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FORESIGHT

Global Private Markets Outlook 2023

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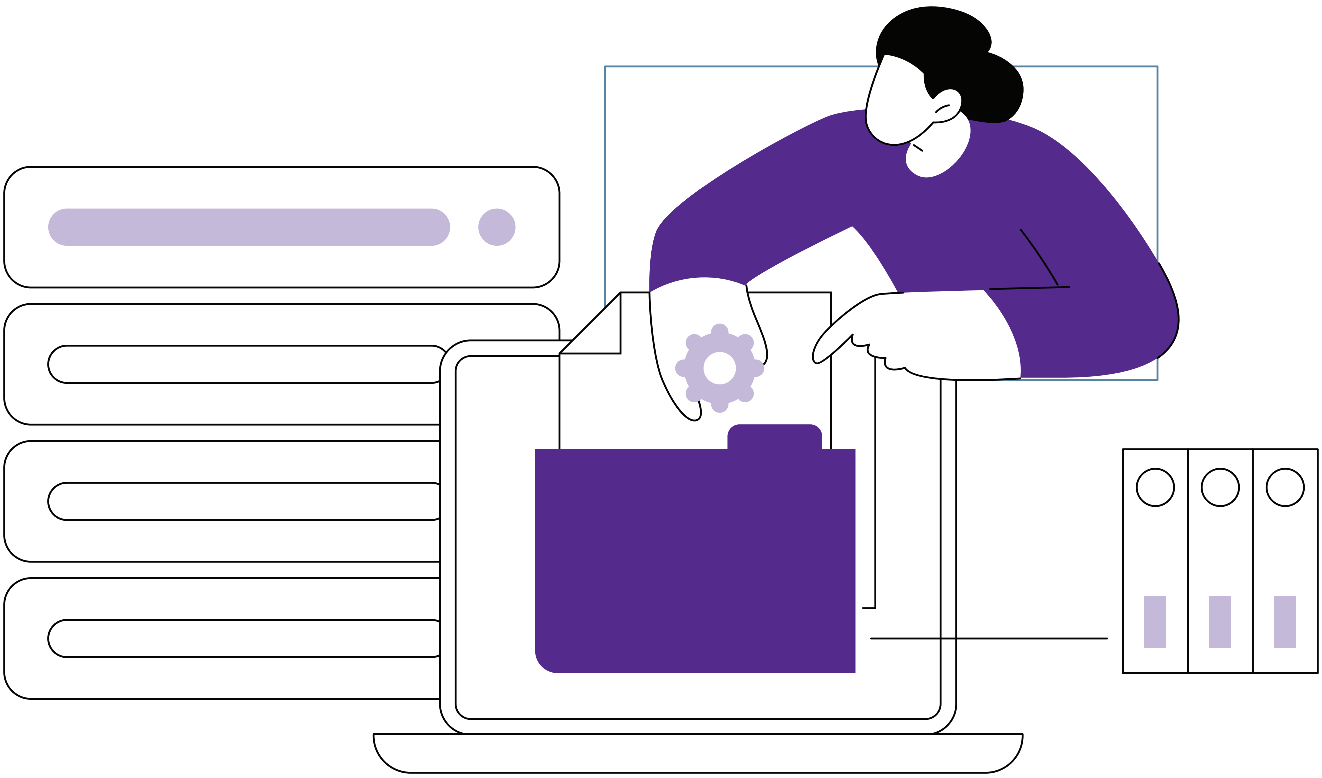


FROM THE CEO

Robert
King

Chief Executive Officer, and Member of the Board

Acuity Knowledge Partners

We are pleased to present the results of the second edition of our survey of private equity and venture capital (PE&VC) firms. Like last year, PE&VC professionals from the industry globally participated and shared their valuable insights.

We at Acuity Knowledge Partners take great pride in our two-decade-long association with the sector. During this period, we have assisted more than 130 PE&VC firms in a range of analytical, reporting, and operational activities. We have worked very closely with these firms, becoming a trusted partner to support their analysis, helping them make better and faster business decisions. With these annual surveys, we aim to collaborate with the sector, so we can provide market participants with research that assists with a perspective on both current and future challenges.

We continue to look at this survey as a step to generate collective wisdom for the PE&VC sector. Last year, we shared the sector's optimism, and this year, we are working closely with our clients to identify emerging challenges due to the current economic headwinds. These headwinds have caused concern for the sector in terms of many core PE&VC activities, including fundraising, investing, valuation, and exits. We are, therefore, monitoring the shifts in sentiment and preference of PE&VC professionals to help them navigate the challenges they face amid current market conditions.

We hope these survey results provide readers with greater transparency and insight into this rapidly evolving market.

INDUSTRY PULSE AND OUTLOOK

As the largest, decade-old practice serving PE&VC clients across regions and strategies, we are trying to gauge sentiment and opportunities available to the global PE&VC sector. Last year, we published the first edition of Foresight – our annual survey of the sector.

Encouraged by the overwhelming response, we strove to continue to feel the pulse of the sector with the second edition of our landmark survey. We wish to thank all the respondents for their participation and sharing their insights.

Sentiment in the current year seems to be quite the opposite of last year. While optimism surrounding fundraising, investment opportunities and the investing environment was high last year, a sense of pessimism now prevails in most parts of the sector. Sentiment was remarkably positive on low interest rates but has now dipped due to economic and geopolitical headwinds.

Rising interest rates dented fundraising expectations for 2023. However, the sector seems to consider this to be a passing trend, as expectations for raising new funds remain strong. Against this backdrop, competition has increased, especially for smaller funds, while large funds remain favoured by LPs. The sector believes investing opportunities may decline in 2023, but the level of difficulty is likely to remain the same as last year. As effects of the pandemic wane, we observe a change in investing preferences, especially in tech areas, such as a recovery in investment in traveltech.

That said, due diligence, portfolio monitoring and deal sourcing are expected to demand most of PE professionals' time. The time spent on deal sourcing may increase at the expense of conducting due diligence. The sector continues to consider outsourcing as a force multiplier. However, as uncertainties relating to geopolitical and economic climates remain, the respondents are taking a wait-and-see approach to partnering with a suitable service provider.

Valuation expectations have declined substantially as the sector witnessed a decline in public indices. More respondents expect challenges to exit strategies, and IPO has fallen out of favour as an exit strategy.

ESG integration with operations has gained momentum. The respondents follow one standard or another, with significant variations across regions. More firms now publish ESG and related reports and have monitoring committees and individuals designated to handle ESG matters. As adoption increases, such considerations would become even more prominent.

Sumit Chhabra
Managing Director,
Co-head of Global Delivery,
Acuity Knowledge Partners

SUMMARY OF OBSERVATIONS

The PE&VC sector had a dream run in 2021, when strong optimism was visible across most operational aspects. However, this lost steam as the economic tide shifted and geopolitical tensions emerged in 2022, resulting in scepticism.

Less than half of the respondents plan to raise funds in 2023, in sharp contrast to last year, when over two-thirds were willing to raise new funds. As a result, there is a slight decline in competition in fundraising. Emerging markets are more optimistic than developed markets about fundraising.

Competition remains a concern this year as well. Macroeconomic factors have also emerged as a top concern and a very strong headwind to fundraising. These two challenges are followed by concerns related to convincing limited partners (LPs) to invest, indicating that LPs are concerned about the current situation.

The number of respondents who believe investment opportunities have declined increased threefold compared to last year. Notably, 40% of the respondents still believe such opportunities may increase. Optimism surrounding investment opportunities seems to be the highest among PE&VC leadership. Regionally, Asia is more positive about opportunities than Europe and North America.

About a third of the respondents believe there is moderate to slightly high difficulty in terms of capitalising on opportunities, mainly due to the lack of suitable opportunities, high valuations and the geopolitical climate. Like last year, these challenges seem universal, applying to all regions and firms.

PE&VC firms are very interested in tech opportunities, although we see a slight shift in preferences as effects of the pandemic wane. While all tech areas registered a slight decline in preference, traveltech gained.

Professionals continue to spend most of their time on three activities – due diligence, deal sourcing and portfolio monitoring. However, due diligence witnessed a decline of 5% in time spent, with more time allocated to valuation and portfolio monitoring.

Despite the challenges expected in the investing environment, PE&VC firms continue to consider augmenting their teams' capacity through outsourcing: 70% of the firms surveyed are willing to outsource their operations (including but not limited to accounting, administration, human resources, operations and technology infrastructure). Notably, all levels of the PE&VC sector continue to demonstrate a willingness to outsource due to the additional bandwidth outsourcing provides.

When it comes to portfolio monitoring (one of the most time-consuming tasks), firms rely primarily on spreadsheets more than on tools, including in-house tools.

Expectations relating to valuation have also shifted – 90% of the respondents expected valuations to remain the same or increase last year; this has dropped to less than 40% this year. This is based on recent volatility in market indices and the number of declines witnessed. Among sectors, real estate remains the most optimistic about valuations increasing as it recovers from the pandemic-driven decline in occupancy and transactions. However, this sector, too, witnessed a sharp decline compared to last year; only 17% of the respondents expect valuations to rise.

Due to the prevailing environment, a substantial three-fourths of the respondents feel exits will be challenging. Preferences in terms of methods of exit are more or less the same, although IPOs are the least preferred method now.

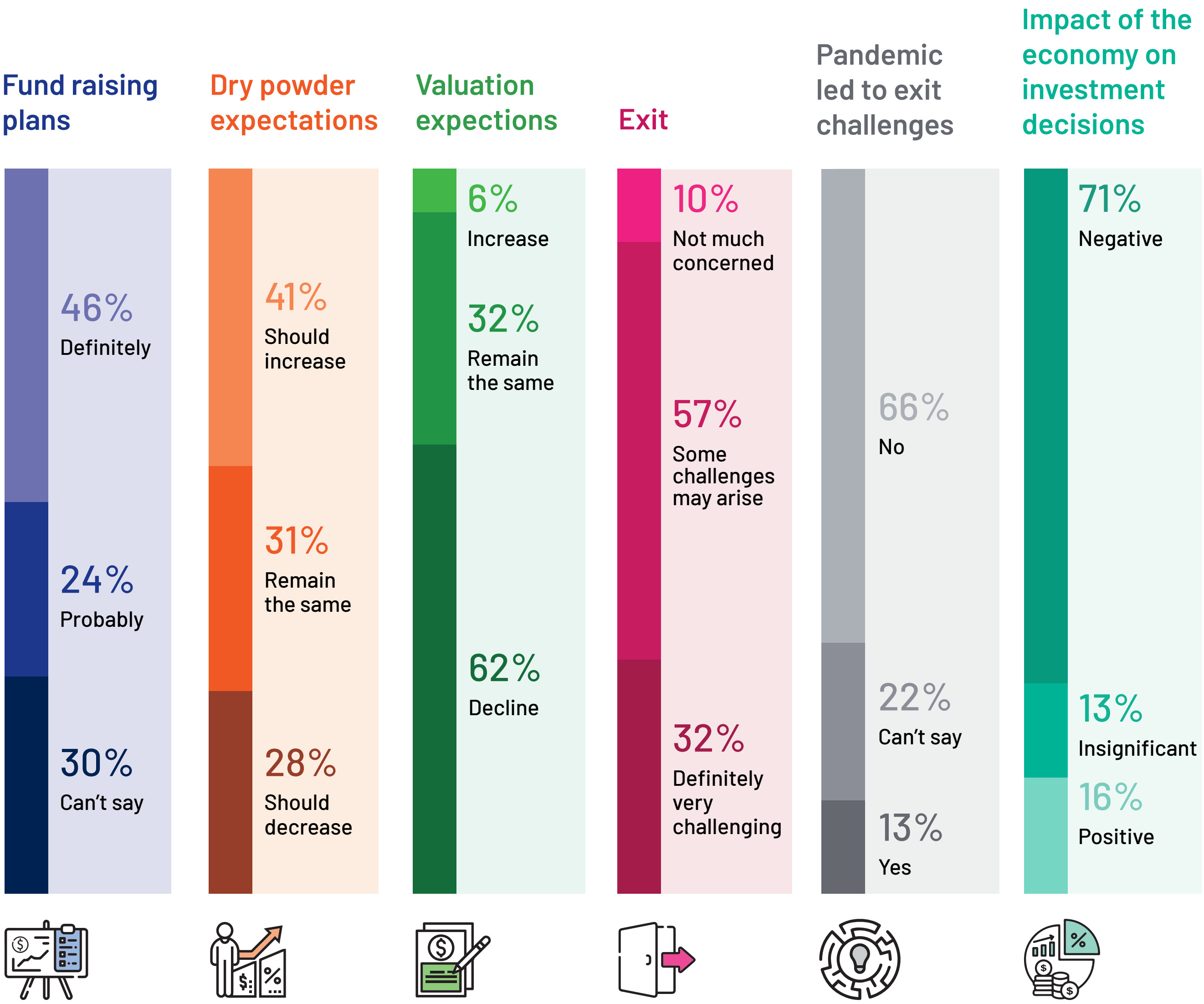
In terms of challenges in the investing environment, high valuations and fundraising remain the most pressing concerns worldwide, with fundraising the top concern. However, there are region-specific outliers; for example, respondents from North America continue to consider high valuations as a top concern. Other challenges include exit and investment opportunities, which resonated with one-third of the respondents. Dry powder-related concerns cooled – from 24% of the respondents last year to 15% currently. The regulatory environment remains demanding.

PE&VC professionals are especially concerned about vigilance and compliance, ESG, jurisdiction, taxation and reporting obligations. Concerns have also increased in relation to the SEC's new Marketing Rule, with respondents believing its requirements are difficult to meet.

ESG is influencing PE&VC operations as concerns over climate change, corporate governance and social disparity continue to heighten. 54% of the respondents are signatories to the UN PRI, and the sector follows a number of ESG-related frameworks. Adoption of these frameworks varies by region: more firms in UK and Asia follow the TCFD than North American firms, which prefer the SASB Alliance.

In their effort to strengthen ESG initiatives, the share of PE&VC firms with an individual designated to deal with ESG-related matters, ESG committees and ESG, CSR or sustainability reports has increased over last year.

PE&VC sector is conscious in current environment



Number may not add to 100% due to rounding

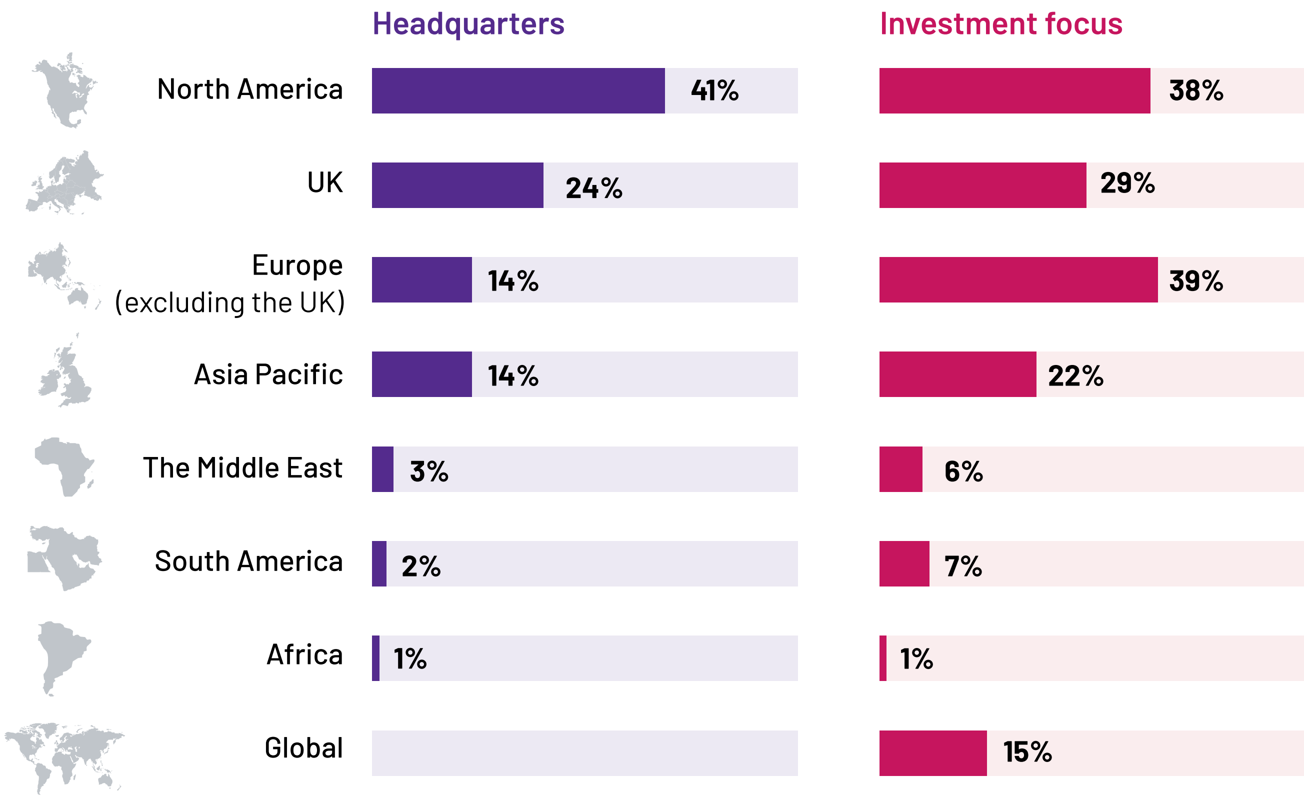
INTRODUCTION

Acuity Knowledge Partners has a deep-rooted relationship with the PE&VC sector, having served its professionals and executives across activities for over a decade. We are also the global leader in serving the sector. Based on this detailed understanding, we launched our debut global survey last year and received a remarkable response.

This year's survey, too, received a substantial response, with the respondents sharing inputs and insights across investment regions, activities, operating environments and relationships, making our survey one of the most comprehensive global surveys that address both opportunities and concerns, especially in the current turbulent economic environment.

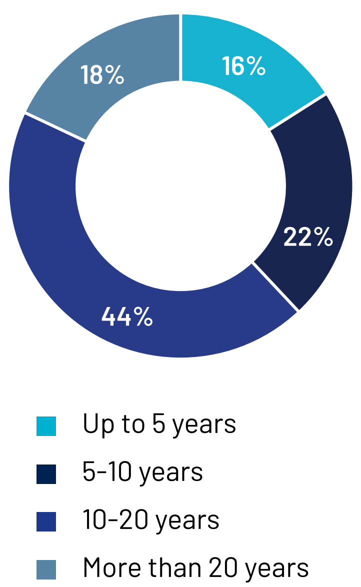
We received responses from c.70 firms from all regions. Our respondents have investing interest worldwide. However, due to the heavy concentration of capital, PE&VC firms and investment opportunities, North America, the UK and Europe, and Asia continued to account for over 90% of the respondents in terms of location of headquarters and investment focus. Our respondents also show interest in Africa and South America, albeit with less focus. Hence, the survey captures the essence of the global investing environment.

Respondents' HQ locations and investing focus

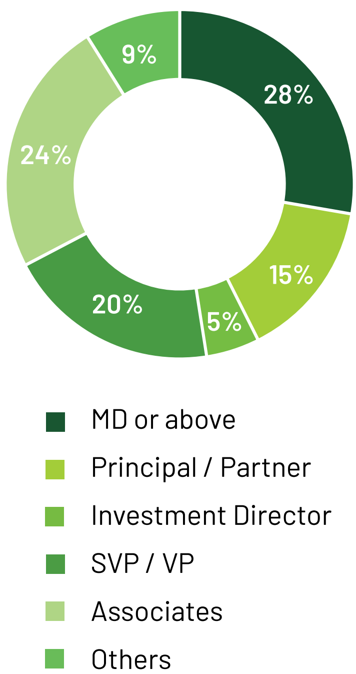


Veterans continue to provide insights; 84% of the respondents have over 5 years of experience in the sector and nearly two-thirds over 10 years of experience. Two-thirds hold leadership positions.

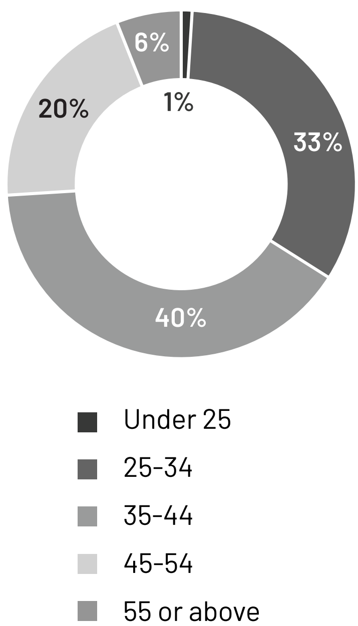
Experience



Current role

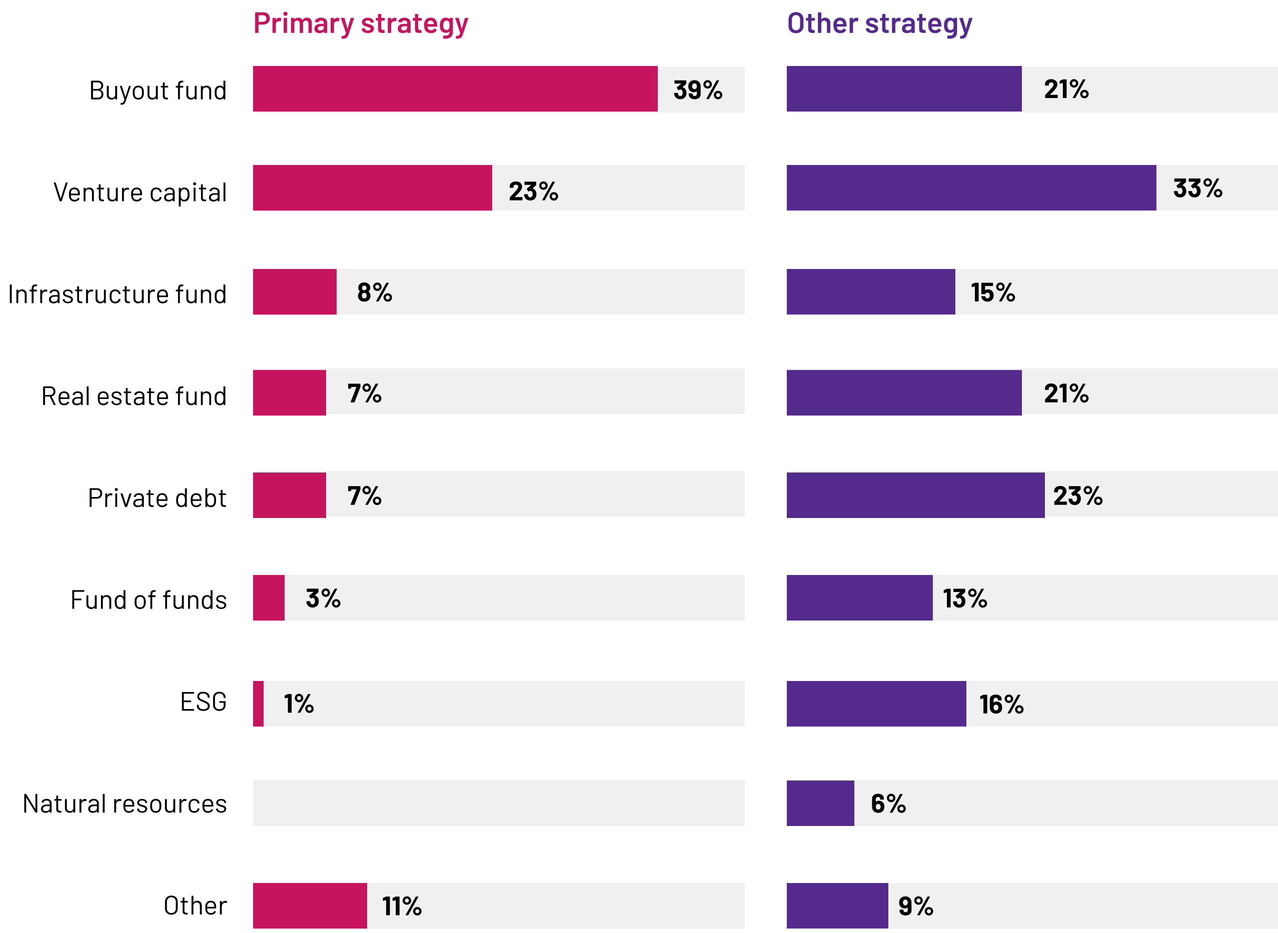


Age

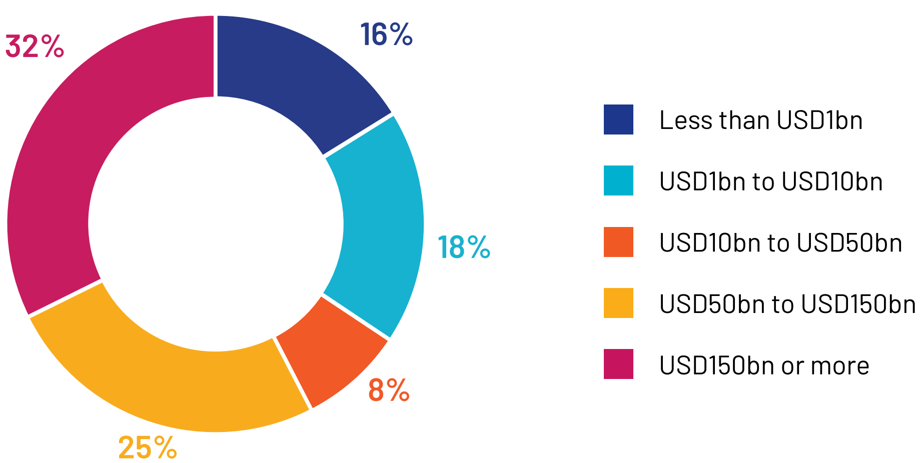


The respondents represent firms that together represent the sector. Most PE firms are buyout funds; therefore, the respondents mostly represent buyout funds, followed by VC firms, which are a subset of their own. We also received responses from firms pursuing other strategies. Sixteen percent of our respondents were from funds with over USD150bn in AuM and 32% from smaller firms, with under USD1bn in AuM.

Strategy



AuM (USDbn)



FUNDRAISING

» *In our previous survey, we mentioned that the low interest rate environment was fuelling fundraising. Not surprisingly, as interest rates rise, GPs are becoming pessimistic about fundraising*

» *LPs prefer large funds; competition among large funds is declining while small funds continue to face high competition*

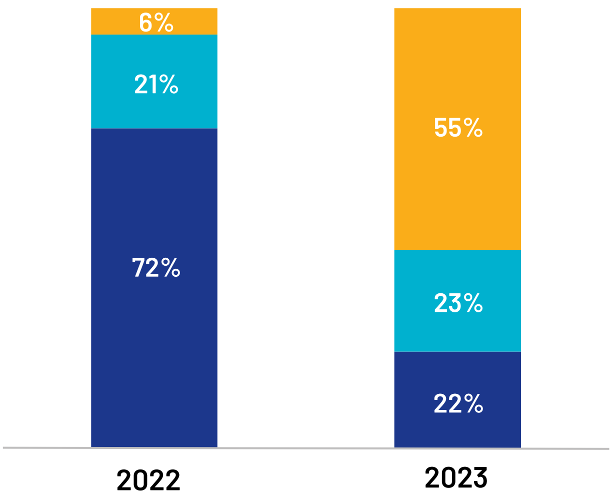
» *New funds and strategy diversification plans have been tempered in the current circumstances, but this likely requires a "wait and watch" approach*

» *Dry powder is at record-high levels and is expected to remain elevated*

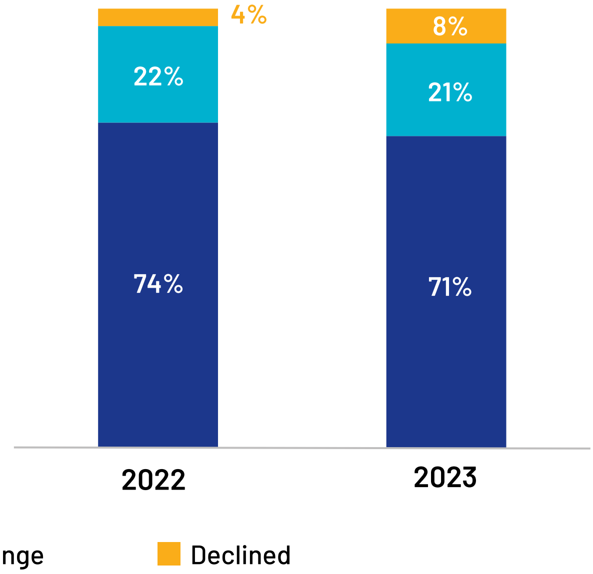
Last year's strong optimism towards fundraising seems to have weakened this year after the numerous challenges relating to economics and geopolitics. Three-fourths of our respondents believed fundraising would remain strong last year. In this survey, only one-fourth of them are optimistic about growth in fundraising, and more than half believe fundraising will decline in 2023. **Our previous survey results showed that this optimism was driven strongly by low interest rate regimes[1]; the sudden, inflation-induced rate increases have dampened fundraising plans.** Fund commitments seem to have slowed and reduced now. Larger managers have more advantages than smaller ones, with smaller funds showing the steepest decline in confidence in fundraising. However, the current blip is likely momentary; long-term prospects for the sector remain intact[2].

Like last year, optimism this year is the highest among associates (33%), although a marked decline from 81% last year. Notably, optimism among senior levels has dropped substantially, from c.70% last year to under 20% this year. This does not come as a surprise, as fundraising is currently at its slowest in the past 20 years, as evidenced by the number of fund closures; despite achieving their targets, they are taking longer to complete[3]. LPs seem to be taking a hard look at fund terms, GPs' strategic drift, team stability and weakness in returns[4]. As a result, the sector is seeing a shortage of fund supply. External factors such as the invasion of Ukraine and other geopolitical events led to supply-chain constraints and macroeconomic imbalances, resulting in a tightening of purse strings and a more conscious approach towards investments.

Expectations for fundraising



Competition for fundraising changed from previous year



[1] Please refer to last year's survey results
[2] https://www.privateequitywire.co.uk/2023/01/11/319036/fundraising-2023-big-squeeze
[3] https://www.privateequitywire.co.uk/2023/01/11/319036/fundraising-2023-big-squeeze
[4] https://www.buyoutsinsider.com/ten-big-changes-in-fundraising/

By region, 45-50% of the respondents are more optimistic about emerging markets (Asia, South America) than about developed markets. This may be due to the resilient debt/GDP ratios of emerging economies. The debt/GDP ratio of Asian economies stood at 63.5% at end-2020, according to the Asian Development Bank (ADB), far lower than the global average of 105%[5]. IMF estimates for 2022 (published in October 2022) place Asian governments' gross debt to GDP at 75.4%, advanced economies' average at 112% and the US's alone at 122%[6].

Susceptibility to rates is, therefore, likely less in Asia than in developed and mature markets. The Middle East seems to echo the sentiment of Western markets towards fundraising; respondents were overly optimistic about the region last year and overly pessimistic in the current survey.

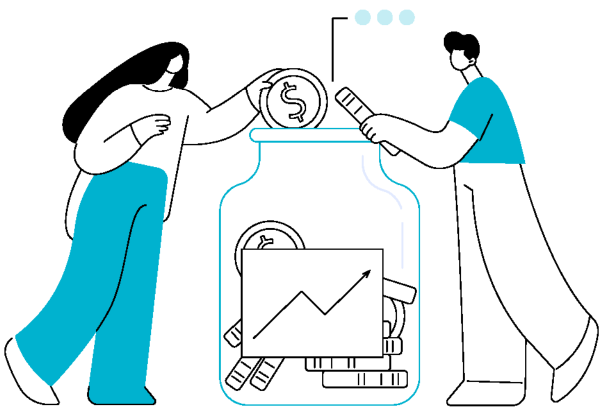
In terms of strategy, while this decline in confidence is across the board, real estate funds seem to be more susceptible to rate increases, as interest rates directly impact prices and the affordability of assets. Hence, more than half of the respondents displayed bearish sentiment. Those with funds of funds (FoF) strategies, which have seen fluctuations in dry powder since 2008[7], also believe the fundraising environment will not be supportive in 2023.

Amid pessimistic expectations towards fundraising, competition for funds is expected to remain high. Over 78% of the managing directors and partners/ principals surveyed stated that they expect competition to increase. Interestingly, **expectations of increasing competition are higher among executives with more years of experience** in the PE&VC sector. This suggests that veterans in the sector expect heightened competition in a sector that is witnessing the most difficult environment in the past two decades.

By region, competition trends seem to be in line with the trends last year, with 70%+ of the respondents expecting competition to increase in the US and Asia. The Middle East, where competition was least expected, sees a slight increase in competition expectations this year; private capital fundraising in the first nine months of 2022 was subdued, reaching only one-fourth of total capital raised in 2021[8].

However, looking at fundraising sentiment in terms of fund size, there seems to be a tectonic shift in favour of large funds. While investors are said to prefer large funds to smaller ones, the difficult fundraising environment has led to a clear preference for large funds.

29% of the respondents from large funds (above USD150bn in AuM) feel that competition has declined (versus 5% last year) as do 6% of the respondents from funds with AuM of USD50-150bn (versus none last year). On the other hand, three-fourths of the respondents from funds with AuM of USD1-10bn feel that competition has increased (versus 58% last year). Funds with less than USD1bn in AuM are at a strategic disadvantage when it comes to fundraising; hence, they seem to always face high competition. Still, slightly more respondents expect an increase in competition this year.



[5] https://blogs.adb.org/blog/how-much-public-debt-is-excessive-for-asian-economies
[6] IMF Fiscal Monitor, October 2022
[7] https://pitchbook.com/news/reports/q3-2022-global-private-market-fundraising-report
[8] https://pitchbook.com/news/reports/q3-2022-global-private-market-fundraising-report

New fundraising

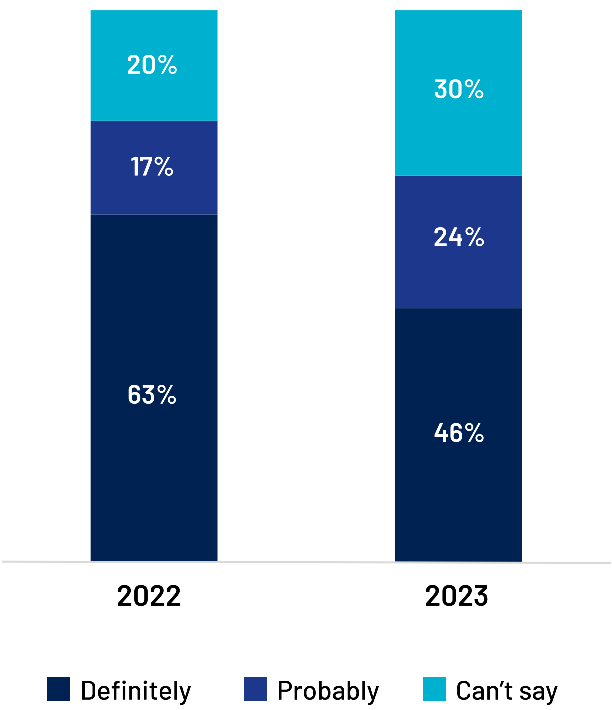
Despite expectations that fundraising may remain challenging, the positive attitude towards raising funds remains intact. Some of the respondents who were positive about raising funds last year have shifted to being less positive this year – they "may probably" raise funds. Respondents in both categories constitute three-quarters of all respondents this year, similar to last year. In essence, this indicates confidence in the long run while they adopt a "wait and watch" approach in the current environment.

The decline in new fund expectations is a significant 11%, led primarily by buyout strategies from the UK and Asia. The Americas and Europe are optimistic.

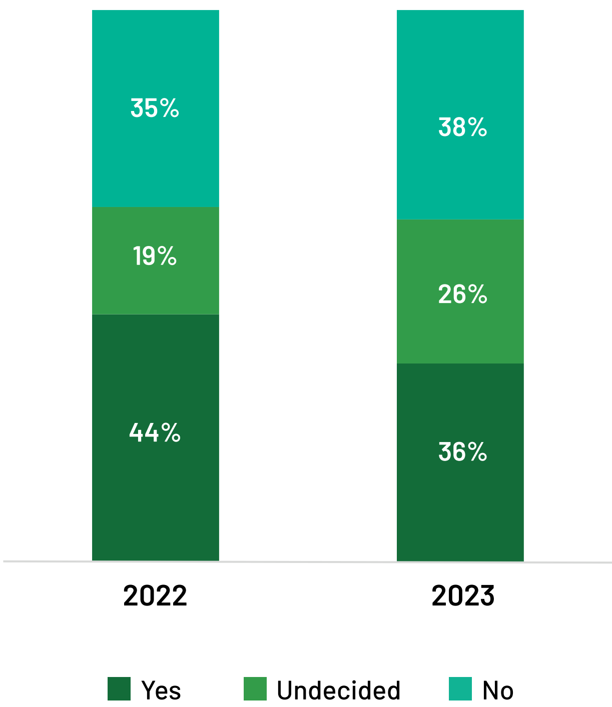
Emerging regions are pessimistic about private capital; two-thirds of the respondents from the Middle East are unsure about new funds unlike last year, when all were planning to raise new funds. On the other hand, VC, private debt and FoFs are more optimistic than last year about raising new funds.

In terms of professionals, PE&VC leadership expectations for new funds in 2023 are slightly tampered from last year, but mid-level executives' expectations for new funds in 2023 see a significant decline (e.g., 89% of VPs were positive about new funds last year versus 25% this year).

Plan to raise new funds



Plan to raise funds with an additional strategy



Openness to additional strategies

Most of the PE firms we surveyed prefer to stick to their strategies. This preference was also evident in our survey last year, where less than half of the respondents expressed openness to strategy diversification. In terms of fund size, strategy diversification follows sentiment towards launching new funds. Large funds are more open to diversifying their strategies. However, even large funds did not expand strategy this year, with c.40% of the respondents (against 12% last year) responding "No". Smaller funds continue to shy away from strategy diversification. Notably, funds in the USD10-50bn range are showing strong willingness to diversify, with more than half of the respondents supporting this, while last year, support was from only one-fifth of the respondents.

Large firms' diversification strategy is usually driven by LPs, as it allows firms to broaden offerings to LPs and balance risk profiles[9]; smaller firms are likely attempting to do the same to emerge as more LP-friendly amid the difficult fundraising environment.

Niche strategies such as infrastructure and real estate were strongly in favour of diversification last year. Although they remain inclined to diversify, current market conditions seem to have tempered their plans slightly, with one-third of the respondents now undecided.

This systemic decline in sentiment is visible across executive designations and experience; the survey identified a 5-25% decline in willingness to diversify, with investment directors registering the steepest decline.

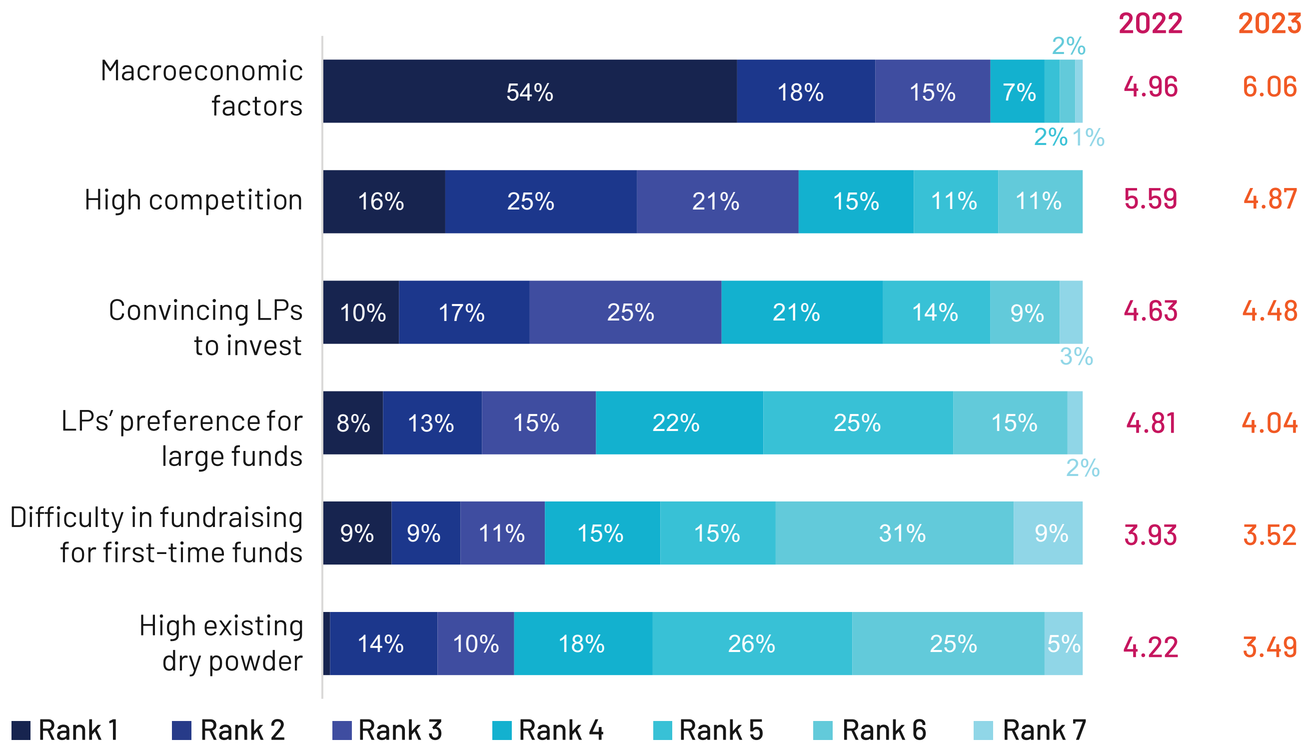
Challenges in fundraising

The fundraising landscape experienced a significant upheaval in 2022 due to the unprecedented events. The Russia-Ukraine war and supply-chain constraints led to increased inflation, driving the Fed to raise interest rates. Other central banks followed suit, with a focus on fighting inflation in their countries, matching the Fed in an effort to preserve their currencies or both. As a result, macroeconomic challenges moved up from the second concern last year to the top concern this year. The focus of all respondents on macroeconomic challenges (macroeconomic conditions were a top concern for 56% of the respondents and among the top three concerns for 88%) suggests that GPs are considering macroeconomic factors as the most significant element impacting fundraising negatively.

High competition and convincing LPs have emerged as the second and third top concerns for fundraising, respectively. Although competition for funds is always strong (over 70% of the respondents reported strong competition in both last year's and this year's surveys), the current high competition is due to the fact that fundraising plans, although having seen a decline, are still largely intact. Last year, 63% of the respondents expected to raise new funds and 44% planned to raise funds with additional strategies. This year sees a small drop – 46% expect to raise new funds and 36% plan to raise funds with additional strategies. Those who do not want to raise new funds increased to nearly one-third of the respondents, suggesting a sizeable increase in the number of those in wait-and-watch mode.

[9] Why large private equity firms are moving to a multi-strategy approach – Private Equity News (penews.com)

Challenges in fundraising in 2023 (along with weighted-average score)



Note: Score is a weightage-average score of the share of respondents assigning importance (ranked) to a particular response divided by 100. We have made a slight variation in calculations from last year so as to compare the previous survey with the current one

A comparison of the challenges reported last year with the ones in this survey shows the challenges are generally the same, with a few variations. Predictably, market conditions driven by macroeconomic factors top the list with a substantial score. Respondents list a host of environmental factors such as geopolitical uncertainty, interest rates and global trade as some of the variables making fundraising difficult. Convincing LPs has gone up one rank, as LPs are reported to be facing constraints on resources, with some having over-allocated to PE.

LPs are also looking at those funds' investment strategies that match their appetite.

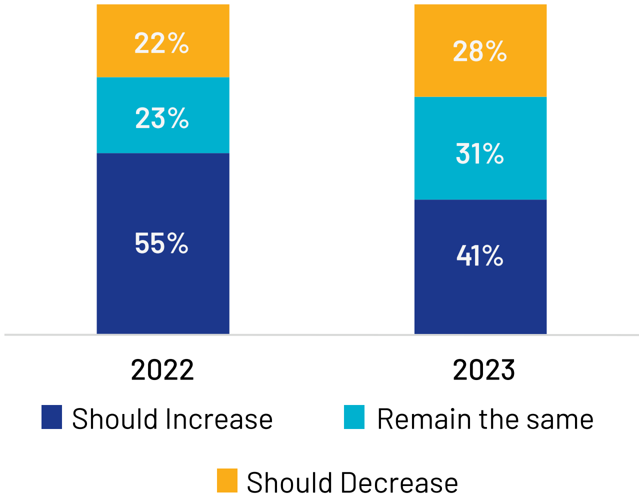
Issues such as regulatory concerns and valuations also pose challenges to fundraising. A few respondents, primarily UK-based, believe Brexit-driven issues persist. In addition, valuation-related concerns are dampening LPs' confidence in committing funds, as valuations are said to be high and facing a risk of correction. Hence, firms' concerns about performance and valuation remain an issue despite the change in market environment this year compared to last year.

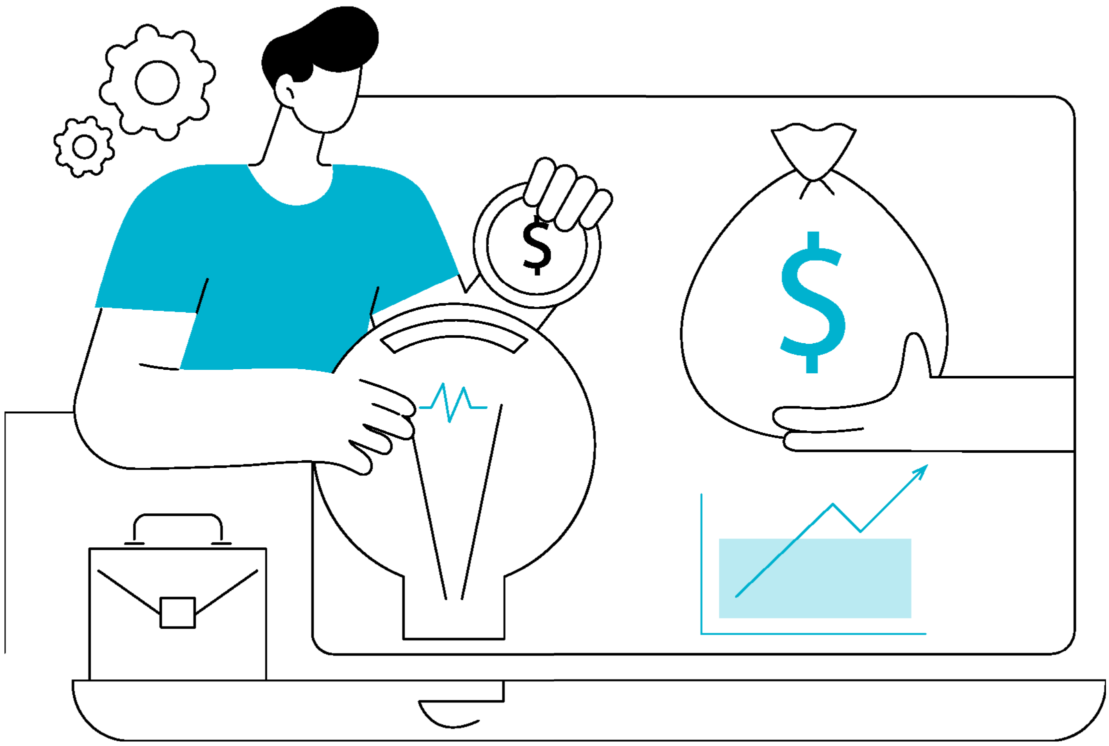
Levels of dry powder

As fundraising concerns remain strong for 2023, dry powder levels are expected to grow moderately. Notably, three-fourths of the respondents believe dry powder levels will not decline. Hence, the sector has sufficient investible cash in 2023 despite monetary tightening.

Although estimates of dry powder in the sector differ, they all point to substantially high levels. Preqin estimates that dry powder increased by 21% from December 2021 to December 2022 to about USD2tn[10].

Expectations of dry powder by the end of the previous year





[10] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/global-private-equity-dry-powder-approaches-2-trillion-73570292

INVESTMENT OPPORTUNITIES

- *Globally, the number of professionals who believe investment opportunities are increasing has declined substantially – from 67% to 41% – as investing confidence deteriorates amid the current geopolitical and economic environment*
- *Expectations for investment opportunities have declined more than expectations for fundraising*
- *Sectors that gained or lost favour amid the pandemic are becoming increasingly homogenised as differences reduce*

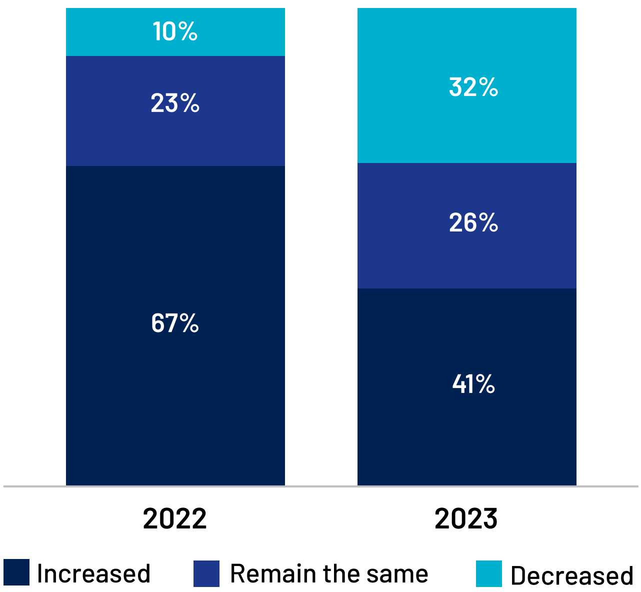
Optimism in the PE&VC sector surrounding investment opportunities has declined significantly from the previous year. Compared to 67% of the respondents who believed opportunities were increasing last year, only 41% now expect investment opportunities to increase. The number of those who believe the status quo will be maintained remained nearly the same at 26%. In general, deal activity began declining in the latter part of 2022 as interest rates rose, concerns about a recession loomed and post-pandemic consumer buying patterns changed[11]. These factors combined reduced cashflow visibility, leading to differences in valuations. As a result, one-third of the respondents believe investment opportunities may decline, significantly higher than the 10% of respondents last year.

Responses differed across demographics. Like they did last year, PE&VC leaders believe investment opportunities may increase, but their optimism is more tempered than last year – 54% are optimistic versus 67% last year. On the other hand, more VPs and associates believe opportunities may decrease.

Considering we are comparing two extreme markets – the overheated market last year against recessionary conditions this year – expectations for investment opportunities have declined more than expectations for fundraising.

Regionally, the most optimism is among firms in the Middle East (100%), followed by Asia (83%). In the other markets, respondents are far less optimistic than last year. One-third of the respondents expect opportunities in North America and the UK to reduce (versus 10% and 0% last year, respectively). For the rest of Europe, two-thirds believe opportunities may decline while no one believes opportunities may increase. However, one-fourth of the respondents from firms outside of Europe but interested in investing there believe opportunities in the region may increase.

Investment opportunities in the past two years



Among strategies, respondents seem to be positive about opportunities for VC, infrastructure and private credit in 2023, although the number is marginally lower than last year. Respondents from firms following an infrastructure strategy are less optimistic than respondents from firms following other strategies and expect opportunities to remain the same as last year. Infrastructure strategy has also moved towards the status quo, registering a marginal drop in the number of respondents expecting opportunities to decline. For the rest of the strategies, respondents expect opportunities to decline compared to last year. Half of the respondents expect opportunities to decrease for buyouts (a fivefold increase in pessimism compared to last year) and real estate (twice as many respondents as last year) in 2023.

While sentiment has weakened across fund sizes, smaller funds remain more optimistic (64% of the respondents from funds with less than USD1bn in AuM) than large funds (25-30% of the respondents from funds with up to USD50bn in AuM). Respondents expect opportunities to decline across the board; this includes a fourfold increase in the number of respondents from smaller funds expecting a decline.

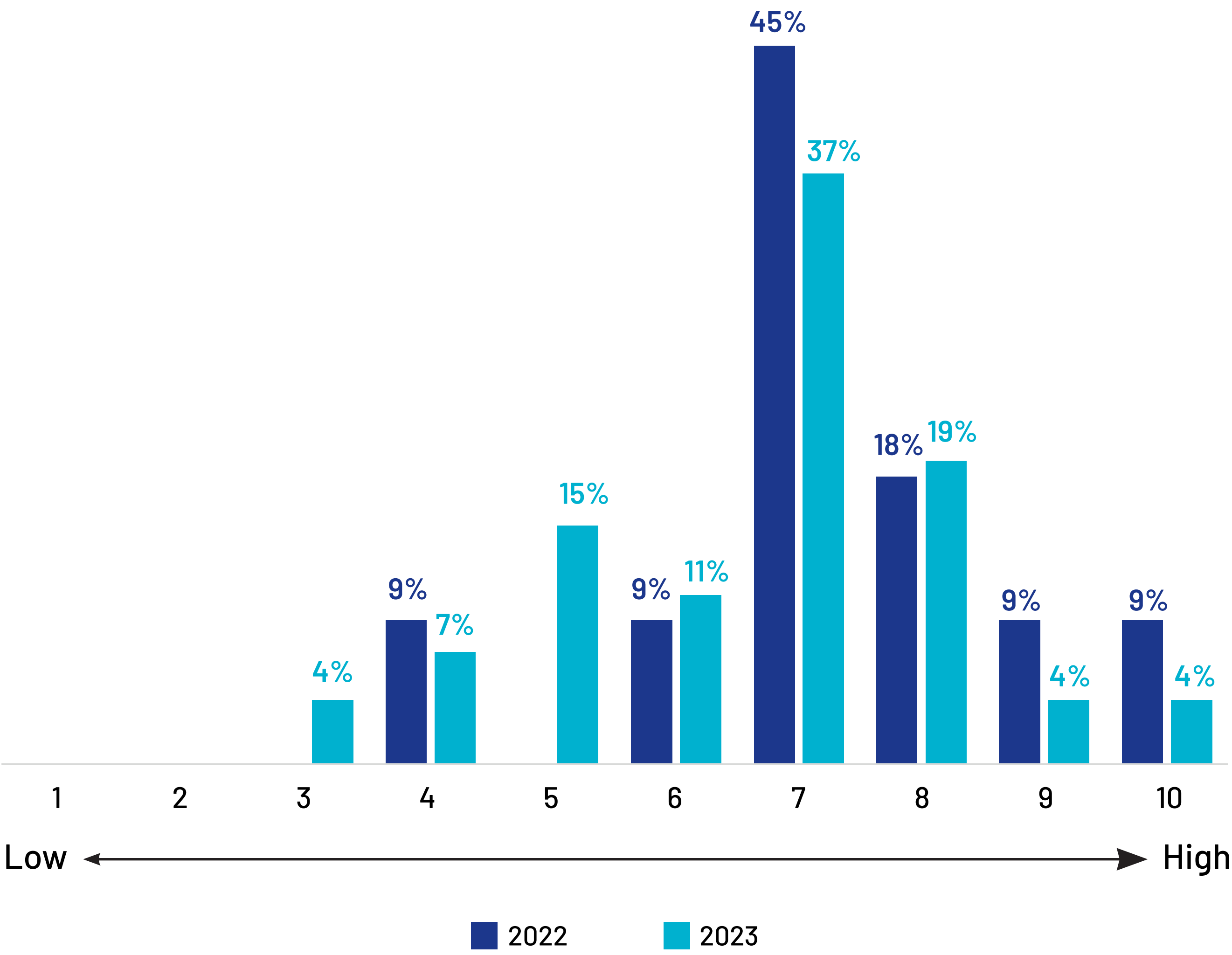
[11] Private Equity In 2023: Never Gonna Give You Up (forbes.com)

Analysing the decline in opportunities

The number of respondents expecting a decline in sourcing opportunities and difficulty in identifying suitable targets this year rose threefold from last year.

Level of difficulty in finding investment opportunities: more respondents stated that investment opportunities have decreased (last year, more respondents expressed moderate to high difficulty in finding investment opportunities). With more respondents expressing increased difficulty, the distribution is wider while the direction remains moderate to high.

Difficulty in finding investment opportunities



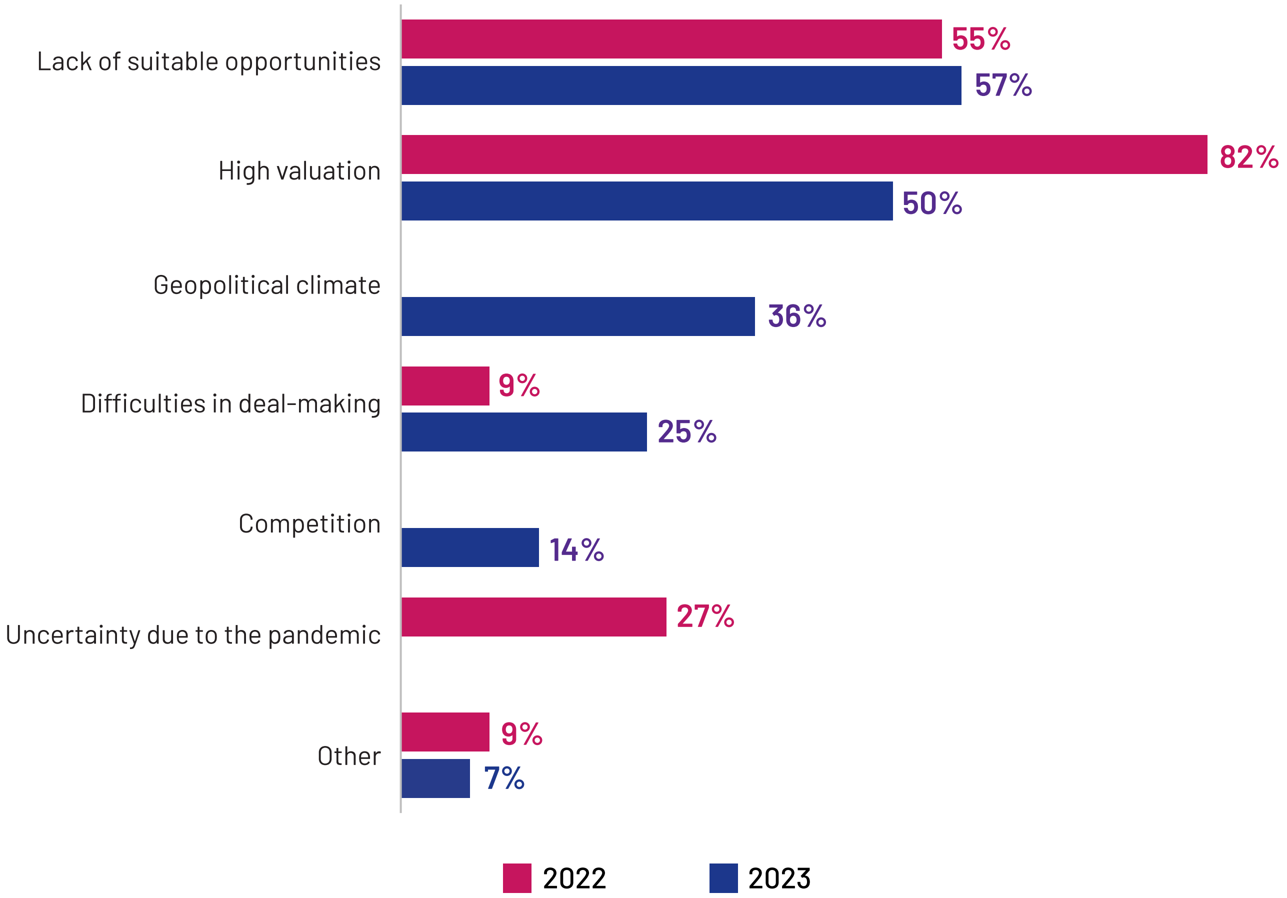
Share of total respondents: 32% (10% last year)

Dry powder deployment is facing challenges on the same lines as last year in terms of identifying suitable opportunities. Valuation also remains a top concern, but its intensity is muted, as respondents believe valuations may correct (refer to section on Valuations and exits for details). After these two concerns, the sector remained concerned about environmental factors – while the pandemic was a key concern last year, the geopolitical climate is of more concern now. Deal making has become almost three times more difficult.

We also tried to look at the impact of competition on investing this year. Competition is not a key impediment, although the high rate of new business formation presents investing opportunities. Current competition is likely for the limited number of good assets that attracts many buyers.

Like last year, ***these challenges seem to be universal, being cited across regions, types of firms and designations.*** Some respondents from Asia and the Middle East felt the decline in opportunities was also due to expectations of a recession and a lack of debt availability.

Challenges expected in deploying dry powder

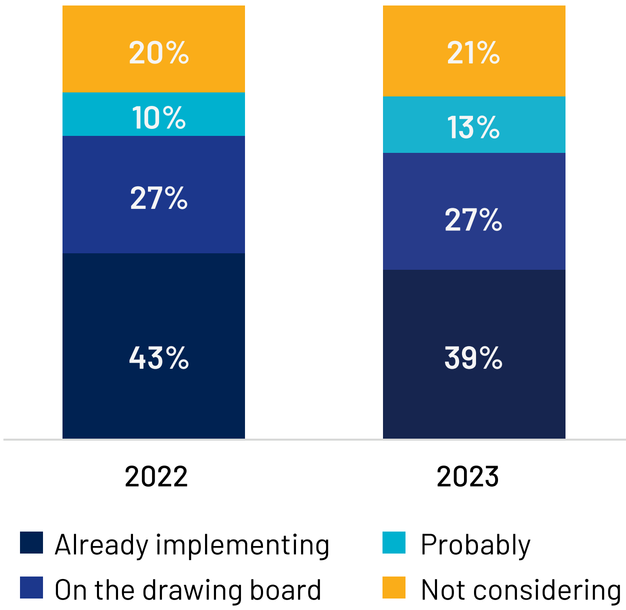


Note: Share of respondents may not total 100%, as respondents cited multiple challenges

New strategies

In all major and well-penetrated markets (i.e. North America, the UK and Europe, and Asia), strategy modification remained strong, with over 60% of the respondents open to it. This seems to relate mainly to a continuation of previous strategies, as strategy-related decisions are long-term in nature and decision making is a continuous process. Implementation of new strategies will likely be limited, with the number of those responding "not considering" increasing. Smaller markets in the Middle East and South America seem to be considering strategy modification, a departure from last year, when they were mostly sticking to their existing strategies.

PE&VC firms planning to modify existing investment strategies



Sector-focused strategies

While some real estate funds' strategies focus exclusively on real estate, and natural resources funds' strategies focus exclusively on energy, PE&VC firms generally actively pursue all key sectors. Based on our previous survey, we added digital technology and infrastructure, which investors still seem to favour. However, preferences for other technology-driven sectors have dropped, primarily as the challenges in 2022 led to a drop in valuation and difficulties in the tech space. Global venture funding registered a sharp 35% decline in 2022 over 2021[12], according to Crunchbase.

Developments in the tech space – the stock-market collapse, large layoffs in the technology sector and the downfall of crypto investing[13] – have made VC firms wary. This is likely driving preferences for non-tech sectors, with respondents indicating an increase in interest in financial services, retail and manufacturing. These sectors are also attracting tech-driven transformation, but they are not entirely tech-dependent and have pent-up demand from during the pandemic.

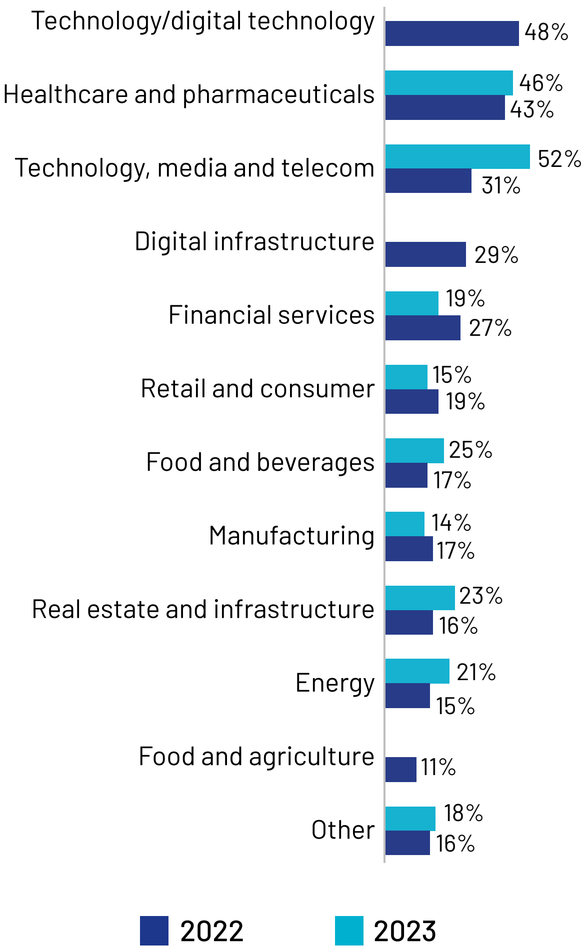
[12] https://www.emergingtechbrew.com/stories/2023/01/09/2022-saw-a-historic-decline-in-vc-funding
[13] https://news.crunchbase.com/venture/global-vc-funding-slide-q4-2022/

In terms of focus area, these survey results show changes in the classification of sectors into three broad segments, based on respondents' preferences:

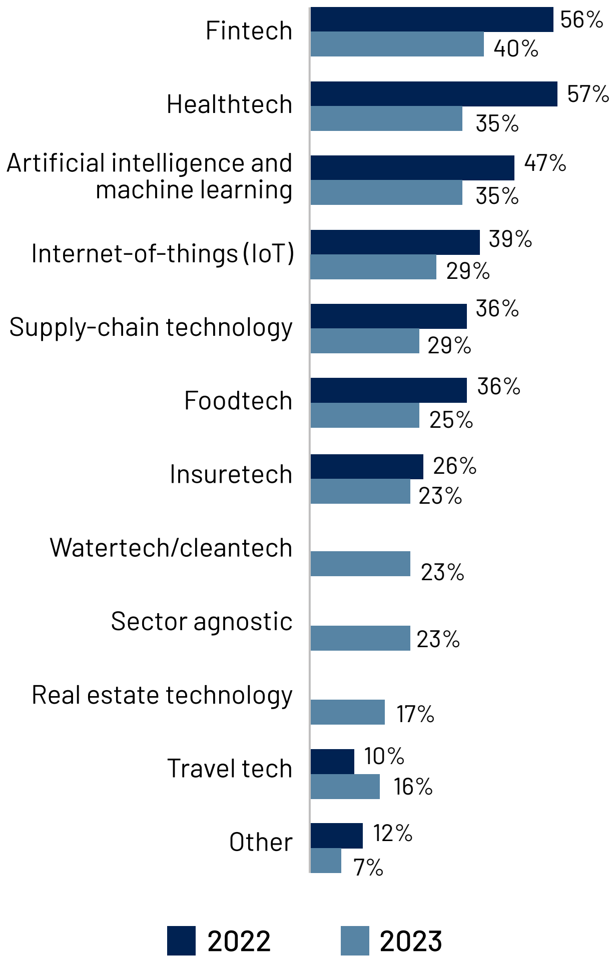
1. High focus: Except for digital technology, no sector received preferences of 45% or more respondents to qualify as a high-focus sector. Last year's preferences for TMT and healthcare have lost a few percentage points, and these sectors fall below this threshold. Digital technology is the sole high-focus sector, although this is a very wide definition.
2. Medium focus: 16-45% of the respondents are focused on most of the target sectors, as investors prefer areas that offer the required returns.
3. Low focus: 15% or fewer respondents are focused on sectors such as energy and food.

PE&VC firms representing all strategies and sizes more or less have the same sector focus. The only notable exceptions are Europe-based firms, which are less focused on the financial and real estate sectors, and private debt firms, which have no focus on the energy and food sectors that are already losing favour among other investors.

Sectors expected to gain investment focus from PE&VC firms



Disruptive technology preferences of PE&VC firms



Tech focus

In a similar vein, tech focus has also become more distributed. The darlings of last year have become more homogenised. In part, the lower share of some technologies is due to the introduction of two more tech categories – cleantech and RE tech – based on feedback received last year. However, there seem to be intrinsic drivers behind these movements. Such a large shift in preference for fintech (from 56% to 40% of respondents) corroborates the sharp 46% decline in fintech funding in 2022[14]. The rising interest rate environment is also expected to negatively impact the sector[15].

Healthtech witnessed a decline in preference (from 57% to 35%) as pressure on health resources amid the pandemic and consumer concerns eased in 2022. Similarly, tech areas impacted during pandemic, such as traveltech, are making a comeback. Within strategies, VC remains on a sharp upward trajectory, albeit muted versus last year, where fintech and healthcare and artificial intelligence are concerned.

Another tech area that received considerable attention is edtech, which emerged due to the "study-from-home" framework adopted amid the pandemic. Funding for the edtech sector declined across stages in 2022, with late-stage funding affected the most, with a 48% decline[16].

As the world returns to normal, tech areas that gained favour amid the lockdowns and increased digital consumption exponentially are declining and those that lost favour are returning. This trend suggests a normalisation of investment approaches.

[14] https://www.financemagnates.com/fintech/fintech-funding-slashed-by-almost-half-in-2022-will-2023-be-any-better/
[15] https://www.financemagnates.com/fintech/fintech-funding-slashed-by-almost-half-in-2022-will-2023-be-any-better/ https://www.financemagnates.com/fintech/fintech-funding-slashed-by-almost-half-in-2022-will-2023-be-any-better/
[16] https://inc42.com/buzz/funding-woes-indian-edtech-startups-report-44-drop-investment-2022/#:~:text=Edtech%20was%20one%20of%20the,from%20%243.8%20Bn%20in%202021.

Regions likely to see more focus

PE&VC firms' focus is on the same lines as last year. North America (43% of respondents), Europe (34%), Asia Pacific (24%) and the UK (24%) are key target regions for investment.

PE&VC focus on technology by region

	North America	South America	UK	Europe (excluding the UK)	Asia Pacific	The Middle East
Healthcare and pharmaceuticals	42%	17%	52%	56%	42%	20%
Technology, media and telecom	21%	17%	36%	32%	32%	20%
Technology/digital technology	42%	33%	36%	41%	53%	100%
Digital infrastructure	27%	17%	20%	35%	47%	20%
Energy	21%	17%	12%	18%	32%	20%
Financial services	27%	33%	40%	32%	32%	60%
Manufacturing	12%	17%	28%	21%	11%	20%
Real estate and infrastructure	21%	-	4%	6%	5%	20%
Food and beverages	12%	33%	24%	18%	16%	20%
Retail and consumer	6%	17%	16%	9%	21%	20%
Food and agriculture	-	17%	12%	18%	5%	-

HIGH LOW

PE OPERATIONS

» *PE&VC professionals spend 64% of their time on deal sourcing, portfolio monitoring and due diligence*

» *A large share of professionals from various strategies, regions and designations are open to outsourcing and believe it makes their operations more efficient*

» *Portfolio monitoring is still performed mostly with Excel-based tools, but there is more interest in third-party tools than last year*

PE&VC professionals spend their time mainly on three activities – deal sourcing (23%), portfolio monitoring (22%) and due diligence (19%). This is the same as last year, with a nominal change in percentage.

In terms of designation, associates and analysts spent a significant amount of time on portfolio monitoring, deal sourcing and valuation, and very little time on ESG and compliance. Leaders spent most of their time on deal sourcing and portfolio monitoring. The trends are more or less the same as last year, except for a considerable decline in time spent by analysts and associates on due diligence (15.9%), compared to 28.6% last year.

The decline is primarily due to an increase in activity relating to deal sourcing, investor reporting and fund marketing. In fact, deal sourcing and investor reporting accounted for more time across designations.

Activities vary across regions, but due diligence, portfolio monitoring and deal sourcing are what take most of the professionals' time. Interestingly, portfolio monitoring accounted for most of the professionals' time this year in North and South America, surpassing due diligence and deal sourcing.

While time spent on most activities in the Middle East this year is similar to last year, barring a few variations, time spent on due diligence has increased at the expense of fund marketing activities. More time is spent on due diligence in the Middle East than in other regions. North America-based firms reported an increase in time spent on valuation while Asia Pacific-based firms spent nearly the same amount of time as last year. Time spent on valuations has declined sharply in the other regions.

In terms of strategies, except for buyout funds, deal sourcing saw a marked increased across strategies – particularly in private debt (19% to 42%), infrastructure funds (20% to 32%) and funds of funds (15% to 27%). Buyout strategies went against the general trend in terms of valuation – buyout firms registered an increase while others reported a decline.

Investment opportunities in the past two years

	2022	2023
Deal sourcing	21%	23%
Portfolio monitoring	21%	22%
Due diligence	24%	19%
Valuation	11%	12%
Investor reporting	8%	10%
Fund marketing	8%	8%
ESG and compliance	8%	6%

Portfolio monitoring

In line with last year, most PE&VC firms rely on Excel-based tools and customised in-house methods for portfolio monitoring. More than half of the firms continue to rely on spreadsheets for monitoring portfolios. Reliance on tools remains limited even if they are customised in-house. In terms of third-party tools, iLevel, followed by eFront, continues to dominate the market.

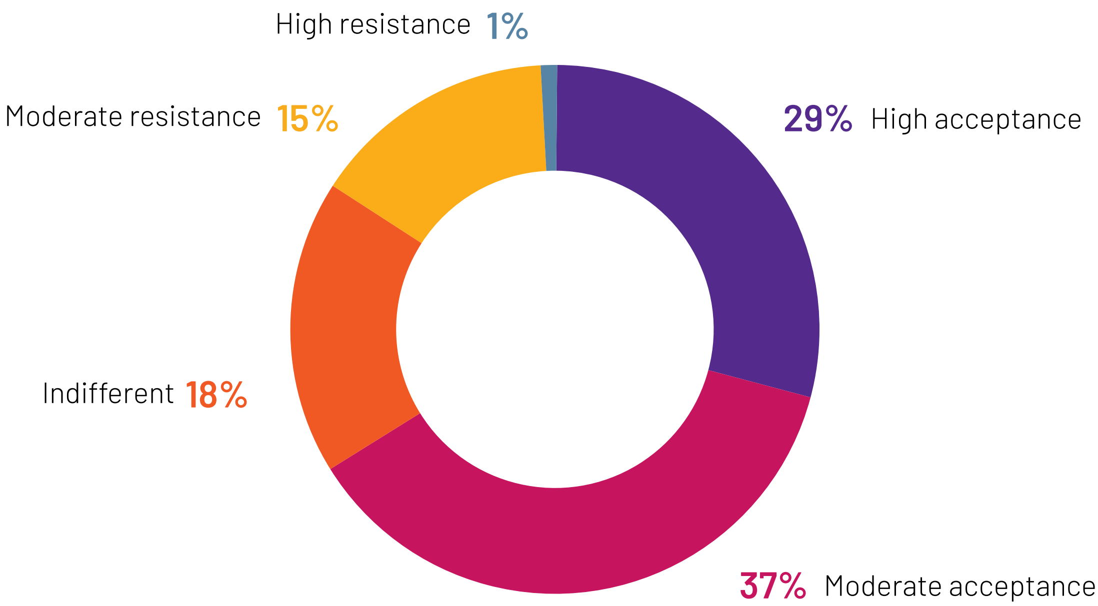
One notable deviation is towards the adoption of third-party tools. PE&VC firms seem to prefer third-party tools to in-house customised tools. About 15% of the respondents stated they were using in-house tools, half the number that said so last year. iLevel seems to benefit the most from this shift in preference, with its use almost doubling over the year. The use of iLevel seems to have proliferated among large buyout firms in Europe and Asia with AuM of USD50-150bn.

We may witness a further shift from in-house to third-party tools in the coming years, with 66% of the respondents inclined to adopt third-party tools in the future. This trend towards third-party tools is similar in all regions and particularly strong in Asia Pacific, South America and North America.

Black Mountain and Dynamo seem to be the next most preferred. iLevel has the highest adoption rate in North America and seems to be a strong preference of buyout funds. eFront seems to be more preferred in Europe.

In terms of portfolio monitoring tools, usage and preference patterns in all markets – Western and emerging regions – seem homogenous.

Acceptance/resistance to adopting third-party tools in 2023



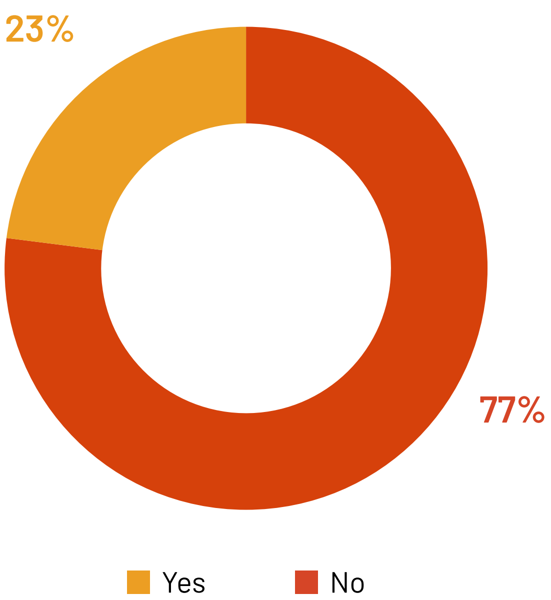
Geographical reach of portfolio management tools[17]

	North America	South America	UK	Europe (excluding the UK)	Asia Pacific	The Middle East	Africa
Customised in-house	✔		✔	✔	✔		
Excel-based	✔	✔	✔	✔	✔	✔	✔
Cobalt	✔						
Dynamo	✔				✔		
FolioSure	✔		✔		✔		
eFront	✔		✔	✔			
iLevel	✔		✔	✔	✔		
Black Mountain	✔				✔	✔	
Attio			✔				
Chronograph	✔						
DealCloud	✔		✔				
Hahan	✔						
internal				✔			
LP Analyst	✔						
Mercatus			✔				
Outsourcing	✔		✔				
Pipedrive		✔					
Zapflow						✔	
Carta	✔						

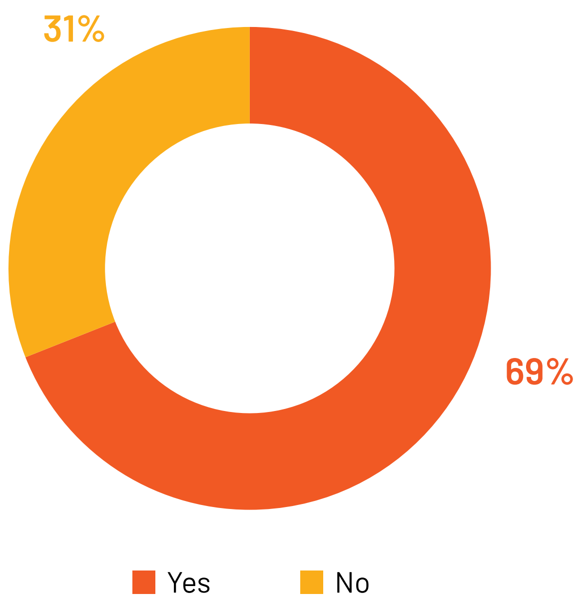
[17] Note: As disclosed by respondents; may not represent actual distribution; excludes FolioSure, our proprietary tool, to avoid conflict of interest

As preference for tools increases, 77% of PE&VC respondents across regions and designations stated that they use multiple tools and systems for their operations. Of these, 69% said they would welcome a one-system tool and decommission their complex and disjointed systems for more efficient and streamlined operations. This mindset is the strongest among vice presidents, followed by associates, as they are the ones who directly manage the nuances due to the complexities and multiplicities of the various systems. Among strategies, except for funds of funds, the others seem to be open to using tools, with venture capital firms the most open.

Organization uses multiple tools/ software in 2023



Interested in adopting a one-system tool and decommissioning complex systems in 2023



VALUATIONS AND EXITS

» *Valuations are declining as global indices become volatile amid rising interest rates, and the decline in M&A activity is making it difficult to find comparable valuations*

» *Late-stage deals faced the largest decline*

» *Finding targets with suitable valuations remains moderate to difficult*

» *There is a significant decline in sentiment towards investing, with the sector aware of the economic crisis developing*

Valuation expectations

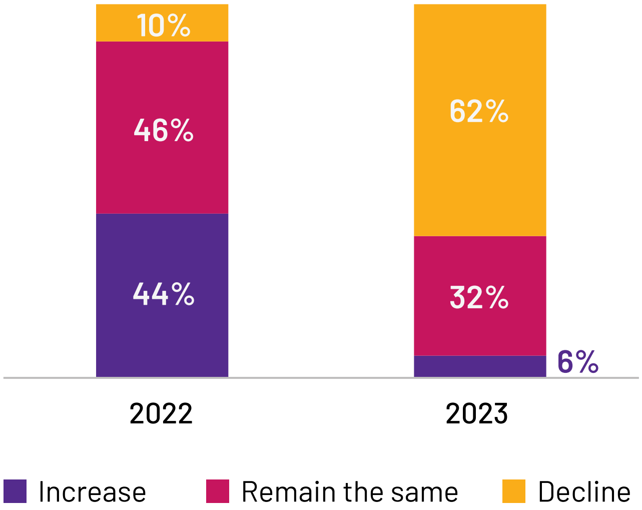
Valuation expectations have shifted significantly, so much so that the trends look inverted. Nearly two-thirds of the respondents believe valuations will decline, a sixfold increase from last year. Global indices were very volatile this year, and private markets faced a staggering number of valuation revisions of portfolio companies. A sample of privately held companies witnessed, on average, a 35% downward revision of their valuations[18] through September 2022, according to Bloomberg.

Amounts raised across stages witnessed a downward trend during 2022, according to Cooley, but Series C and subsequent series were more impacted. Series D and later deals witnessed a staggering 78% drop in amounts raised. Pre-money valuations also declined in 3Q 2022 across stages. Again, later-stage deals were the most impacted – median pre-money valuation for Series D or later deals declined from a record high of USD3.5bn in May 2022 to just USD527m in September 2022, an c.85% decline. Series C declined 74% and Series B 45%[19] from June to September 2022.

The PE&VC sector expects valuations to decline in 2023; expectations are strongest among veterans and senior professionals.

Professionals across regions expect weakness in valuations, but less so in the Middle East and South America. Respondents from South America – from firms headquartered in South America as well as those focused on investing in the region – are more optimistic than other respondents about valuations increasing. South American investors and founders are cautiously optimistic amid the global uncertainty[20]. Confidence in the investment climate in the region looks mixed. Bovespa of Brazil (the largest market in South America) was supportive but declined in July, a usual annual occurrence, with few exceptions. IGPA of Chile (the second largest) and S&P Merval of Argentina (the fifth largest) have risen.

Valuation expectation



However, the third largest (Colombia) and fourth largest (Peru) have declined.

Senior leadership views can be considered as a barometer. Last year, 20% of managing directors (MDs) surveyed forecast a decline while the consensus was 10%. This year, nearly three-fourths of MDs surveyed are suggesting a decline. Veterans and senior designations were less upbeat last year as well.

While expectations of a valuation decline remain universal, a limited number of vice presidents and analysts believe valuations may increase.

Among strategies, real estate witnessed declining transactions and rising vacancy rates. The professionals had positive expectations. Amid the current pessimism, their optimism has been corrected, but 17% of the respondents expect valuations to rise, the most among strategies. The number of respondents who believe valuations may decline is higher than last year across strategies, although the percentage of respondents varies.

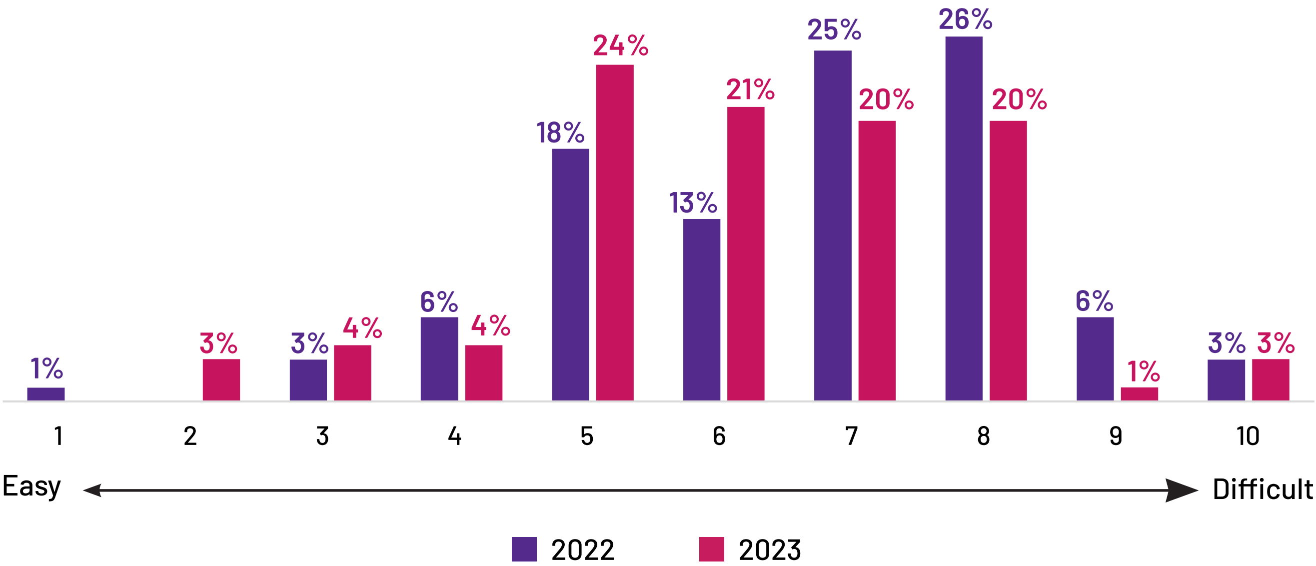
[18] https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-how-private-equity-fared-in-2022
[19] https://www.cooley.com/news/insight/2022/2022-11-21-venture-financing-report-q3-2022
[20] https://techcrunch.com/2022/09/22/in-latin-america-founders-and-investors-seek-to-balance-caution-and-optimism/

Finding targets with the right valuation

In an environment of soaring valuations, finding targets with the right valuation is difficult; almost all the respondents agreed with this last year. The level of difficultly seems to be moderate to difficult, with 81% of the respondents rating it between 5 and 8 or more on a scale of 1 to 10.

The difficulty in identifying targets based on valuation seems to have moderated compared to last year. But remains moderate to difficult, with 85% of the respondents rating it between 5 and 8. The difficulty levels are comparable to the previous year's, despite a correction in valuations. One reason could be the decline in M&A activity that seems to have hampered identification of comparable valuations, and increasing reliance on public indices that are also not performing well[21].

How easy or difficult is it to find investible targets with the right valuation?

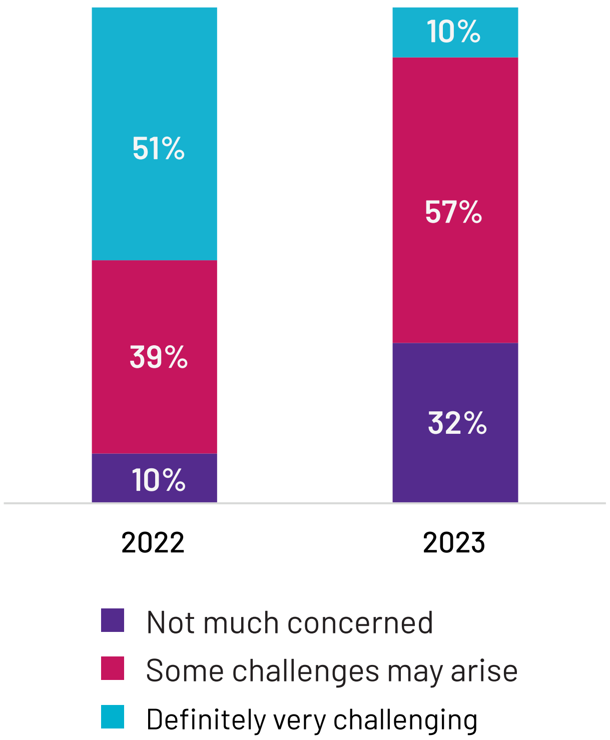


Exit plans

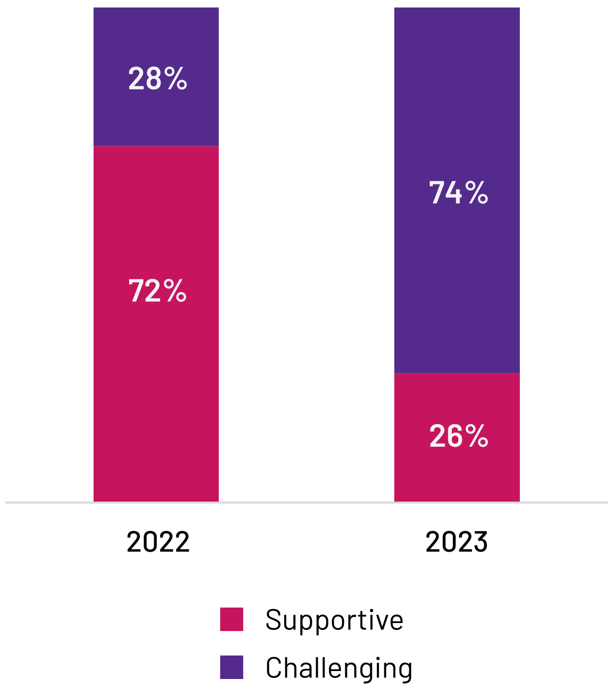
Although valuations and expectations are high, they could increase further. Last year's respondents believed their exit plans for 2022 should hold (51%) or face some challenges (39%); hence, 90% of them were confident their exit plans would more or less remain on track. This trend has inverted – from 90% confidence, 35% are finding it challenging; the number of respondents expecting a moderate level of challenges has risen as well.

[21] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/private-equity-faces-valuation-challenge-in-rocky-year-73314024

Challenges in current exit environment



Contribution of valuations to exit plans



The sector was not that concerned about high valuation levels last time, and transactions were being concluded rapidly. However, despite the decline in valuations, valuation-related exit challenges have increased, with three times the number of respondents believing they have increased compared to last year.

Last year, most respondents found valuation levels supportive of exits, with selected pockets such as real estate finding them very supportive. Currently, the observation is perfectly inverted (as seen in the chart), with respondents across regions, strategies and fund sizes saying valuations are challenging. The most significant decline was among funds with AuM of USD50-150bn

Accordingly, the number of respondents who believe their exit plans are on track has declined considerably – from 51% last year to 10% currently. Some of the others believe challenges may arise, but there was more than a threefold increase in the number of respondents who believe it is a very challenging exit environment.

The most notable difference is in the developed markets of North America, the UK and the rest of Europe, where a negligible share of respondents considered it a challenging environment amid last year's buoyant market. This year, one-third of the respondents believe there are significant challenges ahead.

As concerns of a recession gain traction, half of the sensitive real estate sector expects challenges; last year, over three-fourths of the respondents expected the environment to be supportive and no one expected challenges. Funds of funds witnessed more erosion in confidence than other strategies.

As stated earlier, this challenge is universal and does not discriminate between large and small funds. Although smaller funds seem to face more challenges than large ones, a significant number of respondents from mid-size and large funds (above USD10bn) expect challenges; none of the large funds expected challenges last year.

Preferred exit type

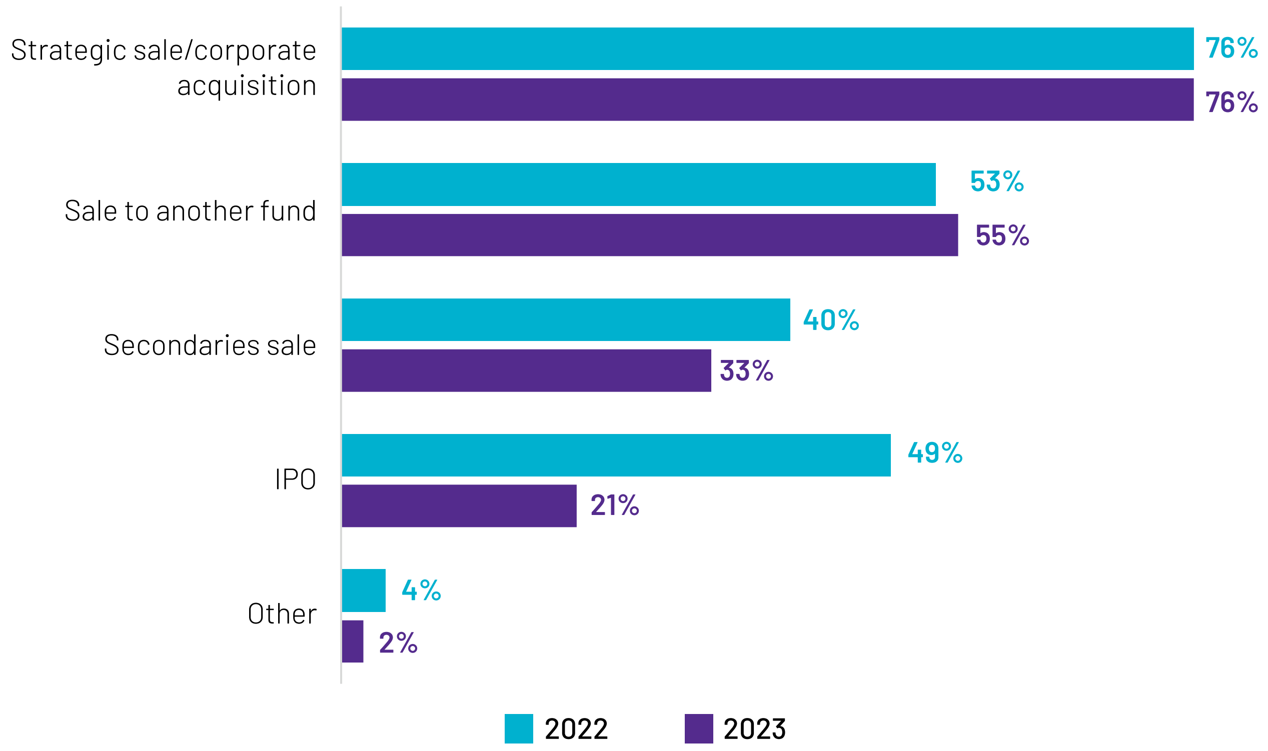
The strong pessimism this year did not change exit preferences; the top choices remained intact. Over three-fourths of the respondents continue to favour a strategic sale/corporate acquisition as the exit avenue for 2022-23. As pricing is a challenge in the current uncertain global economic environment, PE&VC firms prefer a strategic sale, as it allows management and investors to cash out[22] and enables ease of exit in a volatile market[23]. In addition, as SPACs lost their lustre this year and indices are not performing in line with expectations, IPOs lost most of their position.

Strategic sales are a universal option among funds and professionals across geographies.

Despite buyout funds seeming to prefer secondaries more than they did last year, secondaries lost their ranking by a few percentage points as venture funds, funds of funds, infrastructure and private debt were less inclined towards secondaries. Respondents from Asia continued to prefer this option, although the preference moderated from last year (58% versus 67% last year). Europe increased preference for secondaries while the Americas noted a decline.

Other options such as employee stock option plans (ESOPs) and sale-back to promoters/founders are not apparent this year, as exit remains doubtful. Debt funds continue with maturity options as an automatic route.

Preferred exit avenues



Note: Share of respondents will not total 100%, as respondents cited multiple challenges

[22] https://www.criticaleye.com/inspiring/insights-servfile.cfm?id=2310#:~:text=Often%20referred%20to%20as%20the,to%20be%20entirely%20cashed%20out.
[23] https://www.livemint.com/Companies/r8KlsfOCKkn7NjAITyAvLO/PE-firms-opt-for-strategic-sales-in-volatile-markets.html

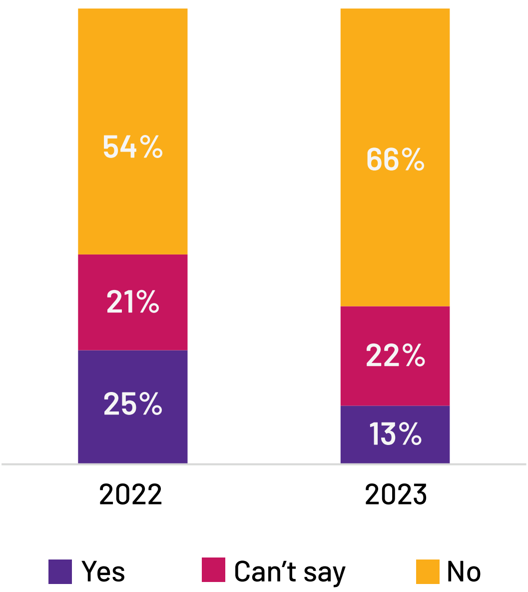
Impact of pandemic on exit decisions

The effect of the pandemic on exit decisions seems to be waning. Last year, 25% of the respondents considered it a factor; the number has now declined by half, with a very limited impact on exit decisions.

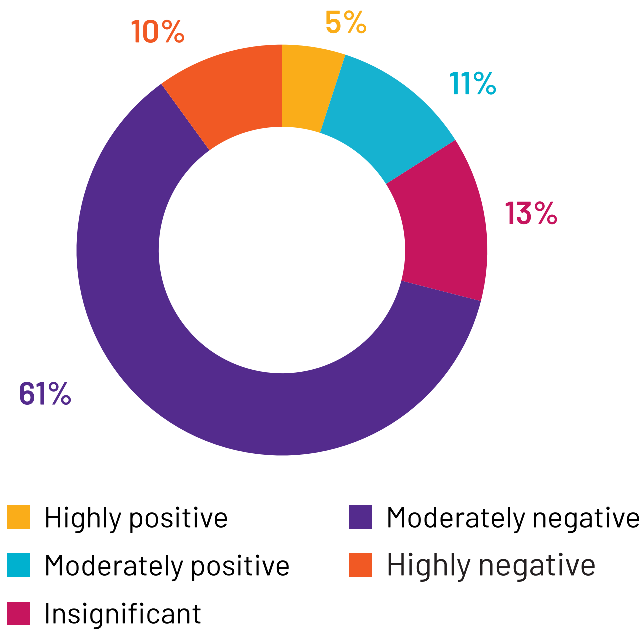
The economic climate is increasingly challenging. A substantial 61% of the respondents found it moderately negative for their investment and exit decisions. This supports the observations noted earlier in this report that the sector is concerned about current events and their potential impact. Interestingly, a significant share of respondents from Asia (42%) believe the current environment may have a positive impact on their investment decisions.

This is likely fuelled by expectations that Asian economies may experience a slowdown but not a recession[24,25]. Among strategies, one-third of the respondents from real estate (which is highly sensitive to interest rates) consider the environment to be very negative.

Pandemic led to challenges to exit decisions



Impact of economic uncertainty on investment and exit decisions in 2023



[24] https://www.ndtv.com/business/recession-unlikely-in-apac-region-in-2023-moodys-3548995
[25] https://www.weforum.org/agenda/2023/01/global-recession-economic-outlook-2023/

THE INVESTING ENVIRONMENT

- *Fundraising and high valuations remain top concerns; fundraising emerged as the main concern*
- *The sector continues to believe regulatory stringency is high and may increase*
- *Key areas of concern relating to regulations are regulator activity, ESG, taxation including cross-border taxation, and vigilance and compliance*
- *LPs have reached a level of comfort with reporting, and requests for change are lower than last year*

The biggest challenges/pain points

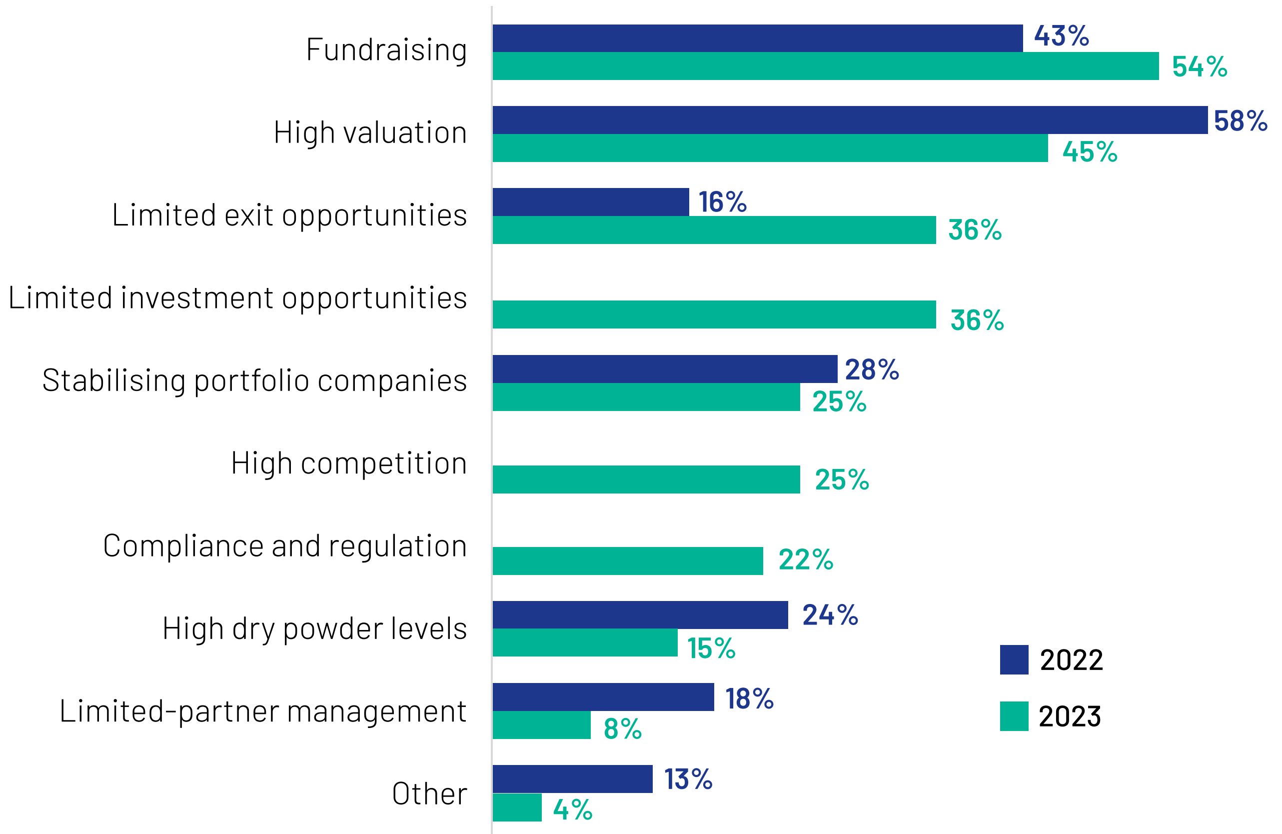
Respondents ranked fundraising (54% of the respondents) as the biggest challenge this year. As valuations corrected this year, fewer respondents than last year counted valuations as a challenge, but they remained the second challenge (45% of the respondents). These were the top two concerns in the previous year as well.

The exceptions are North America-based firms, funds of funds firms among strategies and firms with AuM of USD10-150bn. These respondents' top concern is high valuations, followed by fundraising. Real estate and private debt consider limited investment opportunities as their key concern. Limited investment opportunities also emerged as an important challenge for the sector in North America and Europe (44% of the respondents from each region).

Other challenges that resonated with respondents include limited investment opportunities (36%) and exit opportunities (36%), followed by stabilising portfolio companies (25%) and high competition (25%). Limited exit opportunities registered a twofold increase from last year, with funds of funds rating these as one of their major concerns (67% of the respondents).

Based on feedback on our previous survey, we asked the respondents to rate compliance- and regulation-related issues. About 20% of them stated these were challenges, while one-third of the professionals from Europe, Asia and the Middle East stated these were challenges. Among professionals, a higher share of PE&VC leadership (e.g., 40% of managing directors) rated these as challenges. High competition emerged as another key concern resonating among a quarter of the respondents who stated that it has a negative impacts on three areas – it squeezes returns, impacts pricing and affects talent retention.

Biggest challenges/pain points for a firm



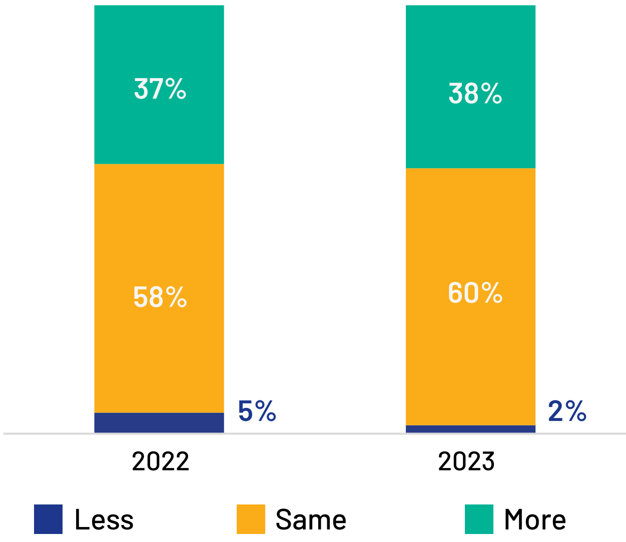
Note: Share of respondents will not total 100%, as respondents cited multiple challenges

Regulatory oversight

Regulatory oversight remains a concern this year; this is likely to continue. The share of respondents who believe the regulatory environment will become less stringent dropped to 2% from 5% last year, while the share of respondents who expect it to remain the same or become more stringent stands at 98% versus 95% last year.

More managing directors and principals expect it to become more stringent than last year. More than half of the veterans surveyed (those with over 20 years of experience) expect stringency to increase. Half of the European firms surveyed expect stringent regulations in 2023, the highest among regions; 33-38% of the respondents from other regions expect more regulations.

Expected degree of regulatory stringency



Specific areas of regulatory concern for PE&VC executives include the following:

Vigilance and compliance: The sector, in general, is facing tighter rules and regulations. A large number of respondents indicate the sector is becoming overregulated, increasing the complexity and burden. The sector faces increased scrutiny for KYC requirements for LPs[26], as governments and international frameworks tighten measures to counter money laundering and terrorist financing. This is exerting more pressure on the sector, according to the IFC, as strong anti-money-laundering and counter-terrorist-financing measures require substantial investment[27].

Regulatory clarity: Sector participants are also concerned about regulatory direction and requirements. They continue to believe regulations are unpredictable, lacking policy stability. Broadly speaking, the PE&VC sector is governed by regulations relating to financial services (such as the Sarbanes-Oxley, anti-trust and foreclosure laws), despite financial services being a different sector. This has a larger impact on certain regions, especially those with nascent PE&VC sectors (e.g., Saudi Arabia and Latin America). In developed regions, the scope of regulations is increasingly expanding. In the US, the SEC's Marketing Rule came into effect on 4 November 2022. Sector participants believe *"it will be hard to meet its requirements, as it is not in line with industry standards"*. In essence, regulatory clarity remains elusive. In regions such as Asia Pacific and South America, fintech regulation-related concerns have also emerged of late.

[26] https://www.nortonrosefulbright.com/en/knowledge/publications/b5862cb5/private-equity-firms-to-face-increased-scrutiny-of-their-aml-procedures

[27] https://www.ifc.org/wps/wcm/connect/e7e10e94-3cd8-4f4c-b6f8-1e14ea9eff80/45464_IFC_AML_Report.pdf?MOD=A-JPERES&CVID=mKKNshy

ESG: The respondents continue to believe environmental requirements are becoming stricter, leading to more compliance-related challenges. Firms are expected to keep abreast of regulatory policy updates, in addition to regulations relating to fees and transparency. Accordingly, firms may require more reporting capacity, especially at the portfolio level. There are concerns that the current AIFMD framework's value addition is limited in terms of environmental and commercial aspects.

Jurisdiction: Firms with operations in more than one country are concerned about regulatory requirements across jurisdictions, such as tax laws in Brazil and other Latin American countries.

Taxation: Clarity on tax is another concern, and the sector hopes for an attractive and consistent tax climate. Broad areas of concern include the tax code, tax rate, carried interest, capital gains and stock option treatment.

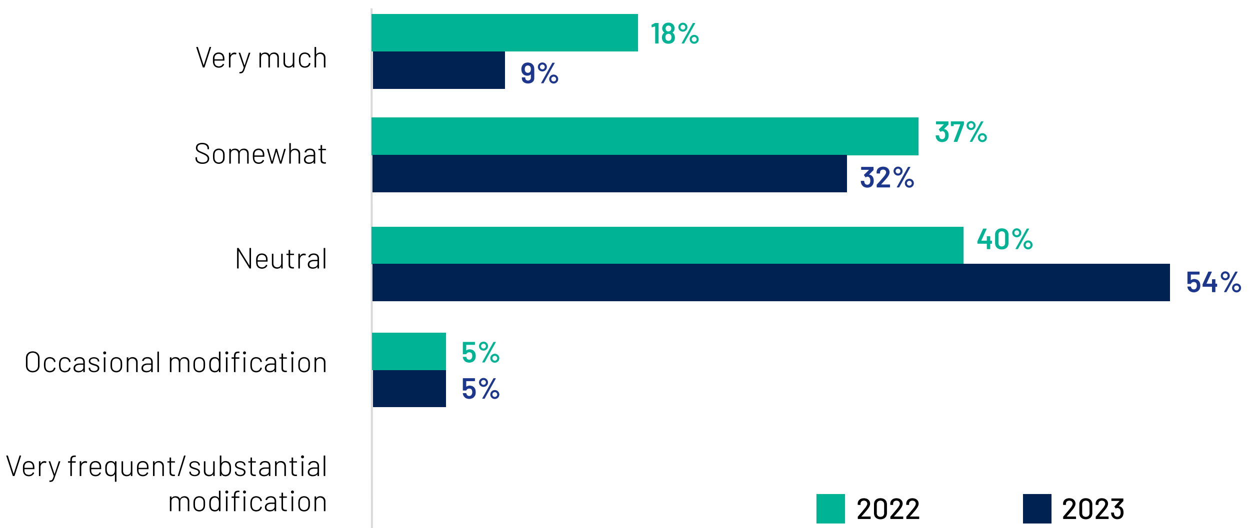
Reporting obligations: The varying degrees of reporting required for different audiences (e.g., the difference in reporting to LPs versus to regulatory authorities) are another burden. When investors and beneficiaries are from different locations, it adds to the burden. The respondents believe a common reporting platform can ease this concern.

This year, as pandemic-related challenges eased and cryptocurrencies witnessed significant volatility, PE&VC professionals did not highlight regulations (or a lack of them) as a concern.

Limited partner-related challenges

In general, compared to last year, PE&VC professionals believe limited partners (LPs) are neutral in their requests for changes in reporting and level of detail, with requests for modifications decreasing. This indicates reporting standards are now established and the templates required are accepted. As highlighted in the previous chapter, professionals are investing 22% of their time in portfolio reporting, with a considerable amount of time spent on recurrent and predictive tasks. Although LPs are becoming increasingly satisfied with GP reporting, North America reports the most neutrality; over three-fourths of the respondents from this region find LPs very neutral.

Limited partners' requests to change reporting frequency and level of detail



ESG

- *The ESG following seems to be fragmented but, in essence, it reflects strong regional considerations*
- *The less sophisticated regions for private markets – Africa, the Middle East and South America – are striving to emulate the developed markets*
- *While many firms track ESG-related parameters, the sector as a whole believes these policies are still a work in progress*
- *ESG considerations are being increasingly integrated into investment decisions*

In this edition, we realigned the queries relating to ESG to increase the distinction between the different aspects of ESG activity undertaken by PE firms and their portfolio companies. We considered this from the perspective of their commitment to the United Nations' Principles for Responsible Investment, commonly referred to as UN PRI. We also expanded the scope and looked at ESG frameworks/standards and coalitions.

The first consideration of private markets' commitment to ESG was through their UN PRI signatory status. The change in status from last year is not large; the number of non-signatories is more or less static at around 46%.

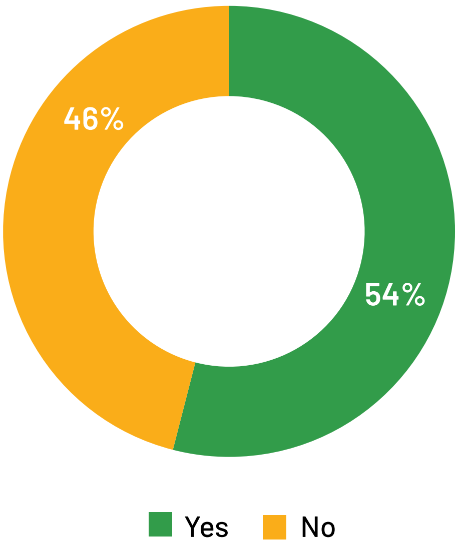
Evidently, ESG investing is proliferating, with a sizeable share of firms becoming PRI signatories.

ESG commitments and initiatives are also reflected in the ESG frameworks professionals and firms are adopting for investment strategies and reporting purposes.

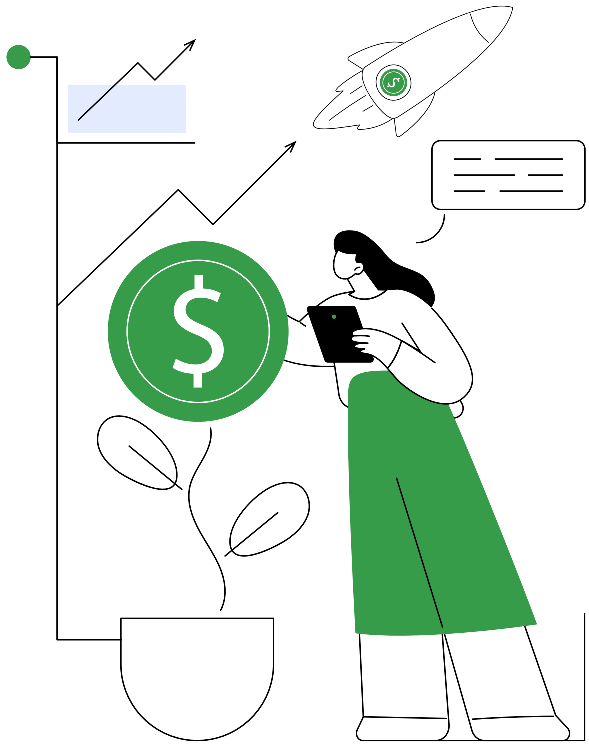
As reflected in our previous survey as well, the UN PRI framework is adopted by more than half of the respondents. Introduced in 2006, it is the oldest standard and has the largest number of funds[28]. The number of signatories increased to 5,179 as of September 2022, representing USD121tn in AuM[29].

Other notable frameworks are the Task Force on Climate-Related Financial Disclosures (TCFD, 16%), SASB Alliance (11%) and Carbon Disclosure Project (11%). There is a large number of additional frameworks

UN PRI signatory status in 2023

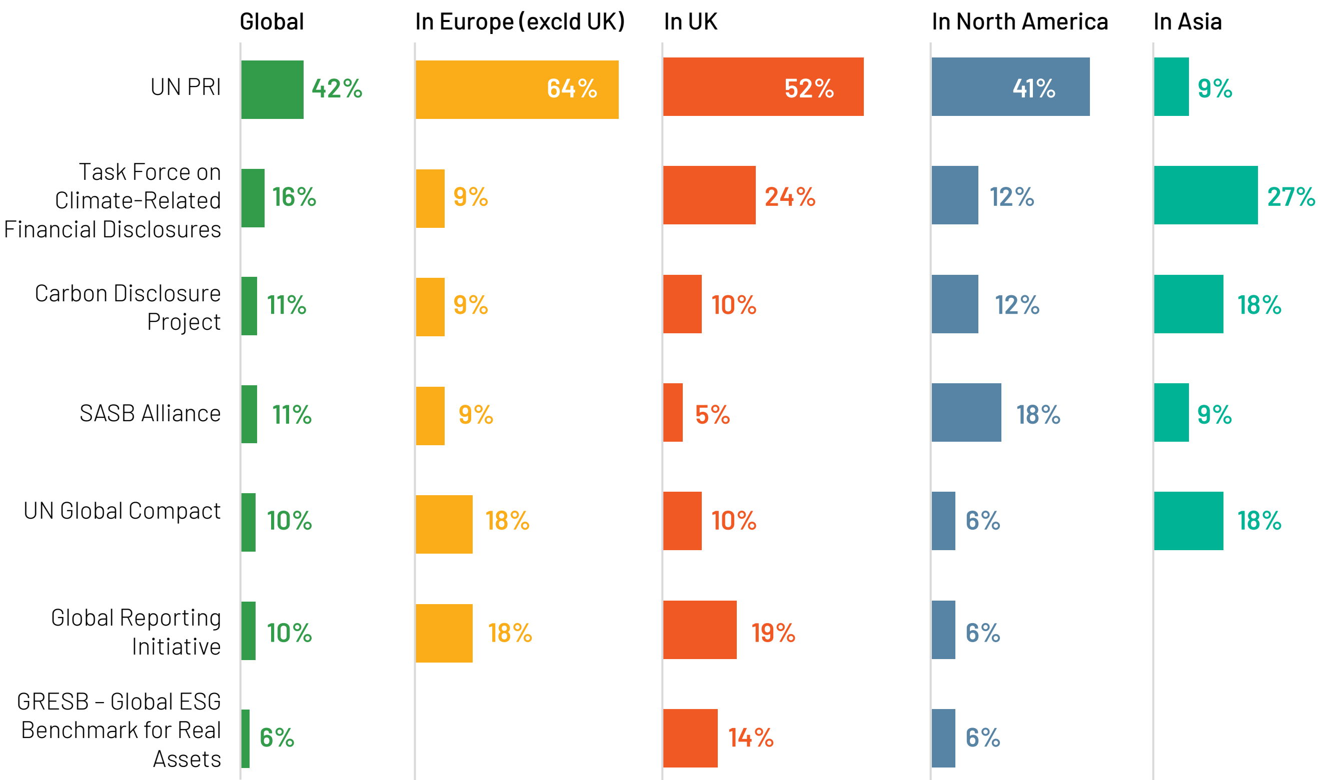


**Signatory status as measured by share of respondents*



[28] https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history—current-status/?sh=c2cc5a32cdd3
[29] https://www.unpri.org/download?ac=17350

ESG frameworks and share of firms following them in 2023



**Signatory status as measured by share of respondents*

The ESG following seems to be fragmented but, in essence, it reflects strong regional considerations.

UN PRI has global appeal, but other frameworks are fragmented and some seem to have regional dominance. The TCFD and SASB dominate in North America, the UK and Asia, with the TCFD preferred. The rest of Europe seems to prefer global standards – the UN Global Compact and the Global Reporting Initiative. South America-based firms tend to adopt global standards such as UN PRI and B Corp certification more than other standards. South America is progressively moving towards ESG adoption. ESG debt issuance in the region increased from USD6.5bn (14 offerings) in 2019 to USD32bn (36 offerings) in 2021[30], according to Refinitiv. The Middle East is least active on ESG matters, with just one-third opting for UN PRI, while the rest of the respondents do not follow any standard.

Among strategies, UN PRI remains the most preferred framework, mainly among buyout funds and infrastructure funds. Interestingly, UN PRI scores above sector-specific standards, with less than one-third of infrastructure funds preferring the Global ESG Benchmark for Real Assets (GRESB). However, real estate funds have a higher focus on GRESB.

On the other hand, climate-focused frameworks such the Task Force on Climate-Related Financial Disclosures (TCFD) is less preferred by buyout funds (3% of respondents) than infrastructure funds (43%), private debt (40%) and venture capital funds (31%).

Besides the established standards, the PE sector is also becoming part of initiatives that are a partnership of PE firms such as the Data Convergence Project and the International Climate Initiative.

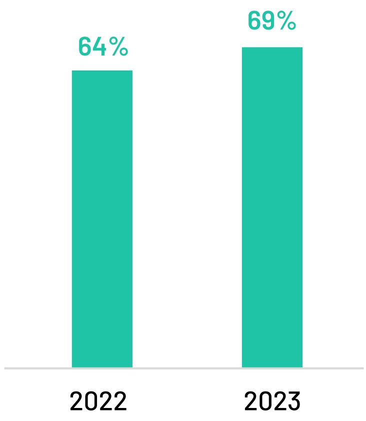
[30] https://www.law.com/international-edition/2022/02/03/esg-matters-take-center-stage-in-latin-america-as-region-eyes-sustainability/?slreturn=20230106085131Co

Maturity of ESG policies

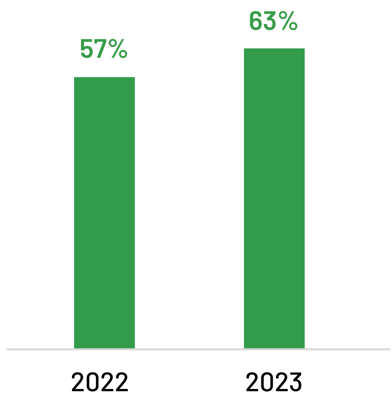
ESG policies are in the making with PE firms. Formulating and crystallising policies is a time-consuming process. A PE firm's journey to achieving ESG maturity typically involves formulating the right ESG strategy and frameworks, with coherent policies and centralised data for reporting and disclosures. Accountability for ESG matters at the firm's highest level of responsibility indicates a mature ESG outlook.

Like last year, one-fifth of the respondents said that their policies are immature, while half of them stated that their policies are partly developed. The remaining 29% said their policies are mature. Two notable exceptions are (1) the Middle East, where ESG seems to have limited traction, and (2) South America, which is striving to emulate Western markets.

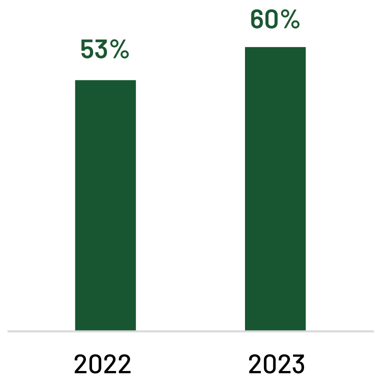
Designated person for day-to-day ESG matters



ESG committee to monitor the performance of portfolio investments



Publish external ESG/ CSR/sustainability reports



As we saw last year, PE&VC firms have taken steps to strengthen ESG-related activity in their organisations. This year, there is progress on all aspects of ESG adoption and reporting. Nearly 69% of the firms have an individual designated to deal with ESG-related matters.

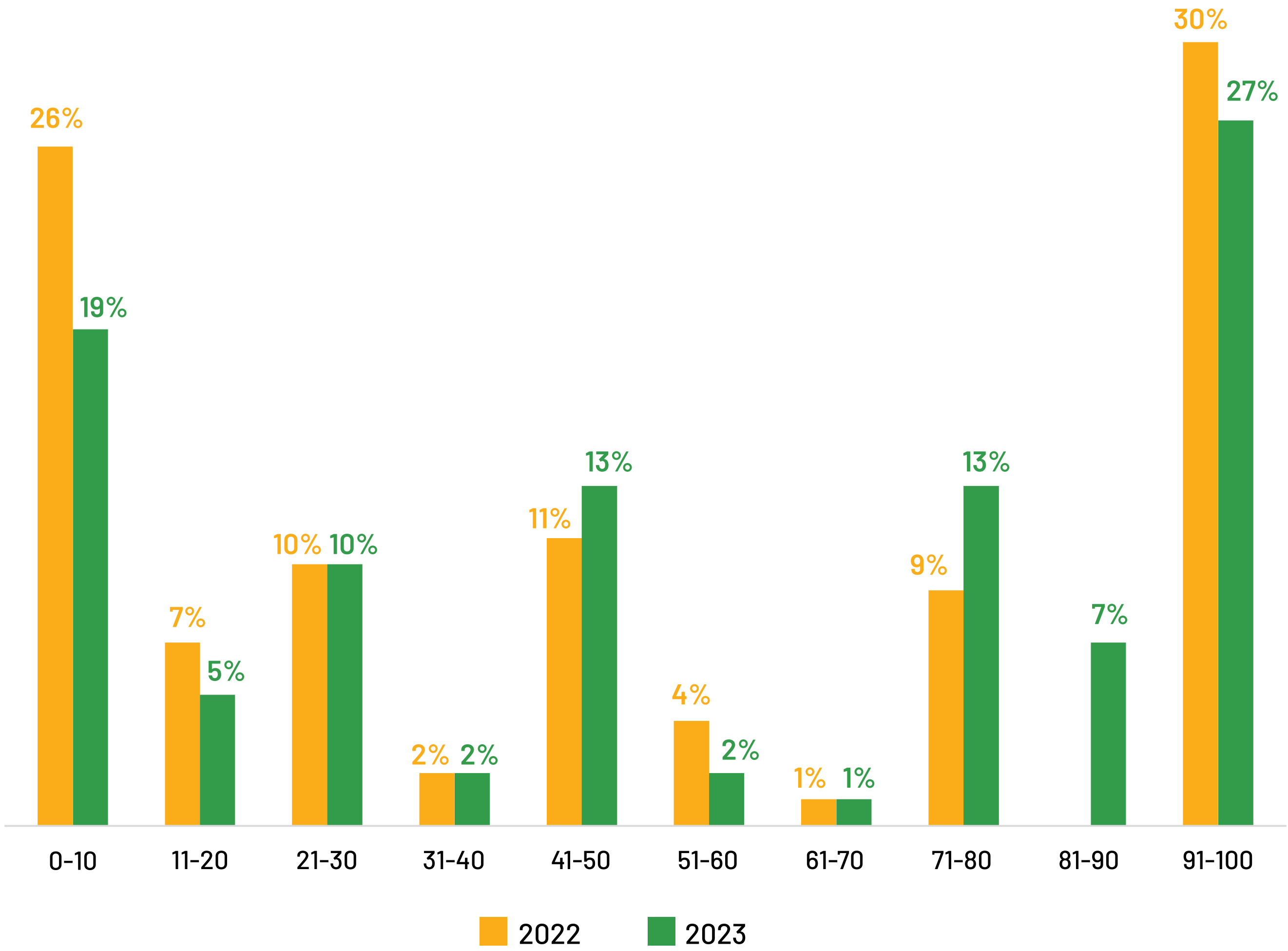
In addition, 63% of the respondents have an ESG committee in their firms to monitor portfolio performance. Lastly, 60% of the firms publish ESG, CSR or sustainability reports. This increase in the share of respondents underscores the sector's commitment and progress in meeting ESG considerations.

We, therefore, believe ESG considerations are being increasingly integrated into investment decisions.

More than half of the sector tracks ESG-related parameters of their portfolio companies. As last year's results indicated, setting up an ESG tracking mechanism is the major challenge. PE&VC firms with well-defined ESG tracking mechanisms do not find it difficult to scale up across portfolio companies.

Like last year, the sector remains broadly divided into early adopters (which have established organisation-wide mechanisms) and recent adopters (which are responding to the ongoing push for ESG compliance). This year's survey shows movement towards increased adoption. The number of firms reporting that more than 40% of their portfolio companies track ESG-related performance has increased.

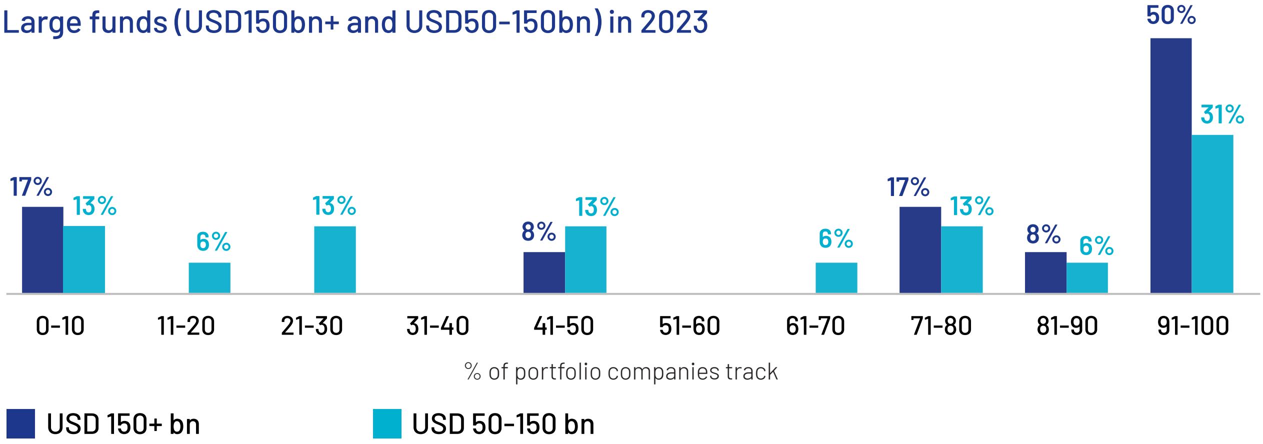
Distribution of portfolio companies tracking key ESG-related performance

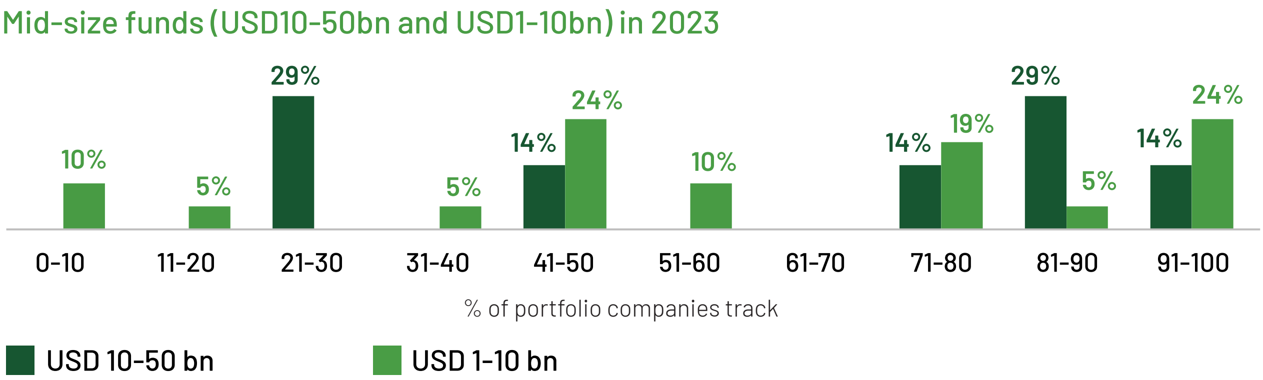


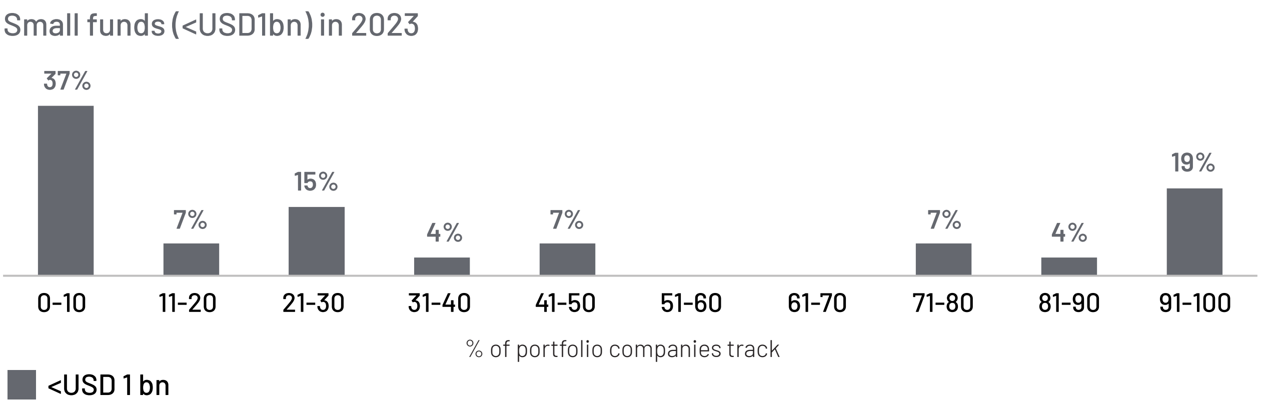
The X axis represents the percentage of portfolio companies

ESG adoption by size of funds

In terms of ESG adoption among firms, mid-size firms have the largest number of portfolio companies tracking ESG performance, while smaller ones also seem to have portfolio companies that track ESG performance.





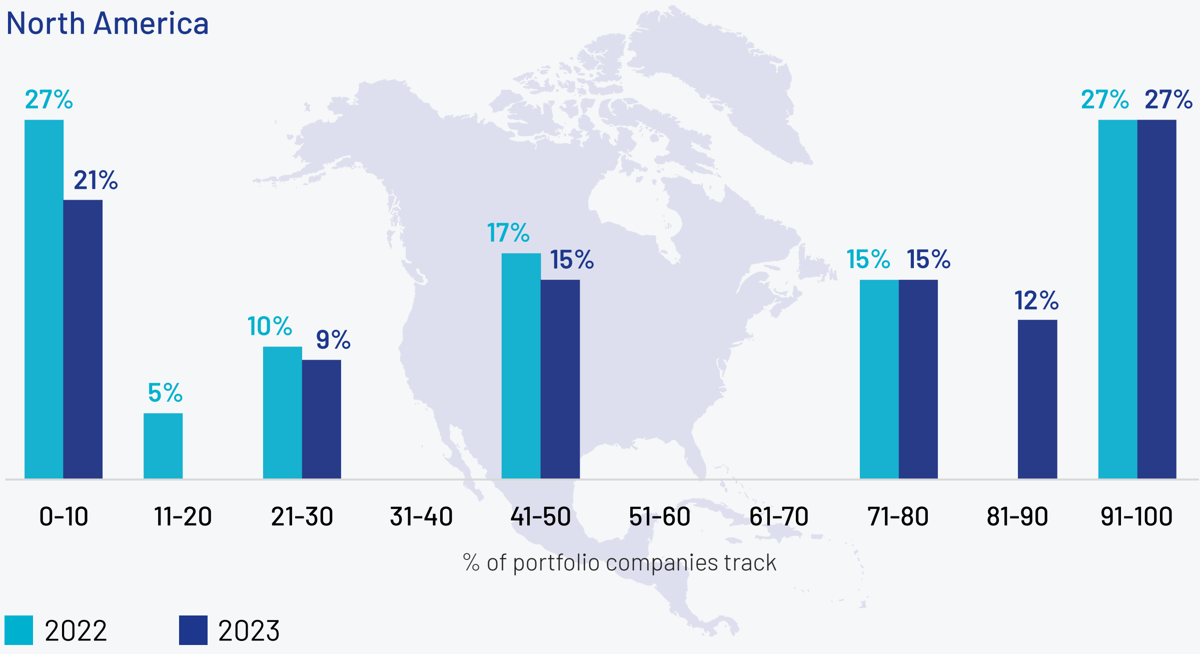


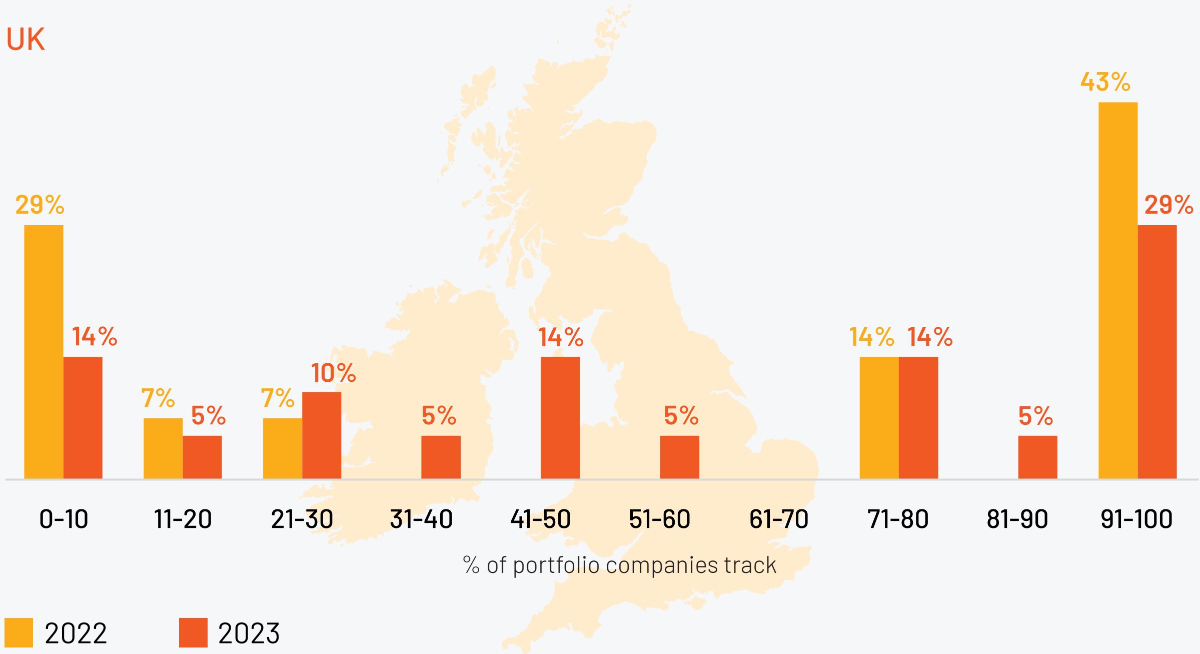
ESG adoption in the private markets follows a number of varied approaches; the basic approach is identifying the relevant ESG parameters and integrating them with the business strategy. Tracking ESG performance is an integral part of adopting ESG across funds.

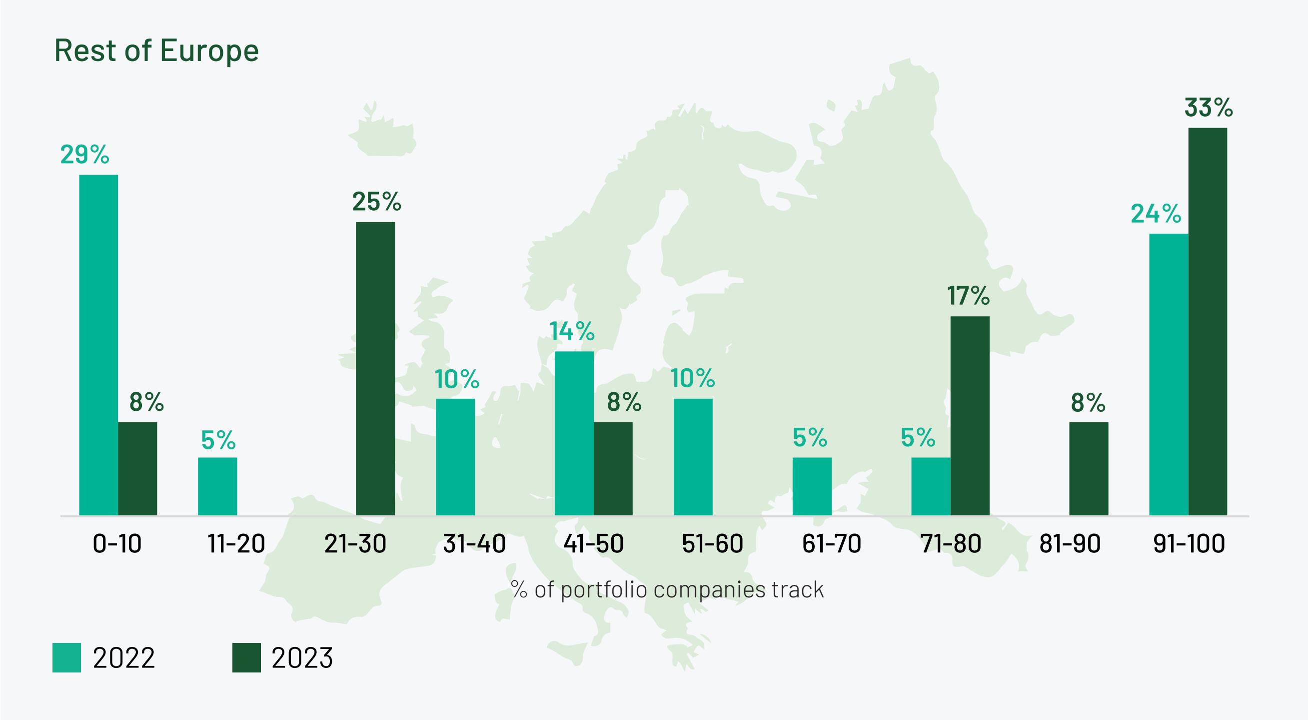
ESG adoption by region

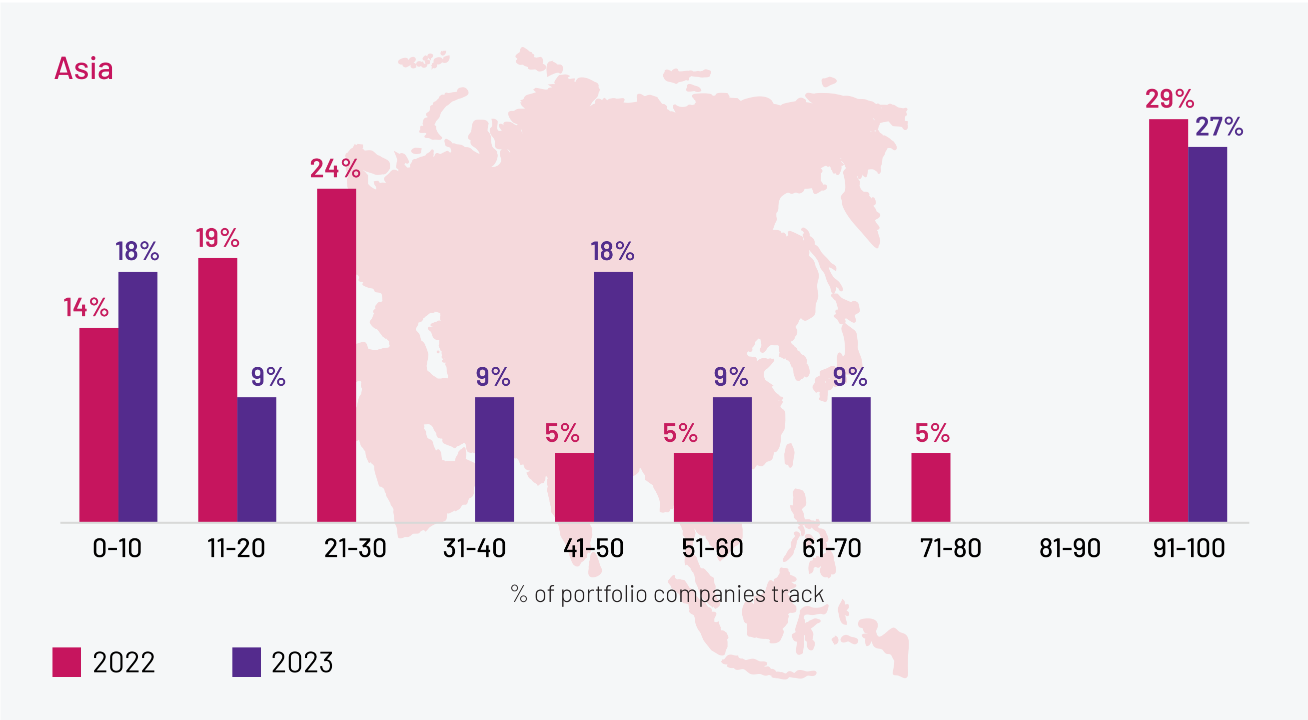
ESG adoption seems not to be restricted to the West and more established regions. South America, Africa and the Middle East continue to demonstrate fragmented distribution, indicating that ESG practices are still evolving there.

Established markets









There are also a number of region-specific regulatory/compliance requirements pushing ESG adoption. These include the Sustainable Finance Disclosure Regulations (SFDR), EU Taxonomy, the Corporate Sustainability Reporting Directive (CSRD) and Nasdaq Board Diversity Listing Rules in European and North American markets.

CONCLUSION

We are delighted to present the findings from our second edition of the survey of the PE&VC sector. Like last year, we made an effort to reach all parts of the sector – regions and strategies – to obtain a first-hand understanding of the developing trends and forces that would shape the sector.

Sentiment towards fundraising took a dive this year, reflecting the rising interest rates and geopolitical tensions. With a significant amount of dry powder already, the sector is expected to at least maintain these levels, if not increase them this year. LPs seems to be more cautious this year, posing a challenge for the PE&VC sector.

The sector feels investing opportunities may decline but still account for a sizeable part of the sector; 40% of the respondents feel they may increase. All tech sectors seem to be attracting investment as pandemic-driven preferences normalise. Valuations were the top concern last year and remain a key concern this year. The pandemic had a limited impact last year, but it has no impact now. Of concern, though, is the current economic environment. Exit considerations remain on similar lines, but IPO is not considered a viable strategy.

PE&VC professionals continue to spend more than three-fourths of their time on four (of seven) key activities and are, therefore, willing to consider outsourcing most tasks. Although decisions seem to be on hold, the preference for outsourcing remains strong.

The sector expects regulatory stringency to continue, and ESG adoption is progressing. Interest in the ESG space is increasing, but firms can be classified into two groups. One: firms that adopted ESG considerations early and now have most of their portfolio companies following ESG guidelines or reporting standards. Large funds mostly fall into this category. Two: firms that have only recently started to focus on ESG factors and have some of their portfolio companies following ESG guidelines.

We will be keenly watching the evolution of the sector in 2023 and beyond.

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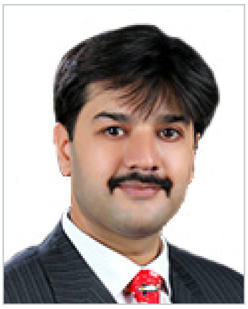
Ambarish Srivastava is an Associate Director within Private Markets practice at Acuity Knowledge Partners, and has about 17 years of experience in business research, analysis and consulting. He focuses on leading deep-dive strategic projects, due-diligence support, issue-focused trend analysis and similar assignments for our Private Markets clients. His previous experience includes tenure with startups, Big Four and consulting organizations, where he focused on industry studies, price forecasting, company analysis, macro-economic studies, and other strategic engagements.

Lead Researcher



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Abhishek is Associate Director at Acuity Knowledge Partners (Acuity) with over 18 years of experience in market research, consulting and data analytics. He is an expert in market research and project management. Abhishek leads multiple large client engagements and key strategic projects. He has been instrumental in setting up and expanding Acuity's primary research business.

About Acuity Knowledge Partners

Acuity Knowledge Partners (Acuity) is a leading provider of bespoke research, analytics and technology solutions to the financial services sector, including asset managers, corporate and investment banks, private equity and venture capital firms, hedge funds and consulting firms. Its global network of over 6,000 analysts and industry experts, combined with proprietary technology, supports more than 500 financial institutions and consulting companies to operate more efficiently and unlock their human capital, driving revenue higher and transforming operations. Acuity is headquartered in London and operates from 10 locations worldwide.

Acuity was established as a separate business from Moody's Corporation in 2019, following its acquisition by Equistone Partners Europe (Equistone). In January 2023, funds advised by global private equity firm Permira acquired a majority stake in the business from Equistone, which remains invested as a minority shareholder.

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