Private Equity and Venture Capital (PE/VC) Sector Roundtable 2023

Event Summary

HARAMBEE

ASHITIVA Advocates LLP

NAIROBI INTERNATIONAL FINANCIAL CENTRE

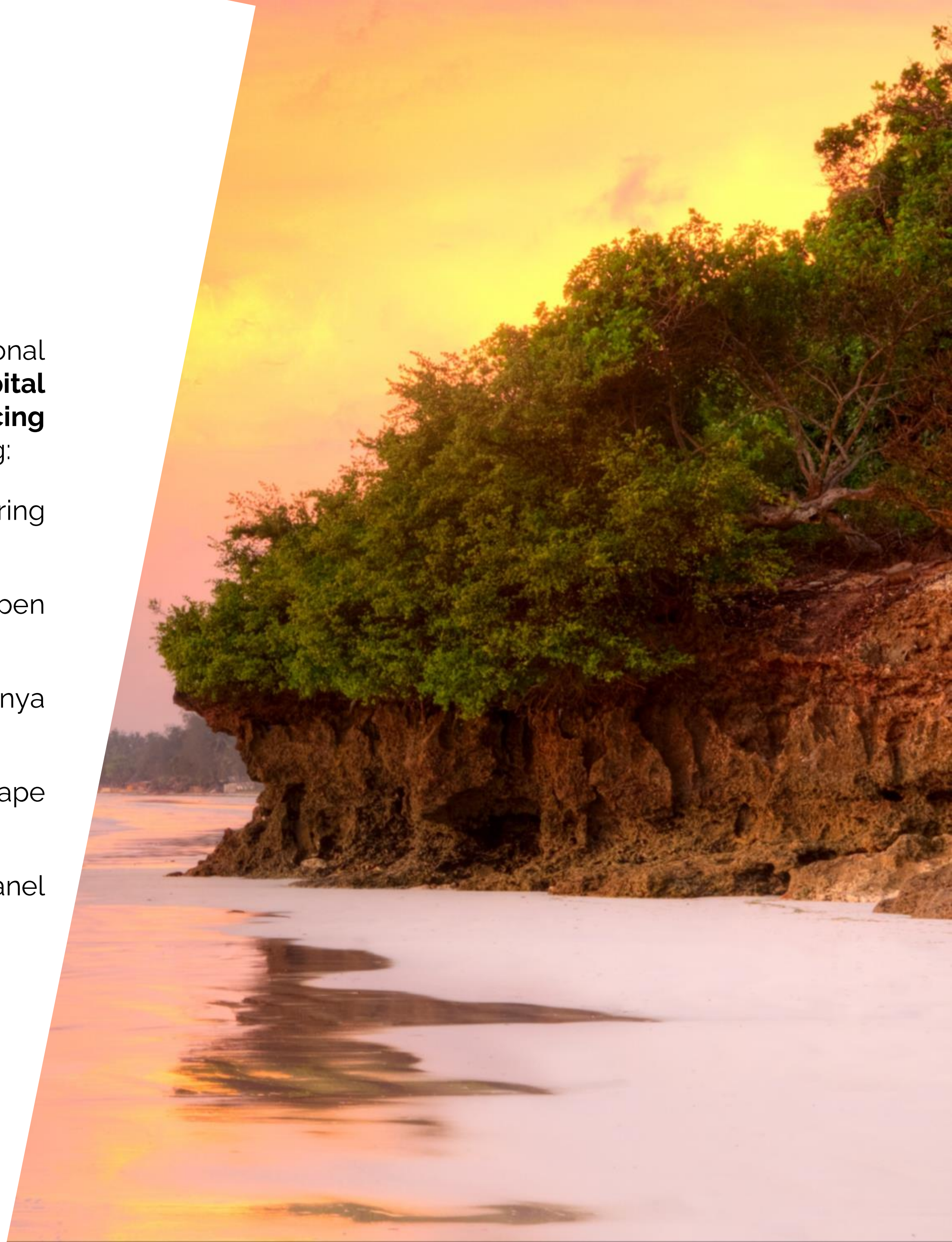
Pinsent Masons

Overview

Ashitiva Advocates LLP in collaboration with Pinsent Masons and the Nairobi International Finance Centre (NIFC) convened, hosted and moderated a **Private Equity and Venture Capital Sector Roundtable on September 12, 2023.** The theme of the Roundtable was **“Enhancing Kenya’s Private Investment Ecosystem**” which sought to achieve specific objectives including:

- outlining the challenges impacting the private investment ecosystem in Kenya and exploring the solutions for growth.
- considering Government of Kenya initiatives that the PE/VC sector can leverage to deepen activities in Kenya.
- proposing policy, tax and legislative enhancements to deepen private investments in Kenya including domicile suitability; and
- providing a platform for sector players to interact with Government representatives to shape policy affecting the PE/VC sector in Kenya.

This is a note of the key points from the Roundtable including the keynote address, panel discussions and the fireside chat that followed.



Contents

Keynote Address

In his keynote address, the Prime Cabinet Secretary **H.E. Musalia Mudavadi** recognized the crucial role played by private equity in the growth of economies worldwide including Kenya. He observed that over the past few decades Kenya has embarked on a transformative journey and made remarkable progress in the socio-economic, political and technological fields.

He underscored that Kenya's present reality offers a unique convergence of factors that must be harnessed to unlock the country's enormous potential. Appreciating that private equity and venture capital have been a catalyst for innovation, job creation, sustainable business growth and overall business expansion, he expressed commitment by the Kenyan government to supporting private equity and venture capital in the following ways:

- creating a favorable regulatory environment that supports investment and innovation;
- enhancing Kenya's digital competitiveness;
- pursuing and maintain strong trade relationships that offer large markets; and
- investing in education and talent development to provide a skilled workforce that attracts investors and that supports businesses.

He concluded by emphasizing that the success of Kenya's private investment ecosystem depends on the collaboration and contribution of all stakeholders in the PE/VC sector. The roundtable was a perfect opportunity for all stakeholders to propose meaningful initiatives that will make Kenya even more attractive to private capital.

Kenya's Macro-Economic Outlook: The Impact on Private Investment

The Panel comprised of **Amb. Kyle McCarter** *(Partner at Everstrong Capital and Former United States ambassador to Kenya)*, **Anzetse Were** *(Senior Economist at Financial Sector Deepening (FSD) Kenya)*, **Kenneth Mwige** *(Director General of the Kenya Vision 2030 Delivery Secretariat)* and was moderated by **Sylvia Kithinji** *(Partner, Ashitiva Advocates LLP).*

This opening Panel considered the ways in which Kenya's current macroeconomic environment has an impact on the PE and VC investment.

According to the World Bank, Kenya's economy is recovering from a polycrisis with Kenya's GPD growth rate remaining in line with its long-term trajectory, even though the economy has faced challenges including global financial conditions, fuel and food price shocks, a historic drought that affected the economy especially in the second half of 2022. Kenya has also faced inflationary pressures, major pressure on the exchange rate and foreign exchange reserves, and debt sustainability challenges.

Macroeconomic conditions can have a substantial impact on the success of private investments considering their long-term horizon.

There are bright spots amidst Kenya's challenging but resilient macroeconomic environment.

Anzetse Were observed that the decline in the macroeconomic environment in several countries in Africa including Kenya characterized by inflationary pressures, major pressures on the exchange rate, debt sustainability challenges will persist in the medium term and will continue to have an impact on consumer spending, investment spending, government spending and net exports and value chain resilience. Notwithstanding this decline, Anzetse pointed out that there are bright spots in the form of increased Foreign Direct Investment (FDI) interest in Kenya and Africa generally from a broader range of investors.

The new interest from non-traditional investors offers different capabilities, risk appetite and sector interest thereby diversifying possibilities for private investment. In addition, traditional investors are reviewing their approach, financing options and sectoral interest which is likely to deepen private investment.

A challenging macro-environment offers opportunity for public private partnership.

In addressing what strategies private equity firms should adopt in a challenging macro environment, Ambassador Kyle Mc. Carter highlighted the opportunities for investors to partner with government to deliver investment such as large infrastructure projects that support economic growth and deliver tangible impact.

Kenya's unique advantages such as the entrepreneurial spirit of its people, makes it competitive in comparison to other African jurisdictions facing similar macro-economic challenges. However, the potential for partnership led investment and economic growth can only be fully realized with a conducive and predictable policy, regulatory and tax environment.

Kenneth Mwige added that the Government of Kenya's Vision 2030 economic aspirations are intended to be delivered through a collaborative effort between private sector and public sector with government contributing 30% of the investment with the objective of catalyzing private sector investment.

Bridging the gap between the private and public sectors is key in attracting the 70% needed from the private sector. This can only be achieved through the efforts of initiatives such as the Nairobi International Finance Centre (NIFC) and the Kenya Investment Authority (KENINVEST).

In turn, private investment offers the appropriate financing options to enable Kenya to meet its long-term economic objectives under Vision 2030.

Investment Perspectives: Success factors and barriers related to PE/VC investment in Kenya

This panel was made up of **Diana Gichaga** (*Founder & Managing partner of private-equity support*), **Peter Fry** (*Director, Kua Ventures Limited*), **Mohamed Saeed** (*Investor Relations & Capital Raising Manager, Zoscales Partners*) and was moderated by **Oliver Crowley** (*Partner, Pinsent Masons)*.

The Half Year Venture Capital in Africa Report, 2022 by the African Private Equity and Venture Capital Association described Kenya as a top ten (10) investment destination by deal volume and value. Its dynamic and creative business environment, and its numerous promising startups that draw investors' attention are some of the features that make Kenya stand out as a top PE/VC investment destination in Africa. Valuable insights have subsequently emerged from the various deals that have taken place on the factors that make an investment successful as well as the challenges that need to be overcome.

Each stage of the lifecycle of PE/VC investments presents opportunities and challenges that determine the overall success of investments. Kenya and the region experience unique success factors and barriers under each stage, which this panel shared perspectives on.

Need for proper documentation and record keeping by entrepreneurs.

Lack of documentation combined with unrealistic projections set by entrepreneurs, unwillingness to give capital and an unfavorable macro-economic environment were highlighted as some of the key barriers to PE/VC investment in Kenya. Proper record keeping and documentation significantly support investment decisions by investors. It enables investors to verify representations made by the entrepreneurs as accurate especially during the due diligence process.

Diana argued that lack of documentation often translates to lack of preparedness by entrepreneurs which deters investors.

Relationship management and mutual understanding by both entrepreneurs and investors

Entrepreneurs need to set realistic expectations with investors which is crucial for building trust, managing risks, avoiding disappointment and generally maintaining credibility. Peter Fry observed that entrepreneurs need to manage relationships with investors whilst maintaining transparency and making investors aware of the aspects of their businesses that need investor support. By the same token, it is crucial for investors to understand entrepreneurs better by thinking through entrepreneurs' lenses and understanding their businesses better.

Coupling of investment and exit strategies for successful deals.

A successful PE exit marks the success of an investment. The panel acknowledged that the region's exit environment has not been without challenges, whilst highlighting that Africa's initial public offers (IPOs) are scarce and therefore not suitable as an exit mechanism for PE investors. Mohamed attributed exit success to applying a multifaceted approach such as diversifying exit options, longevity in the assessment period and planning on the exit prior to acquisition. This, coupled with strong investment strategies contribute to successful exits. He gave an example of Zoscales' '3c' investment approach which entails (a) concentration by having relatively few portfolio companies; (b) control through obtaining an equity stake in the entrepreneur's business; and (c) champions by working with industry leaders.

Leveraging the Nairobi International Finance Centre (NIFC) to deepen PE and VC investments in Kenya

Mr. Oscar Njuguna, (*the Acting. CEO of NIFC*) delivered a presentation on the ways in which investors can leverage the NIFC to deepen their investments in Kenya.

The Nairobi International Finance Centre (NIFC) was established as a flagship project under the economic pillar of Kenya's Vision 2030. NIFC is designed to be a leading financial hub, that offers an efficient gateway for investors and businesses to the African market. The NIFC is focused on providing an operating environment that is efficient and attractive for investors. Its key pillars include providing efficiency in operating frameworks, improving the legal and regulatory environment in Kenya including the dispute resolution frameworks within the financial and technology sectors, and providing incentives and predictability in Kenya's tax regime.

In its bid to achieve its objectives, the NIFC's framework has been designed to ensure that the following measures are put in place for the benefit of investors:

- No company ownership restrictions while setting up in Kenya.
- No nationalization or expropriation of property.
- No restrictions on repatriation of profits.
- Investors can employ qualified staff of choice.
- Tax and regulatory predictability.
- Efficient business establishment; and
- Government and regulatory support from the NIFC.

Currently, entities certified under the NIFC enjoy various incentives. For example, Capital Gains Tax (CGT) application, in instances where a company invests five billion Kenya shillings; and the transfer of such investment is made after five years, the applicable CGT rate shall be the rate that was prevailing at the time that the investment was made. In addition, the Corporate Tax application, in instances where a company operates a carbon market exchange or emission trading system, the applicable corporation tax rate shall be 15% for the first ten years from the year of commencement of its operations.

Enhancing the private investment policy, tax and regulatory landscape in Kenya

The panel was constituted by **Dr. Adano Roba** (*Acting Director General, Competition Authority of Kenya*), **Josephine Kang'ong'a** (*Head of Legal and Regulatory Framework, Capital Markets Authority- Kenya*), **Michael Koome Mburugu** (*Regional Tax Partner, PKF International*), **Hope Wandera** (*VC Investor, VU Venture Partners*) and was moderated by **Ribin Ondwari** *(Partner, Ashitiva Advocates LLP).*

While Kenya's regulatory environment is fairly supportive of investment, there is room for improvement. Some hurdles facing both investors and investees include constraints on ownership, tax inefficiencies, slow licensing processes, bureaucratic hurdles, insufficient public private collaboration, infrastructure gaps and other factors that can negatively impact private equity and venture capital investment. Kenya can design a responsive and favourable framework that fosters investor confidence and supports sustainable economic growth.This panel considered the designing of a responsive and favourable policy, tax and regulatory framework that fosters investor confidence and supports growth of entrepreneurship.

Tax certainty and fairness are crucial for investor confidence.

In response to what investors look for in a tax environment, Micheal Mburugu shared that investors search for certainty and fairness in a country's tax regime. Investors will avoid investing in a jurisdiction with an unpredictable tax regime. PE and VC have a long-term investment horizon, and uncertain tax regimes discourage investment decisions.Investors also look for jurisdictions with fair tax regimes that optimise revenue collection across the country's taxpayer base as opposed to the application of disproportionate tax increments on a segment of the taxpayer population. This could lead to unintended consequences such as informalization, reduced economic growth and reduced competitiveness.

Collaboration on policy and regulatory development is needed to create a favourable environment for PE and VC investment.

Josephine Kang'ong'a shared that the Capital Markets Authority (Registered Venture Capital Companies) Regulations (the "Regulations") were established as a regulatory tool intended to promote VC set up and investments in Kenya. The Regulations allowed for some tax benefits on dividends associated with VC financing transactions. For example, the Income Tax Act Kenya, under the Income Tax (Venture Capital Enterprise) Rules, 1997, provided for tax exemption on the income of Acacia Fund Limited on the dividends and gains arising from trade in the shares of any of its venture companies, which was earned during the first ten (10) years of first investment in any of those companies, subject to compliance with any rules or regulations governing venture capital companies as may be made by the Commissioner of Income Tax.

Regrettably, the Regulations failed to achieve their objectives due to limited VC investment activity in the country at the time of the Regulations coming into force. Additionally, these Regulations exclusively applied to VC entities organized as companies, overlooking the fact that partnerships have been the more favoured model for VC legal structures.

In a different example, the Start-Up Bill 2022 Kenya (the "Bill"), does not adequately respond to market realities and could fail to achieve its intended objective. Hope Wandera observed that the Bill's definition of a startup does not capture the distinct characteristics that differentiate startups from small and medium-sized enterprises (SMEs), and whose legislative architecture could potentially fail to address the real needs of startups. It is therefore imperative to establish a more robust and coordinated regulatory development approach involving regulators and all relevant stakeholders to ensure regulations are responsive to sector needs.

Regulation should be used as a tool to promote PE and VC investment.

Dr Adano Roba, highlighted the importance of regulators playing both a facilitative and enforcement role to promote investment. For example, the Competition Authority of Kenya (the "CAK") is mandated to investigate restrictive trade practices on horizontal, vertical and abuse of dominance cases that could lead to market distortion. This is crucial in fostering fair competition, creating market transparency, and encouraging innovation which consequently attracts investments.

He shared that the CAK has adopted a well-balanced regulatory approach that finds a middle ground between dealing with anti-competitive behaviour and permitting legitimate business to thrive including approval of M&A deals.

Dr Adano also shared that despite the availability of a robust legal and institutional competition framework, the dual notification process involving CAK and the COMESA Competition Commission in relation to regional cross border transactions could potentially dampen PE/VC interest. Dr Adano suggested the importance of re-evaluating this dual notification process to avoid dissuading PE/VC investors from participating in M&A deals within Kenya and the broader region.

Josephine Kang'ong'a added that there needs to be an effective legal framework that allows PE and VC investors to smoothly exit through the capital markets. Presently, Kenya has not experienced any exits through the capital markets. However, if the legal and policy frameworks are favourable for exit for example the application of fair tax treatment and availability of effective dispute resolution mechanisms, such legal and policy measures would contribute to the growth of the PE and VC sector whilst simultaneously deepening the capital markets.

Navigating the investment landscape: Opportunities in Kenya and lessons from other jurisdictions.

The Panel was composed of **Belvas Otieno** (*Investment Officer, International Finance Corporation*), **Joseph Murabula** (*Chief Executive Officer, Kenya Climate Innovation Center*), **Chibuzo Ene** (*Chief Executive Officer, Nathan Claire*) and was moderated by **Lisa Botha** (*Partner, Pinsent Mason*).

Kenya can enhance its attractiveness as a private investment destination by adopting the success drivers from other jurisdictions. The success factors from other jurisdictions also may offer potential opportunities for Kenya in its own context.

Kenya remains an attractive investment destination, albeit more can be done.

Kenya is deemed to have many investment opportunities in comparison to other jurisdictions including in sectors such as climate, water, energy, consumables, infrastructure, energy and many more, due to various factors including being a regional gateway. It was suggested that incentivizing entrepreneurs by lowering tax rates as well as enhancing the ease of complying with tax procedures would be beneficial to the country's entrepreneurial and investment ecosystem.

Data driven decision making is crucial in enhancing governance in the region.

The panel recognized that the quality of governance has significantly improved in the course of the years in Kenya which has contributed to its success as a financial hub compared to other African destinations. Kenya and other countries in the region should however be more deliberate in harnessing quality data and utilizing such data to guide decision making by government agencies and authorities.

Development impact is clear, but commercial return remains elusive.

Investment in Kenya (and Africa generally) generates clear developmental impact results. However, there is a scarcity of deals that offer promising commercial viability and consequently, there is an apparent need for entrepreneurs to enhance return to their investors in order to deepen investment by attracting commercial investors, whose investment participation is crucial for later stage investment rounds as opposed to development finance institutions (DFIs) whose participation should be more prevalent at the earlier stages.

Lisa, summarized the discussion by noting that there's need to maximize returns and narrow the loss gap; entrepreneurs need more clarity on legislation; SMEs need more access to innovative finance suitable to grow business; there is need to incentivize the growth of talent and particularly support top talent with entrepreneurial skills that work independently by assimilating them into functioning entrepreneur ecosystems to ensure that their growth is not limited to ; and there is need to enhance the involvement of stakeholders, including at grassroot level, in decision-making by government.

Fire Side Chat: Harnessing Kenya's Potential to Deepen Private Investment

The Roundtable ended with a fireside chat by **Dr. James Mworia**, **CFA** *(Group CEO and Managing Director, Centum Investment Company PLC)* who was interviewed **by Terryanne Chebet** *(Strategic and Business Development Lead, CNBC Africa)* on how investors can harness Kenya's potential and deepen private investment.

Kenya offers diverse sectors and investment strategies should be market and data driven.

Kenya has a diverse range of sectors that offer opportunities for investment including housing, education, financial services, energy, agriculture, and technology. An analysis of the economy demonstrates that these sectors will be critical to Kenya's current and future economy. Investors should invest, modify and/or scale their investments based on a strong market hypothesis that is data driven.

Special Economic Zones provide a suitable operating framework for investors.

Operating frameworks such as the Two Rivers International Finance and Innovation Centre (TRIFIC) Special Economic Zone (SEZ) aim to solve the problem of fiscal inefficiencies faced by investors bringing capital into Kenya. SEZs established under the Special Economic Zones Act enjoy incentives such as exemptions from stamp duty, Capital Gains Tax (CGT), taxes on interest and filming licenses. These incentives make it easier for FDI to flow into the country by making it fiscally attractive for investors to scale investments and compete globally.

Execution strategy is as crucial as the value creation plan.

Investments should not be made purely on the basis of a business' value creation plan without considering the business' execution strategy. The execution plan must include the selection of a good leader and competent management team and the establishment of processes to make sure that the leader can support their team during the implementation process. In addition, execution must involve significant focus on managing inputs that will deliver results, monitoring and review activities, risk management and execution with the end in mind. Businesses that effectively balance value creation and risk management are considered to be highly attractive for investment.

The role of leadership is critical for business success and deepening investment.

James underscored the role of leadership in deepening private investment and supporting business growth. He described the role of leadership as "clearing the path" for teams to execute their mandates effectively. This entails dealing with any potential challenges that are beyond the control of the business, for example. regulatory challenges.

Our approach to Investment Support in Kenya

The Roundtable showcased the vast untapped potential of Kenya and its private equity and venture capital sector. Ashitiva Advocates and Pinsent Masons, with the support of their partners are committed to supporting their clients to navigate the current investment environment while leading or supporting initiatives, in collaboration with sector players, that will contribute to a more conducive climate for private equity and venture capital investment.

This Investment Support Initiative is led by Partner, Sylvia Kithinji, Senior Partner, Nelson Ashitiva from Ashitiva advocates LLP, Partner, Lisa Botha and Partner, Oliver Crowley from Pinsent Masons.

Sylvia Kithinji

Nelson Ashitiva

Lisa Botha

Oliver Crowley

ASHITIVA Advocates LLP

NAIROBI INTERNATIONAL FINANCIAL CENTRE

Pinsent Masons