FINANCE DIGEST

PRIVATE CAPITAL: OFFERING MORE THAN ACCESS TO FINANCE

Introduction

Capital. A crucial factor of production and arguably one that gels together the other three, entrepreneurship, labor and land (where applicable), in initiating or propelling a successful enterprise. It is therefore of no surprise that the availability of capital, most especially financial, and technical know-how could differentiate the success of one business from another even if all other factors are held constant. Appreciating this, what role does private capital play in developing access to finance and what impact has it had on the entrepreneurial ecosystem in Kenya?

Access to Finance

In the Kenyan context, access to finance is characterized by a robust formal lending market from banking institutions, mobile money & digital lending as well as a growing capital markets. Formal lending institutions in Kenya have however often applied stringent lending policies and requirements such as high collateralization, strict credit history requirements, business plans, financial statements and generally compliance requirements which entrepreneurs cannot meet or afford.

In the recent past, mobile money lending had become the preferred lending alternative to bank financing owing to the less restrictive compliance requirements but was often coupled with predatory lending. The gazettement and coming into force of the Central Bank of Kenya Digital Credit Providers Regulations, 2021 as well the enactment of the Data Protection Act, 2021 have since sanitized the mobile money and digital lending industry leaving the pool largely to telcos and a few digital lenders whose credit line may not be sufficient to scale and sustain businesses.

Capital markets on the other hand have largely indicated lacklustre performance as a means of raising capital with the Nairobi bourse experiencing a hiatus on initial public offers (IPOs). The last IPO was the Nairobi Stock Exchange's (NSE) self-listing about nine (9) years ago. There has also been a recent listing by introduction in 2020. Public corporate bonds have also shown a mixed bag performance in terms of listing frequency after having experienced no activity for about five years since 2015.

The Gap & Private Capital

It is apparent. Kenya's entrepreneurial ecosystem faces a significant capital gap. Private capital through private equity, venture capital and foreign direct investments has significant potential to bridge this gap.

Kenya has maintained a steady position in terms of ranking as a top ten investment destination in Africa. It has ranked between third and fourth in the years 2019, 2020, 2021 and 2022 in terms of venture capital activity according to the African Private Equity and Veture Capital, 2021 and 2022 Venture Capital in Africa Reports published in April 2022 and April 2023 respectively. The Burbidge Capital, Annual East Africa Review Financial Review, 2022 indicated that Kenya had 97 disclosed private capital deals at a disclosed value of USD 1.35 billion in 2022. Further, Kenya has been the leading country in East Africa so far in 2023 in terms of number of deals according to Burbidge Capital

monthly financial reviews. According to the Burbidge May 2023 financial review, the latest published report, Kenya had garnered a whooping 48 deals out of 64 total disclosed deals in East Africa.

These statistics are a clear fortification of the position highlighted under the World Bank's survey of the Kenyan private equity and venture capital landscape, published in October 2018 (the **World Bank's Survey**), which identified Kenya as a one of the most attractive East African destinations where fund managers can establish offices as a launch pad to execute cross-border investments in companies operating in Africa.

Private capital has been a fundamental driver in the scaling up of businesses in Kenya across various sectors such as financial services, consumer discretionary, information technology, communication, agriculture and manufacturing. Many private equity or venture capital backed companies have indicated tremendous success not only because of the financing provided, but also because of the technical and leadership support that is often attached to private capital.

Private capital has therefore played a critical role in offering a successful alternative to other options of financing, thus in its own right enhancing access to capital for Kenyan entrepreneurs.

Impact on Kenyan entrepreneurial ecosystem

Private equity and venture capital backed companies have experienced better financial return and various sectors have grown as a result of high investment activity. Private capital has also had significant impact on increasing employment opportunities.

A. Financial Return

Private capital backed companies benefit from improved operational efficiencies from their investors, which are usually marked by streamlined cost structures, optimized capital allocation, adopting new technologies and new business models. The companies also benefit from more opportunities and value derived from access to capital and access to networks.

Combined, these elements contribute to increased revenue, profitability and growth of the private capital backed companies. The Kenyan market has seen companies on the verge of insolvency turn around into sustainable businesses and through the support of private capital. Similarly, the Kenyan market has witnessed the rise of many startups hinged off the support of private capital.

A. Sectoral Growth

Various sectors have benefitted from the private capital investment activity in Kenya. The table below indicates a highlight of the distribution of venture capital investment activity in Kenya from 2014-2021 by sector:

Sector	% of Venture Capital deals by volume
Financials	23%
Consumer Discretionary	18%
Information Technology	15%
Industrials	14%
Communication Services	9%

Source: *Venture Capital in Africa Report (Third Edition), African Private Equity and Venture Capital Association, April 2022*

An illustration of private capital's impact on sectoral impact growth is for instance through Kenya's fintech industry. It has been receiving a huge chunk of private capital investment and is vibrant to the extent that Kenya's capital city, Nairobi, has become known as the "Silicon Savanna". This explains the country's concentration of fintech start-ups, hubs, accelerators and investors. A Harvard Business Review article recognized Kenya as a global hub of fintech Innovation whilst recognizing that venture capitalists, traditional finance firms, governments, and even the average smartphone user each have had a hand in the massive acceleration and growth of the sector.

B. Employment Opportunities

Private capital has boosted employment opportunities in Kenya by increasing the availability of funds and business prospects, especially for small and medium enterprises (SMEs) that struggle to obtain financing from banks or capital markets. According to the World Bank's Survey, private capital investors have contributed to the creation of both direct and indirect jobs in Kenya. It for instance, reported that that Acumen Fund's (a fund that focuses on impact investing in agriculture, housing, power, and education) portfolio companies have created nearly 50,000 jobs in East Africa, of which more than half are in Kenya.

A Center for Strategic and International Studies (CSIS) brief on SMEs in Sub-Saharan Africa further appreciated that SMEs generate about 80% of jobs across the continent, and thus their growth through initiatives such as capital from blended finance contributes to poverty reduction and economic development.

These jobs have improved the livelihoods of low-income households and communities, as well as access to essential services such as education and health.

Conclusion

Private capital has played a huge role in developing access to finance for Kenyan businesses as an alternative to other forms of financing. It has also had a huge impact on Kenya's entrepreneurial landscape and economy. There is need for deliberate sector engagement to seek ways to further propel its success as a form of financing.

For more information on the above piece please contact:

Nelson Karumba
Associate – Corporate Commercial Law
nkarumba@ashitivaadvocates.com

Sylvia Kithinji
Partner – Corporate Commercial Law
skithinji@ashitivaadvocates.com

Disclaimer: *This article is intended for general use. It does not create an advocate-client relationship nor does it constitute legal or financial advice.*

KENYA'S JOURNEY IN SUSTAINABLE FINANCE: WHERE ARE WE NOW AND WHAT DOES THE FUTURE HOLD

Sustainable finance, also popularly referred to as 'green finance', refers to investment decisions that factor in environmental, social and governance (ESG) considerations. The aim of taking into account ESG considerations when making financial investments is to create sustainable economic activities and projects.

The European Union gives examples of these ESG considerations. It proposes that the **environmental** considerations might include climate change mitigation and adaptation, as well as the environment more broadly. **Social** considerations could refer to issues of inequality, inclusiveness, labour relations, investment in people and their skills and communities, as well as human rights issues. The **governance** of public and private institutions – including management structures, employee relations and executive remuneration – plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process.

In Kenya, sustainable finance is quickly gaining ground. As Kenya focuses on the growth of its economy, it recognizes that economic growth should not come at the expense of the environment and peoples' welfare .

A. Current State of Sustainable Financing in Kenya

Kenya's journey towards sustainable financing has been marked by significant milestones. There are several initiatives that Kenya has championed in the realm of sustainable financing. These include:

i) Regulatory and Policy Initiatives

The Constitution of Kenya 2010, in Article 69 provides for the respectful and sustainable use of the environment the environment, through the conservation of natural resources.

In 2016, Kenya launched the Climate Change Act whose purpose was to mobilize both public and private sector actors to transition to a low-carbon economy. Kenya is in the process of enhancing its climate change legislation through Climate Change (Amendment) Bill, 2023.

Additionally, Kenya recently released the Carbon Credit Trading and Benefit Sharing Bill 2023, which has been approved by the National Assembly Budget and Appropriations Committee for formal introduction to parliament. If the said bill is approved by parliament and assented into law, there shall be established:

- a regulatory framework for the trading of carbon credits and benefit sharing in carbon credit trading;
- the Carbon Credit Trading and Benefit Sharing Authority; and
- the registration and regulation of the carbon credit trading business

There has also been sector specific climate change policy initiatives. In 2021, the Central Bank of Kenya (CBK), released the Guidance on Climate-Related Risk Management. The guide empowers CBK to guide institutions in order to maintain a stable and efficient banking and financial system. It recognises that climate change poses a substantial risk and can pose an opportunity for the financial sector and therefore requires banks to: embed the consideration of the financial risks from climate change in their governance arrangements; incorporate the financial risks from climate change into their existing financial risk

management practice; and develop an approach to disclosure on the financial risks from climate change.

Kenya's capital markets framework also takes into account ESG considerations. In 2015, the Capital Markets Authority (CMA) issued the Code of Corporate Governance Practices for Issuers of Securities to the Public (the Code). This code underscores the significance of businesses aligning their strategies with ESG (Environmental, Social, and Governance) principles. Each fiscal year's conclusion necessitates boards of companies issuing securities to the public to include in their annual reports a declaration of their governance policy and the extent to which they have adhered to the Code. However, it's essential to note that the Code has embraced the "apply or explain" methodology, indicating a shift from a rule-based approach, as seen in the 2002 Corporate Governance Code, which followed a "comply or explain" model. Consequently, if the board deems it in the company's best interest, it has the option to adopt a practice that diverges from the Code's provisions, but it must provide a comprehensive explanation for doing so.

In 2019, the CMA issued a Policy Guidance Note in Green Bonds, highlighting the guiding principles for the issuance of Green Bonds. This development helped to facilitate the successful closing of Kenya's first green bond in 2019 by Acorn Holdings, a Kenya based real estate company. The KES 4.3 Billion (USD40m) bond was raised for the construction of environmentally-friendly student accommodation for over 5,000 university students in Nairobi. This bond issuance not only attracted local investors but also showcased Kenya's potential to tap into green financing opportunities. This is the only green bond issued in Kenya so far, however, with the rise of sustainable financing in Kenya, there's likelihood for issuance of more green bonds.

At a policy level, Kenya launched its Green Economy Strategy and Implementation Plan (GESIP) in 2017. GESIP outlines Kenya's vision for sustainable development, emphasizing the need for clean energy, resource efficiency, and conservation.

ii) Renewable Energy Projects

Over 80% percent of Kenya's electricity is generated through renewable energy sources. Its investments in geothermal, wind, hydro and solar energy have positioned it as a leader in clean energy production in Africa. According to a report by the World Bank on 'Action Against Climate Change: Seizing opportunities in a decarbonizing world 2023', Kenya is leading in sub-Saharan Africa in the development of a well-diversified power generation mix and could achieve a fully green grid by 2030. The report states that Kenya has a unique opportunity to stay on a low-carbon growth path while meeting its on-grid electricity needs entirely from green energy sources. Projects like the Lake Turkana Wind Power plant and the Olkaria Geothermal plant have significantly increased Kenya's green energy capacity.

iii) Private Sector Led Sustainable Financing

Kenya's private sector has embraced sustainable financing by implementing the CMA and CBK guidelines mentioned above. Major banks and financial institutions have started offering green financial products, such as green bonds and sustainable investment funds, to meet growing demand from environmentally conscious investors.

In 2015, the Kenya Bankers Association (KBA), developed ssustainable finance

principles. According to KBA, these principles are required to inform financiers on how to optimise the balancing of their business goals with the economy's future priorities and socio-environmental concerns. The principles were developed in line with international best practice and consistent with the financial sector's environmental and social risk management aspirations.

There is more opportunity for the private sector to plug into the green financing opportunities in Kenya. According to a 2021 report by the National Treasury (Kenya) on '**The Landscape of Climate Finance in Kenya'**, private finance represented almost 41% of the total climate finance tracked in Kenya, and most of this was directed to renewable energy generation. Foreign private sector actors invested KES 64.9 billion (USD 643 million) in climate-related capital in Kenya, predominantly in renewable energy projects. Apart from renewable energy, philanthropic foundations represent one of the few international private entities that have actively invested in other climate-related sectors, specifically contributing to projects related to adaptation, healthcare, and water in Kenya. Consequently, there arises a pressing need for an expanded role of the private sector in addressing climate issues in these critical sectors beyond renewable energy.

iv) International Partnerships

Kenya has subscribed to the UN Sustainable Development Goals (SDGs) commitment to sustainable financing has attracted international attention and support. Partnerships with organizations like the United Nations Development Programme (UNDP) and the International Finance Corporation (IFC) have facilitated the implementation of sustainable projects and investments

Kenya is also a signatory to the Paris Agreement which came into force in 2017. The objective is to ensure that Kenya's greenhouse gas emissions is lowered by 32% by 2030 as part of Kenya's Nationally Determined Contribution (NDC).

B. The Future of Sustainable Financing in Kenya

The future of sustainable financing in Kenya is promising. Anticipated developments include:

i) Growth of Green Bonds and Green Equity

Kenya is well positioned to experience a surge in green bond issuances, channeling capital into sustainable initiatives. These bonds are expected to fund projects in areas like renewable energy, afforestation, and climate-resilient agriculture.

There is also potential for more green equity investments, with investors increasingly preferring to invest in companies that are focused on sustainability. Green equity funds have been growing rapidly. In a report by International Monetary Fund (IMF) on 'How Investment Funds Can Drive the Green Transition', the total sustainable funds, including those with a climate-specific label, totalled about $3.6 trillion in 2022.

ii) Technological Advancements

New technologies, such as blockchain and fintech solutions, will play a crucial role in making sustainable financing more accessible and transparent. The emerging technologies will assist in the collection, analysis, and reporting of ESG data. Automated tools and algorithms can assess a company's sustainability performance, providing investors with valuable insights for making informed decisions.

There is also an opportunity for technolo-

gy firms to actively contribute to positive change through the utilization of both unprocessed and refined ESG data. They could explore the potential of distributed ledger technology to access additional sources of funding. The increased liquidity created by this can be allocated towards sustainable initiatives or can support the overall growth of companies dedicated to positive environmental contributions.

Improved and increased digital platforms and crowdfunding websites will make it easier for individuals and institutions to invest in sustainable projects and green bonds. These platforms help to democratize access to sustainable financing opportunities, encouraging broader participation in green financing.

Technology serves as a catalyst for the advancement of sustainable financing by enhancing data analysis, risk evaluation, transparency, accessibility, and operational efficiency. This empowerment fosters more effective collaboration among investors, financial institutions, and sustainable projects, ultimately driving positive environmental and social outcomes.

iii) Collaboration and Partnership

The collaboration between government, the private sector, and international organizations will play a pivotal role in expanding and amplifying sustainable financing initiatives.

An example of the aforementioned collaboration is the commitment made by Kenya during the Africa Climate Summit recently concluded in Nairobi, in September, 2023 (‘the Summit’), to launch a New Green Hydrogen strategy and roadmap that will elevate green hydrogen in Kenya. This commitment will support HDF Energy (Hydrogène de France), a company that develops large-scale green hydrogen infrastructure and manufactures high-power fuel cells in Africa, in its announcement at the Summit, to start development studies to install a first green hydrogen power plant in Kenya. This will see the deployment of 180 MW of solar PV combined with 500 MWh of long-term hydrogen-based storage, for an investment valued around 500 million USD.

Additionally, the commitments and announcements made at the Summit equated to a combined investment of nearly USD 26 billion from public, private sector, and multilateral development banks, philanthropic foundations, and other partners in the development financing community. Collaboration from these parties will therefore play a key role in realising these commitments.

C. Conclusion

Kenya is well positioned for deeper sustainable financing. For Kenya to achieve its NDC by 2030, a deliberate shift towards sustainable financing will be paramount. Sustainable financing is not merely a choice but an imperative for Kenya’s development and the preservation of its environment for generations to come.

For more information on the above piece, please contact:

Sally Kamau
Senior Associate – Corporate Commercial Law
skamau@ashitivaadvocates.com

Sylvia Kithinji
Partner – Corporate Commercial Law
skithinji@ashitivaadvocates.com

Disclaimer: *This article is intended for general use. It does not create an advocate-client relationship nor does it constitute legal or financial advice.*

INVESTOR READINESS 101: 6 GOLDEN RULES KENYAN ENTREPRENEURS NEED TO KNOW

Background

Entrepreneurs often come up with great and revolutionary ideas. Cognizant of the fact that access to funds is a critical gamechanger in the entrepreneurship lifecycle, many businessmen approach private capital investors to help them scale up and improve their businesses. Whilst some businesses will be successful in securing funding, the majority will often not despite having viable business ideas. It is paramount for Kenyan entrepreneurs to understand the common pitfalls that prevent access to private capital whilst being conscious of what investors are looking for. Ashitiva Advocates LLP has engaged with various businesses that have faced challenges in accessing capital and below, we provide our bespoke guide on what Kenyan entrepreneurs need to know whilst seeking private capital investments.

What is investor readiness?

Investor readiness is the extent to which a business is perceived to have the attributes that make it an attractive and profitable investment opportunity for potential investors.

Why should they demonstrate it?

Private capital is a valuable source of funding for Kenyan entrepreneurs at any stage of business, whether during the startup, growth, maturity or even decline phase. However, navigating through accessing private capital may be a challenging process without the applying the right tools. Investors often have certain standards and expectations for the businesses which they invest. An investor's main aim is to maximize return based on their risk tolerance. It is therefore understandable that they set strict criteria when it comes to their investments.

Investors further often apply the 100:10:1 ratio, or a variation of it, as a rule of thumb when it comes to evaluating businesses that they are likely to fund and succeed. Greg Mitchel, in his article, 'The 100/10/1 Funnel' expounds that out of 100 businesses reviewed, 10 are selected for further evaluation and one ultimately receives financing. The rationale is that investors have to consider many businesses to find one good investment. Therefore, to increase chances of selection, it is imperative for Kenyan entrepreneurs to enhance their investor readiness by understanding the requirements and expectations of investors.

The Golden Rules

Accordingly, there are several steps and nuances that Kenyan entrepreneurs need to familiarize themselves with in the process of raising capital. Although this list is not exhaustive, the critical ones include:

A. **Strong Value Proposition:** Entrepreneurs need to be able to communicate a distinctive value offering which goes beyond merely highlighting a product or service. It needs to clearly articulate how it addresses a market gap and resonates with the needs of potential customers. A well-crafted value proposition, with verifiable proof of concept should illustrate how an enterprise's unique qualities can translate into compet-

itive advantage, customer loyalty, and ultimately, financial success. It should also help align the entrepreneur's business goals with the expectations and interest of investors in generating value and return.

B. Legal Compliance: The legal compliance landscape is constantly evolving, especially in tandem with technological evolution in this digital age. For instance, Kenya has recently enacted the Data Protection Act 2021, and its corresponding regulations in response to the need to protect personal data and uphold data privacy. The tax regulatory landscape is also constantly evolving in response to the country's fiscal needs as well as addressing and improving tax collection inefficiencies.

Non-compliance with statutory requirements often results in some form of penalization such as fines which poses risks to an entrepreneur's business and consequently investors. In light of the fact that that investors value good corporate standing and prefer to minimize risk, entrepreneurs must view compliance as a strategic component of their business. Compliance gaps may may deter potential investors from carrying through with an investment or lead to investor withdrawal in instances where an investment has already been made.

C. Good corporate governance: In addition to demonstrating compliance with legal requirements, entrepreneurs should also demonstrate good corporate governance practices. This includes putting in place appropriate governance frameworks and adopting policies and procedures that promote organizational health. Good corporate governance attracts investors because it shows that a company is managed ethically, transparently and accountably. Effectively, it helps to build investor trust and confidence. It does so by providing assurance that: quality decision making will be made by the board and shareholders of the company, the investors' funds will not be subjected to risk of fraud or mismanagement and that management of the business will be overseen effectively.

More so, some private capital investment models involve acquisition of control in the entrepreneur's business. Simon Witney, in his book '<u>Corporate Governance and Responsible Investment in Private Equity</u>' notes that a well-established governance model enables a more seamless integration of interests through contractual means which ensures that investors' preferences are taken into account and that they are informed as shareholders.

D. Financial Projections: Entrepreneurs should be able to present financial projections that can clearly and convincingly show the potential performance and value of their enterprise to investors. According to a Harvard Business Review article, financial projections should not only indicate the expected revenue, expenses, and profits of the enterprise, but also show how the enterprise would be able to grow and sustain its competitive advantage and market share in the long run. The financial projections should also include re-

alistic assumptions, scenarios, and risks, as well as the key drivers and indicators of growth and success

E. Demonstrate strong leadership:. Strong leadership is a key factor in enabling businesses to establish and maintain positive and productive relationships with their investors. Leaders play a crucial role in setting and communicating the vision, mission, and goals of their businesses, as well as the strategies and actions to achieve them. Entrepreneurs should therefore be able to demonstrate strong leadership skills that can inspire, motivate, and empower their teams, as well as foster a culture of innovation and growth. Likewise, entrepreneurs should be able to show that they can attract, retain, and develop the best talent for their businesses, as well as manage risk, governance, and stakeholder expectations effectively.

F. Impact:

Investors direct their capital to enterprises that generate social or environmental benefits in addition to their financial gain. According to the Impact Investing Global Market Report 2023, the global impact investing market grew from $420.91 billion in 2022 to $495.82 billion in 2023 at a compound annual growth rate (CAGR) of 17.8% and is expected to grow to $955.95 billion in 2027. An analysis prepared by Bridgewater indicated that there are about 38 impact funds in Kenya. These statistics are an indicator that impact investing is a growing trend, a fact which entrepreneurs need to be cognizant of.

Entrepreneurs wishing to increase their chances of attracting and retaining impact investors should demonstrate and quantify the social or environmental impact of their services or business models. A McKinsey quarterly article highlighted that entrepreneurs should also demonstrate skills in balancing economic returns with social impact. Some of the impact metrics that entrepreneurs should be keen on demonstrating include: number of lives impacted; economic empowerment such as through income generation or job creation; environmental sustainability; community engagement; and sustainable development goals alignment which considers factors such as poverty eradication, quality education, clean energy and social justice.

Conclusion

Investor readiness is not a one-time event, but a continuous process that requires constant improvement and adaptation.

For more information on the above piece please contact:

Nelson Karumba
Associate – Corporate Commercial Law
nkarumba@ashitivaadvocates.com

Sylvia Kithinji
Partner – Corporate Commercial Law
skithinji@ashitivaadvocates.com

Disclaimer: *This article is intended for general use. It does not create an advocate-client relationship nor does it constitute legal or financial advice.*

Our Address and Contacts

NAIROBI

Victoria Towers, 1st Foor, Kilimanjaro Ave, Upperhill
P.O. Box 21372-00100 GPO Nairobi
Tel: +254-20-2710880 / 0722- 764-732
Dropping Zone, Box 208, Revlon Professional Plaza,
Email: info@ashitivaadvocates.com
website: www.ashitivaadvocates.com

NAKURU

Assumption Centre - off Moi Road, 2nd Floor, Wing 2A
P.O. Box 18023-20100, Nakuru
Tel: +254-020-2034579 / 0721 154 544
Email: info@ashitivaadvocates.com
website: www.ashitivaadvocates.com

GIGIRI

Warwick Centre, Block B, UN Avenue, Gigiri
P.O. Box 21372-00100 GPO Nairobi
Tel: +254 773 480 015
Email: info@ashitivaadvocates.com
website: www.ashitivaadvocates.com