken during the crisis.** This could result in significant efficiency gains in local food chains and improved access to basic products and services. E-Commerce is another industry expected to benefit from the crisis.

"The pandemic has given a significant boost to platform economy and digital matchmakers."

To give some examples of our response, in March, we announced a USD 1 million investment into Kasha, an e-commerce platform improving women's access to health, hygiene and self-care products in East Africa. In May, we announced a USD 15 million loan to ETC Group, that processes, warehouses and trades agricultural produce, with most of its footprint in Africa. The company has a strong role in integrating local farmers into global value chains, while also promoting more efficient logistics.

Also in May, we announced an additional investment into BOPA, a company that is developing microfinance businesses in Asia. BOPA has a strong track record in promoting financial inclusion and women's empowerment.

Australis Aquaculture is a forerunner is sustainable aquaculture in Vietnam and a Finnfund investee since 2017. Currently, the staff follows the company risk assessment and response plan including the use of protective equipment. (Photo: Australis)

Summary: A way to recovery

During ‘a crisis like no other’, as the IMF frames it, most developing country governments are not equipped to support their private sector amidst the crisis. This is even though private sector contribution to economic and societal development is widely acknowledged and highlighted, also, on the UN 2030 Agenda for Sustainable Development and the associated Sustainable Development Goals (SDGs).

While lockdowns have been necessary in the developing world, both to contain the spread of the virus and to buy time for the ill-equipped health care systems, their socio-economic costs are a lot higher than in the developed world.

“To bridge the rising financing gap in the private sector, development finance institutions are now needed more than ever.”

Developing country governments face rising health care and social security related expenditure at a time when both domestic and foreign income falls. **Lower remittances, capital outflows and falling commodity prices further undermine many sovereign’s ability to support their private sector while they also contribute to unsustainable debt levels.** To bridge the rising financing gap in the private sector, development finance institutions are now needed more than ever.

Thus far we have seen how supply chain disruptions have disproportionately affected the forestry sector, while energy producers have been challenged by a heightened off-taker risk during the pandemic. Local financial institutions face a growing risk of rising payment arrears as their borrowers lose jobs or livelihoods, while they play a key role in providing the much-needed leeway for their borrowers. Agricultural businesses have had to adapt to the new situation by adjusting their operating models, product offering and risk management practices.

Despite of the acute challenges, several megatrends continue to advocate investing into emerging and developing markets.

Population growth, urbanisation and climate change require a significant scale-up in investments into sustainable energy production, improved city infrastructure including water, sanitation and health, as well as investments into innovations, technologies and digital solutions that entail efficiency gains and improve access to basic products and services across sectors and industries.

Just like the IMF and the World Bank have provided crucial lifeline to sovereigns, development finance institutions like Finnfund continue to do the same in the private sector space. **By investing, we allow our investees to maintain jobs and positively contribute to a sustainable and inclusive economic growth at a time, when that contribution is more important than ever.**

Thanks to our development-oriented mandate and our capacity to absorb risk, we and other DFIs are well positioned to invest in healthy developing country businesses, even when the risks are on the rise. **Governments could support these endeavours by providing the right kind of risk-sharing mechanisms and instruments that leverage the scarce taxpayers’ money, promote efficient public-private partnerships and succeed in attracting additional capital into sustainable investments globally.**

We have less than 10 years to achieve the SDGs. The pandemic is a massive setback, but it is not a reason for giving up on a more prosperous future. On the contrary, inspired by the urgency, we will work harder than ever, to not only catch up the progress lost but to speed up the global advancement towards the financing and implementation of the SDGs and the UN 2030 Agenda.

Read more about our work at www.finnfund.fi

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Suomenkielinen tiivistelmä - Summary in Finnish

Eväitä elpymiseen: Analyysi koronakriisin vaikutuksista kehittyviin markkinoihin ja niillä toimiviin yrityksiin

Koronapandemia on ollut ennennäkemätön sokki maailmantaloudelle. Kansainvälinen valuuttarahasto IMF ennustaa maailmantalouden supistuvan 4,9 prosenttia vuonna 2020. Saharan eteläpuoliseen Afrikkaan ennustetaan ensimmäistä talouden lamaa 25 vuoteen, kun alueen bruttokansantuotteen (BKT) ennustetaan pienenevän 3,4 prosenttia. Kuvaavaa on, että vielä ennen pandemiaa Saharan eteläpuoliseen Afrikkaan odotettiin 3,5 prosentin kasvua.

Kehittyvillä markkinoilla toimivat yritykset kohtaavat toiminnassaan nyt samanlaisia haasteita kuin yritykset ympäri maailman. **Kehittyvissä maissa toimivien yritysten lähtökohdat kriisistä selviytymiseen ovat kuitenkin usein heikommat** kuin keskimäärin kehittyneillä markkinoilla. Pandemian hillitsemiseen liittyvät rajoitustoimet, globaali talouden taantuma, maailmankaupan hidastuminen ja rahoitusmarkkinoiden lisääntynyt heilahtelu vaikuttavat erityisen negatiivisesti juuri moniin kehittyvien maiden yrityksiin.

Yhteiskuntien sulkeminen on ollut tarpeellista viruksen leviämisen estämiseksi. Monissa kehittyvissä maissa **sulkujen sosiaaliset ja taloudelliset vaikutukset ovat kuitenkin huomattavan suuret**. Monen pienyrittäjän tai epävirallisen sektorin työntekijöiden toimeentulo riippuu päivittäisistä tuloista. Sosiaaliturvan puutteiden vuoksi köyhyys on kasvava uhka. Maailmanpankki ennakoi, että koronakriisin seurauksena 49 miljoonaa ihmistä voi vajota äärimmäiseen köyhyyteen. Köyhyyden odotetaan lisääntyvän maailmanlaajuisesti ensi kertaa sitten vuoden 1998 Aasian talouskriisin.

Köyhyyden ohessa myös **eriarvoisuus ja sukupuolten välinen tasa-arvo uhkaavat kasvaa**. Työpaikkojen ja toimeentulon menetykset uhkaavat erityisesti matalatuloisia sekä epävirallisella sektorilla työskenteleviä, kun taas etätyö on mahdollista usein korkeatuloisille. Kriisi iskee kovaa naisvaltaisille toimialoille: turismiin ja hotellialaan, ruuan myyntiin sekä valmistavaan teollisuuteen. Kansainvälisen työjärjestö ILO:n mukaan 40 prosenttia työllisistä naisista työskentelee näillä sektoreilla, kun vastaava miesten osuus on 36,6 prosenttia. Naisia työskentelee myös miehiä enemmän aloilla, joissa tartunnan saamisen ja toimeentulon menettämisen riski on korkea.

Maailmantalouden ja -kaupan hidastuminen heijastuu vahvasti kehittyvien maiden talouksiin, joissa monen viennin rakenne on yhä yksipuolinen. **Useat Afrikan taloudet ovat riippuvaisia öljyn, maataloushyödykkeiden, teollisuusmetallien tai jalometallien viennistä.** Ehkä voimakkaimmin kriisi on iskenyt juuri öljynviejätalouksiin, kuten Nigeriaan ja Angolaan sekä turismista hyötyviin maihin, kuten Egyptiin, Marokkoon, Etelä-Afrikkaan, Itä-Afrikan maihin kuten Keniaan, Tansaniaan ja Ruandaan sekä Mauritiuksen ja Kap Verden kaltaisiin saarivaltioihin. Aasian maista Kambodzassa, Thaimaassa, Vietnamissa, Nepalissa ja Sri Lankassa 6,0–9,0 prosenttia kaikista työllisistä työskentelee turismialalla.

Viennin romahtaessa putoavat myös ulkomaiset tulot, joita tarvitaan tuonnin rahoittamiseen. Huolimatta siitä, että esimerkiksi useissa Afrikan maissa on merkittävää potentiaalia kotimaisten ruuan arvoketjujen kehittämiseen, maat ovat yhä riippuvaisia ruuan tuonnista. Myös pandemian hoitoon tarvittavia terveydenhuollon tarvikkeita ja laitteita tuodaan pääosin ulkomailta. **Vientitulojen ehtyessä ruuan ja elintärkeiden tuotteiden tuonti on nyt paikoin uhattuna.** Tilannetta vaikeuttaa vielä se, että monissa kehittyvissä maissa tärkeässä roolissa olevat diasporan rahalähetykset ulkomailta tyrehtyvät.

Rahoitusmarkkinoiden turbulenssi heijastuu negatiivisesti useisiin kehittyviin talouksiin. Maaliskuussa todistettiin sijoittajien ennätysmäistä joukkopakoa kehittyviltä markkinoilta. Tilanne on tasaantunut sen jälkeen, mutta vasta Kiina on pystynyt kääntämään pääomavirrat takaisin edukseen. Toisin on muun muassa Intiassa, Indonesiassa ja Etelä-Afrikassa, joihin pääomat eivät vielä ole palautuneet. **Pääomien paetessa riskilisät ja rahoituskustannukset nousevat, mikä on heikentänyt sekä kehittyvien valtioiden että niissä toimivien yritysten rahoituksen saatavuutta sekä näiden maiden valuuttoja.** Hyödykehintojen, erityisesti öljyn ja teollisuusmetallien, hintojen lasku näkyy niin ikään alentuneina ulkomaisina tuloina.

Koronapandemia on vaikuttanut Finnfundin päätoimialoilla toimiviin yrityksiin eri tavoin. Kansainvälisiin toimitusketjuihin liittyvät ongelmat ovat heijastuneet tähän mennessä eniten metsäsektoriin, jossa esimerkiksi tavarantoimitukset ovat viivästyneet. Energiasektorilla taas ovat kriisin aikana korostuneet sähkönostajien maksuviipeisiin tai sovituista tariffeista poikkeamiseen liittyvät riskit. Rahoituslaitoksista erityisesti pienrahoituslaitokset ovat haastavassa asemassa koronapandemian edessä, sillä niiden asiakkaista moni on kriisin vuoksi menettänyt tulonlähteensä. Maataloudessa toimivat yritykset ovat joutuneet tekemään muutoksia riskienhallintaansa ja toimintamalleihinsa sopeutuakseen muun muassa hyödykehintojen ja valuuttakurssien vaihteluihin sekä liikkumisen rajoituksiin.

Monissa kehittyvissä maissa **julkisen talouden kantokyky ei riitä yksityisen sektorin tukemiseen kriisin keskellä**, vaikka yksityisen sektorin tärkeä rooli on tunnistettu muun muassa YK:n kestävän kehityksen ohjelmassa ja tavoitteissa (Sustainable Development Goals). Kotimaiset ja ulkomaiset tulot ovat romahtaneet samanaikaisesti, kun esimerkiksi terveydenhuoltoon ja sosiaaliturvaan liittyvät menot ovat voimakkaasti kasvaneet. Monen maan velkakestävyys on uhattuna, ja velkojen uudelleenjärjestely on jo ajankohtaista esimerkiksi Ecuadorissa ja Sambiassa.

Maailmanpankki ja IMF ovat tarjonneet kehittyville maille kriisin aikana hätärahoitusta, joiden avulla maat selviytyvät kriittisimmistä kuluistaan, kuten välttämättömien tuontitavaroiden hankinnoista. **Finnfundin kaltaiset kehitysrahoituslaitokset taas vastaavat yksityisen sektorin rahoitustarpeisiin hetkellä, jolloin kansainväliset pääomat ovat monesta maasta paenneet.** Investointimme turvaavat kehityksen kannalta tärkeitä työpaikkoja, tarjoavat tärkeitä palveluja ja hyödykkeitä sekä tuottavat kotimaisia verotuloja.

Vaikka pandemia on akuutti haaste useille kehittyville maille, näiden **markkinoiden valtava potentiaali ei ole hävinnyt.** Päinvastoin: väestönkasvu, kaupungistuminen, ilmastonmuutos ja digitalisaatio ovat megatrendejä, jotka puoltavat yhä investoimista kehittyville markkinoille sekä merkittävien kehitysvaikutusten että sijoittamisen näkökulmasta.

Koronakriisi korostaa tarvetta investoida yhteiskuntien parempaan resilienssiin. Kriisi on myös tuonut mukanaan **uudenlaisia mahdollisuuksia esimerkiksi erilaisille alustatalouden ja verkkokaupan innovatiivisille toimijoille**. Nerokkaimmat liiketoimintamallit tuottavat sekä positiivisia kehitystuloksia että mahdollistavat muualla ja monissa kehittyneissä maissa nähtyjen kehityksen välivaiheiden yli loikkaamisen esimerkiksi ruuan tuotantoketjujen tehostamisessa tai peruspalveluiden saatavuuden parantamisessa.

Kriisin keskellä Finnfundin ja muiden kehitysrahoittajien tavoitteena on huolehtia siitä, että taloudellisesti terveet mutta pandemian vuoksi ongelmiin ajautuneet yritykset selviytyvät kriisin yli. Tarve pitkäjänteiselle yhteistyölle sekä riskiä sietävälle ja vastuulliselle rahoitukselle on nyt erityisen suuri: **kaupallisia rahoittajia korkeamman riskinottokykymme vuoksi voimme jatkaa**

aktiivista sijoitustoimintaa myös silloin, kun liiketoiminnan riskit kehittyvillä markkinoilla ovat kohonneet. Valtiot voivat tukea toimintaa luomalla riskinjakomekanismeja, joiden avulla lisätään yksityisen ja julkisen sektorin kumppanuuksia ja houkutellaan tärkeisiin investointeihin yksityistä pääomaa.

YK:n kestävän kehityksen tavoitteet on määrä saavuttaa seuraavan 10 vuoden aikana. Pandemia on takaisku mutta ei syy luovuttaa. Takamatkalta lähteminen on vain syy juosta entistä kovempaa. Uusien kriisien estämiseksi on pidettävä huoli, että elpymisen aikana pääomat ohjautuvat yhä voimakkaammin investointeihin, joilla **tuotetaan konkreettisia ratkaisuja paitsi pandemian tuottamiin akuutteihin haasteisiin myös muihin kestävän kehityksen haasteisiin.**