THE LANDSCAPE FOR IMPACT INVESTING IN EAST AFRICA
ACKNOWLEDGMENTS

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We would especially like to thank our interview participants—without their key insights this report would not have been possible. We include a full list of interviewees in the Appendix.

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<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
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<tr>
<td>AFD</td>
<td>Agence Française de Développement (French Development Agency)</td>
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<td>AfDB</td>
<td>African Development Bank</td>
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<tr>
<td>BIF</td>
<td>Burundian Franc</td>
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<tr>
<td>BIO</td>
<td>Belgian Investment Company for Developing Countries</td>
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<td>BoP</td>
<td>Base of the Pyramid</td>
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<td>CEPGL</td>
<td>Communauté Économique des Pays des Grand Lacs (Economic Community of the Great Lakes Countries)</td>
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<td>COMESA</td>
<td>The Common Market for Eastern and Southern Africa</td>
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<td>Corporate Social Responsibility</td>
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<td>Development Finance Institution</td>
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<td>Democratic Republic of the Congo</td>
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<td>EAC</td>
<td>East African Community</td>
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<td>EBT</td>
<td>Ethiopian Birr</td>
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<td>Environmental, Social, and Governance</td>
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<td>ETB</td>
<td>Ethiopian Birr</td>
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<td>Foreign Direct Investment</td>
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<td>FMCG</td>
<td>Fast-Moving Consumer Goods</td>
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<td>Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (Netherlands Development Finance Company)</td>
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<td>Focus countries</td>
<td>Countries under the study where non-DFI impact investors are most active in. Namely Ethiopia, Kenya, Rwanda, Kenya, and Uganda</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GEMS</td>
<td>Growth Enterprise Market Segment</td>
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<td>GIIRS</td>
<td>Global Impact Investing Ratings System</td>
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<td>GIZ</td>
<td>Gesellschaft für Internationale Zusammenarbeit (German Agency for International Cooperation)</td>
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<tr>
<td>Growth-stage business</td>
<td>Company has a functioning business model and its current focus is developing new products / services or expanding into new markets</td>
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<td>HDI</td>
<td>Human Development Index</td>
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<td>ICC</td>
<td>International Criminal Court</td>
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<td>ICT</td>
<td>Information and Communication Technology</td>
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<td>IFAD</td>
<td>International Fund for Agricultural Development</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IRIS</td>
<td>Impact Investing and Reporting Standards</td>
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<td>KES</td>
<td>Kenyan Shilling</td>
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<tr>
<td>LP</td>
<td>Limited Partner</td>
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<tr>
<td>Mature business</td>
<td>Profitable company with a developed and recognizable brand</td>
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<td>MDG</td>
<td>Millennium Development Goal</td>
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<tr>
<td>MFI</td>
<td>Microfinance Institution</td>
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<td>MSME</td>
<td>Micro, Small and Medium Enterprise</td>
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<td>NGO</td>
<td>Non-Governmental Organization</td>
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<td>Countries covered in the study but have limited non-DFI impact investor activity. Namely Burundi, Djibouti, Eritrea, Somalia, South Sudan, and Sudan</td>
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<td>OPEC Fund for International Development</td>
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<td>OPIC</td>
<td>Overseas Private Investment Corporation</td>
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<td>PE</td>
<td>Private Equity</td>
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<td>PPA</td>
<td>Power Purchasing Agreement</td>
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<td>PPP</td>
<td>Purchasing Power Parity</td>
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<td>Public-Private Partnership</td>
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<td>Preferential Trade Area Bank</td>
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<td>RDB</td>
<td>Rwanda Development Board</td>
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<td>RFP</td>
<td>Request for Proposal</td>
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<td>RWF</td>
<td>Rwandan Franc</td>
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<tr>
<td>SACCO</td>
<td>Savings and Credit Co-operative</td>
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<td>SAGCOT</td>
<td>Southern Agricultural Corridor of Kenya</td>
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<tr>
<td>SDG</td>
<td>Sudanese Pound</td>
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<td>SGB</td>
<td>Small and Growing Business</td>
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<td>SME</td>
<td>Small and Medium-Sized Enterprises</td>
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<td>State-Owned Enterprises</td>
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<td>SOS</td>
<td>Somali Shilling</td>
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<tr>
<td>SSP</td>
<td>South Sudanese Pound</td>
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<td>TA</td>
<td>Technical Assistance</td>
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<td>TIC</td>
<td>Kenya Investment Centre</td>
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<td>TZS</td>
<td>Kenyan Shilling</td>
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<tr>
<td>UGX</td>
<td>Ugandan Shilling</td>
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<tr>
<td>UN DESA</td>
<td>United Nations - Department of Economic and Social Affairs</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nation’s Conference on Trade and Development</td>
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<tr>
<td>USAID</td>
<td>The United States Agency for International Development</td>
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<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
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<tr>
<td>VC</td>
<td>Venture Capital</td>
</tr>
<tr>
<td>Venture-stage business</td>
<td>Sales have begun but cannot sustain the company’s operations. The business model is still being aligned with the realities on the ground</td>
</tr>
<tr>
<td>WASH</td>
<td>Water, Sanitation, and Hygiene</td>
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<tr>
<td>WHO</td>
<td>World Health Organization</td>
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</tbody>
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INTRODUCTION

Kenya and its capital city Nairobi are the center of East African impact investing. As the economic and financial capital of East Africa, Kenya boasts the largest concentration of impact investors and the most impact capital disbursed. Nairobi is often the first port of call for both impact and conventional investors operating in the region, even if they look for opportunities beyond Kenya. Indeed, when comparing the countries in the region, Kenya comes out on top for virtually every metric measured for impact investing in this study.

Beyond activities in impact investing, the Nairobi Stock Exchange launched the Growth Enterprise Market Segment (GEMS), specifically designed to provide a way to publicly list smaller companies. Though GEMS has seen limited uptake to date, the platform represents a broader market commitment to small and medium enterprise (SME) support. The Kenyan banking sector has also been expanding their SME lending. This includes expanded product ranges with new structures like trade financing as well as extensive marketing and outreach efforts. While hurdles like high collateral requirements remain, small and medium enterprises (SMEs) increasingly gain access to financing through both impact and conventional sources.

The greatest threat to Kenya’s central role in East African impact investing relates to ongoing concerns around the country’s security and political stability. Kenya has suffered numerous terrorist attacks from the Somali terrorist group Al-Shabaab, the most visible of which was an attack the Westgate shopping mall attack in September 2013. In addition to these attacks, Kenya’s overall political stability has been fragile since the dramatic post-election violence in 2007-2008. Nevertheless, concerns over the security and political situations appear to have subsided as of this writing in early 2015.

FIGURE 1: MAP OF KENYA

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1 Most of the non-DFI impact investors active in Kenya focus on early-stage businesses that have some track record and operational structures in place. For more detail on this early-stage focus, please see the East Africa regional chapter of this report.

2 Information for this report was gathered prior to the April 2015 attack at Garissa University College. The insights presented here do not reflect possible changes in the perception of stability following that event.
COUNTRY CONTEXT

With the exception of post-election violence in 2007-2008, Kenya is generally considered to be one of the strongest and most stable countries in the region. This is reflected across economic indicators, though the country still requires support to improve human development indicators and increase linkages between disadvantaged populations and the rapidly growing national economy.

Gross Domestic Product

Kenya has seen strong growth in recent years, averaging 6% GDP purchasing power parity (PPP) growth year-on-year for the last ten years (see Figure 2). GDP currently stands at approximately USD 87 billion in PPP terms, and USD 52 billion in current price terms, making it a strong regional player and the largest economy in the East African Community trading block, which includes Kenya, Uganda, Rwanda, Tanzania, and Burundi.3

![Figure 2: GDP (PPP), 2004–2013](image)

Source: IMF World Bank Economic Outlook, April 2014

Estimated GDP jumped 25% in September 2014, when Kenya re-based its GDP currency calculation by changing the base year from 2001 to 2009.4 The higher figure improved Kenya’s debt-to-GDP ratio, which may help the government borrow money at more favorable rates in international markets. However, re-basing increased Kenya’s GDP per capita to just over USD 1,200 and moved it from “low-income” country

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4 Ibid.
status to “middle income,” which could reduce access to low-interest foreign debt available through the World Bank and International Monetary Fund.\(^5\)

Re-basing improved the 2013 GDP growth rate from an estimated 4.7\% to 5.7\%.\(^6\) Regardless of re-basing, Kenya has enjoyed strong GDP growth over the last decade, interrupted only in 2008/2009 in response to both the post-election violence and the global financial crisis.\(^7\) This follows inconsistent growth in the 1990s, with GDP growth ranging from negative figures to 4\%.\(^8\)

In addition, the industrial sector is expected to grow in the next few years in response to Kenya’s strong push to expand power generation, which is ongoing. The government has committed USD 1.8 billion to add 5,000 MW in power supply capacity by 2017, building on its 1,664 MW of current capacity in an attempt to reduce inconsistent supply and planned blackouts, which currently pose challenges for the manufacturing and processing industries.\(^9\)

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6 Ibid.


Foreign Direct Investment (FDI)

Strong GDP growth has been accompanied by increasing FDI. In 2013, there were more than USD 500 million in FDI inflows (see Figure 3).\(^{10}\) Despite these robust absolute FDI inflows, a strong local economy means that Kenya has the second lowest FDI as a percentage of GDP of any country in the region.

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The single largest source of FDI remains the United Kingdom, of which Kenya was formerly a colony. Together with Mauritius and the Netherlands, these three countries originate more than 50% of all Kenyan FDI inflows, predominately through equity vehicles (see Figures 4 and 5). Strong FDI inflows are also expected in the future, given recent oil discoveries near Lake Turkana and continuing plans to develop the Lamu corridor pipeline and port.

After the UK, Mauritius and the Netherlands constitute the next two largest sources of FDI into Kenya. Despite these two countries’ relatively small size, they represent a large source of FDI because many private equity and venture capital funds base themselves in these jurisdictions to benefit from favorable tax regimes.
Inflation and Exchange Rates

Kenyan inflation has been extremely volatile, fluctuating from around 4% to more than 15% (Figure 6). In addition, concerns about foreign exchange rates complicate impact investors’ ability to disburse local currency debt. The Kenyan Shilling has steadily depreciated against the US dollar since 2008, reaching approximately 90-to-1 in late 2014, reducing the hard currency value of any local currency debt that international investors disburse in Kenya.

However, impact investors are most concerned by the sudden spike in foreign exchange rates in 2011, when the Kenyan Shilling depreciated sharply against the dollar and then rapidly returned to prior levels. In that year, the Kenyan Shilling was one of the most volatile currencies in the world. Multiple potential reasons for this volatility have been given, including policy changes made by the Central Bank of Kenya in 2010 and the increasing macro-economic imbalance of Kenya’s economy.\(^\text{12}\) Regardless of the cause, such rapid swings expose investors to potentially sudden and significant foreign exchange losses, which in turn limit their ability and interest to lend in local currency. Please see the East Africa regional chapter for additional discussion of local currency dynamics.

SUPPLY OF IMPACT INVESTING CAPITAL

Excluding DFIs,13 at least 136 impact capital vehicles are active in Kenya, managed by some 95 impact investors. Most non-DFI impact investors in Kenya work in multiple countries, but at least USD 240 million has been committed specifically to investments in Kenya (Figure 7). Beyond these dedicated funds, there is nearly USD 2.5 billion in capital committed regionally that could be deployed in Kenya and, following historical deal flow, is more likely to be deployed in Kenya than in any other country.

**FIGURE 7: TOTAL CAPITAL COMMITTED BY NON-DFI IMPACT INVESTORS**

USD MILLIONS

<table>
<thead>
<tr>
<th>USD MILLIONS</th>
<th>MULTIPLE COUNTRIES, INCLUDING KENYA</th>
<th>ONLY KENYA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,500</td>
<td></td>
<td></td>
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<tr>
<td>2,000</td>
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<tr>
<td>1,500</td>
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<td>1,000</td>
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<td>0</td>
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</table>

Source: Open Capital Research

13 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.
Broader Investing Landscape

Despite the volume of impact investing activity in Kenya, it represents a small part of the overall investment picture. For example, banks, SACCOs, and chamas together have almost USD 39 billion in total assets under management and there are other sources of capital, such as commercial private equity funds, hedge funds, and others, that even further increase assets under management (Figure 8). Banks had more than USD 17 billion in loans outstanding in 2013 alone, which is almost 27 times the disbursements made by non-DFI impact investors and more than 4 times more than disbursements made by all impact investors over the same period.

Impact investing fills an important gap in the market for early-stage financing, even though it only represents a small portion of total investment activity to date. Though more willing to lend than banks in much of the region, Kenyan banks remain risk averse and are usually unwilling to invest in start-up or early-stage enterprises. When willing to lend, banks typically require extremely high collateral ratios, occasionally higher than 100% of the loan amount. Many early stage businesses are unable to satisfy these requirements. Kenyan banks are improving access, offering creative structures like trade financing or crop cycle-based repayments, but there still remains a large gap in the market for early-stage investments that may be higher risk. Even if a business can post required collateral, Kenyan bank interest rates are high and have steadily increased over the past decade, rising from 12.5% in 2004 to 17.3% in 2013.

14 SACCOs are cooperative savings groups that typically take deposits and offer loans. SACCOs are formally recognized institutions and are subject to government regulation.

15 Chamas are informal lending associations set up voluntarily. Though similar in function to SACCOs, they are not legally recognized. Nevertheless, chamas are extremely common and most Kenyans belong to at least one chama.

Indeed, in 2012 interest rates spiked to nearly 20%, more than four times higher than the average bank interest rate in the United States over the last ten years, which stood at over 4%.17

These high interest rates limit the practical availability of bank financing. For example, despite strong demand for new housing, there are less than 14,000 mortgages in Kenya,18 due in part to the high cost of debt. This limited availability for conventional financing structures provides a market opportunity for private investors who are able to provide equity capital, cheaper debt options, or who require less collateral for lending to both consumers and companies.

Impact investors fill an important role to identify innovative solutions that address difficult sectors and circumstances that conventional investors may overlook or dismiss, providing needed capital to businesses that would otherwise struggle to access finance. By contrast, most local banks, chamas, SACCOs, and conventional sources do not have an impact focus and therefore do not look to invest in social enterprises. Chamas, for example, are an excellent source of local capital, but tend to focus on financial returns, investing in real estate, deposits, and treasury bonds, rather than the innovative new businesses that impact investors often seek.

Impact Capital Disbursed

Kenya’s pre-eminent position in East African impact investing is illustrated in the numbers. Most tellingly, almost half of all impact capital disbursed in East Africa has been placed in Kenya—this represents more than USD 650 million of non-DFI capital and more than USD 3.6 billion of DFI capital (Figure 9). This is more than double the amount deployed in the next most active country in East Africa (Uganda) for non-DFI investments.

<table>
<thead>
<tr>
<th></th>
<th>Capital disbursed</th>
<th>Deals made</th>
</tr>
</thead>
<tbody>
<tr>
<td>DFI</td>
<td>USD 3.6 Billion</td>
<td>136</td>
</tr>
<tr>
<td>NON-DFI</td>
<td>USD 650 Million</td>
<td>221</td>
</tr>
</tbody>
</table>

Source: Open Capital Research


In addition, Kenya boasts the largest number of non-DFI impact capital vehicles (136) and the most non-DFI impact capital committed, with over USD 240 million committed specifically to Kenya and a further USD 2.5 billion committed to multiple countries, including Kenya. These figures are similar to most East African countries, as most impact capital vehicles have a wide geographic focus spanning multiple countries in East Africa and often Sub-Saharan Africa. However, despite the fact that about 90% of the capital committed to Kenya could be deployed elsewhere, Kenya is more likely to receive regionally committed capital if the pattern of historical deal flow continues.

**Investments over Time**

Impact investing remains a relatively young sector. Non-DFI impact investors have been present and investing in Kenya for more than a decade, but the limited data available with specific dates for non-DFI impact investments prevents more definitive conclusions. Nevertheless, non-DFI impact investors almost universally report that impact investing activity began to pick up after 2008. Given this timeline, many non-DFI impact portfolios in Kenya are beginning to seek exits from their earlier investments. There are still few examples of successful exits and it will be interesting to see what exit examples emerge over the next 5-10 years.

The industry’s youth is also reflected through DFI direct investments, which have grown over the last four years, especially since 2010 (Figure 10). In addition to an increasing number of deals, the average deal size has also increased, driven in part by large energy projects such as the Lake Turkana Wind project and larger disbursements into commercial banks. The slight decline in deals for 2014 in Figure 11 is likely the product of incomplete data reporting at the time of data collection in late 2014, as many investors attempt to close final deals before the end of the year.

**FIGURE 10: DFI DIRECT INVESTMENTS BY YEAR**

![Figure 10: DFI Direct Investments by Year](chart)

- **USD Millions**
- **Capital disbursed**
- **Deals**
- **# Of Deals**

Source: Open Capital Research
Sector

The distribution of investments by sector broadly reflects impact investor interest areas (Figure 11). Most non-DFI impact investors have expressed interest in agriculture and financial services as target sectors, while these two sectors have also received the most deals (more than 40% of all deals in Kenya). Despite a slightly larger number of deals in agriculture, the large investment sizes possible when placing capital into established banks and MFIs drives a larger total amount of capital to financial services. Similarly, housing projects tend to have larger average deal sizes than other sectors as these projects must often internally finance mortgages for low-income customers in addition to funding typically large construction costs.

Despite their prominence as interest sectors for non-DFI impact investors, education and energy have seen significantly fewer deals. The disconnect between interest in these sectors and the number of deals implies that impact investors see fewer viable, investible opportunities and have difficulty placing capital.
By contrast, DFIs overwhelmingly favor direct investments in financial services (more than 38% of all investments) and energy (roughly 14% of all investments). These two sectors have received more than 70% of the total capital disbursed directly by DFIs, driven by large energy projects such as dams and wind farms as well as significant investments in local commercial banks (Figure 12).

**FIGURE 12: DFI DIRECT INVESTMENTS BY SECTOR**

USD MILLIONS

Source: Open Capital Research
Deal Size

Examining the size of deals disbursed reveals that almost two-thirds of non-DFI impact investments in Kenya are between USD 500,000 and USD 5 million, with the average deal size at just over USD 3 million (Figure 13). Around 11% of deals are below USD 250,000, though interviews suggest that many of these transactions anticipate placing larger amounts of capital through later tranches. In particular, non-DFI impact investors tend to look for businesses that are young but have at least some key operational structures and track record in place.

By contrast, DFI direct investments are typically significantly larger. The overall average deal size for DFI direct investments stands at more than USD 26 million, nearly nine times the average size of non-DFI impact investor deals (Figure 14). This large ticket size is driven primarily by large investments in energy projects as well as several large placements in commercial banks. Moreover, though deals under USD 10 million constitute roughly 50% of the total direct DFI investments, just 3% of direct DFI deals were under USD 1 million, compared to more than 50% of deals made by non-DFI impact investors.
Due to lack of available data at the time of writing, this report is unable to provide a definitive break-down of non-DFI direct investments by instrument in Kenya. However, investors interviewed report that in recent years they have begun to adopt more creative investment instruments beyond the traditional debt and equity used in most of the known deals. In Kenya, more than anywhere else in East Africa, non-DFI impact investors report increasingly using quasi-equity structures such as convertible debt or revenue-participating debt. Reflecting their focus on earlier stage investments, these structures help balance investor risk and return expectations with the typically limited cash flows common to early-stage companies.

Though creative structures have become increasingly common among non-DFI impact investors, DFI direct investments have been overwhelmingly in the form of debt, with some additional equity deals (Figure 15). Debt investments constitute nearly 75% of all capital disbursed by DFI direct investments and more than 60% of all direct DFI deals. Together, debt and equity investments account for more than 75% of all direct DFI deals and more than 85% of capital disbursed through DFI direct investments.

![Figure 15: DFI Direct Investments by Instrument](Source: Open Capital Research)
Local Presence

In addition to the intensity of investing activity in Kenya itself, impact investors increasingly place local staff in Kenya as a gateway to reach the entire region; there are now five impact investors that have chosen to headquarter their operations in Nairobi and 43 more have local offices (see Figure 16). In addition to the staff on the ground, Nairobi is the most common destination when impact investors based abroad visit the region.

This concentration of impact investor presence does not extend beyond the capital. However, an increasing number of impact investors are actively looking for deals in Kenya’s rapidly growing second-tier cities, as well as in the other countries in the region (particularly Uganda and Tanzania). Nairobi is so central to the impact investing industry in East Africa that some impact investors have begun to voice concerns that the Nairobi market may be saturated. In fact, some impact investors have deliberately based their staff outside of Kenya to avoid the perceived saturated market.19 This proposition is contested, however, as some impact investors argue that creative, locally-connected investors are able to source high-quality deals without competition.

Beyond pipeline development, impact investors see significant value in strong local networks as they evaluate opportunities. Investing in this market, with limited legal recourse, requires implicit trust between the impact investor and the entrepreneur. Particularly if an enterprise has been operating informally, it can be difficult to evaluate its history. As such, being embedded in local social networks that can evaluate the trustworthiness of the entrepreneur is extremely important. Deep social and professional networks that extend beyond the impact investing sector will be difficult to develop without long-term local presence.

Impact Tracking Standards

Impact investors’ dual mandate to realize both financial and social/environmental returns requires a strong focus on measuring impact as part of their core activities. As in the rest of East Africa, most impact investors in Kenya create tailored metrics for each portfolio company to accurately capture individual impact and reduce administrative burdens. For more detail on impact measurement in East Africa, see the East Africa regional chapter of this report.

19 See, e.g., Mango Fund and HRSV.
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

There is strong demand for impact capital from entrepreneurs operating in Kenya. Despite Kenya’s progress and relative development compared to other countries in the region, significant gaps remain in the provision of key goods and services, creating opportunities for entrepreneurs to build enterprises that fill these needs while also realizing financial returns.

Development Context

Despite robust economic growth and official recognition as a middle-income country in 2014, Kenya remains well below global averages for human development indicators (HDI) as defined by the United Nations (see Figure 17). Overall, Kenya ranks 147th out of 187 countries according to the UN HDI Index, which is a composite statistic of a number of metrics, including health, education, and income indices.\(^2\)

![FIGURE 17: UN HDI SCORES, 2008-2013](http://hdr.undp.org/en/data)


This low ranking is driven by Kenya’s performance in key developmental indicators. For example, more than 43% of Kenyans live on less than USD 1.25 per day, well above the global average of roughly 25% (Figure 18). Similarly, more than 45% of Kenyans live below the Kenyan national poverty line, compared with roughly 35% on average globally. Notably, however, less than 16% of Kenyans live in extreme poverty as compared with 18% globally.\(^\text{21}\)

Kenya also considerably underperforms global averages on key health metrics. Kenya’s indicator for under-five mortality is more than 50% higher than the global average, reflecting unequal access to healthcare between wealthy and low-income populations. Under-five stunting, an effective proxy for childhood health and long-term prosperity, is roughly 30% higher than global averages (Figure 19).\(^\text{22}\)


\(^{22}\) Ibid.
On both health and poverty metrics, Kenya broadly resembles the rest of East Africa, though tends to be higher than regional averages. However, on some educational metrics, Kenya significantly outperforms the region, though it still remains well below global norms. For example, nearly 30% of Kenyans age 25 and above have at least some secondary education, which is nearly twice the East African average but only half the global average. Approximately 60% of appropriately aged Kenyans are currently enrolled in secondary education, which is also nearly twice the East African average but less than the global average of 74% (Figure 20). However, Kenya remains close to East African averages along other educational metrics, such as literacy rates and gross enrollment in tertiary education.23

**FIGURE 20: KEY EDUCATION INDICATORS (LATEST AVAILABLE DATA POINT)**

Source: UN Human Development Report 2014

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Educational metrics are a particularly important barometer for future progress because of Kenya’s demographics. Like other East African countries, Kenya has a disproportionately young population, where almost 45% is under the age of 15 and more than 60% is under age 25 (Figure 21).24 This has led to high youth unemployment, but higher levels of education make it more likely that the youth boom will translate to positive economic growth as these youth enter new employment opportunities and begin to create entrepreneurial activity.

FIGURE 21: POPULATION BY AGE AND GENDER

Source: UN ESA, World Population Prospects

Entrepreneurs

Kenyans are generally strongly entrepreneurial, and both entrepreneurs and impact investors see opportunities for new businesses across sectors including education, housing, healthcare, water and sanitation, energy, etc. Correspondingly, social enterprises seek capital across the spectrum of funding from start-up and SME-size deals to capital for scaling up, though they are primarily start-up and early-stage businesses. This matches the focus for many non-DFI impact investors, who primarily target earlier-stage businesses, and also aligns with the local landscape. As with the rest of East Africa, there are few mature social enterprises.

However, despite Kenya’s relatively developed business environment compared to the rest of East Africa, entrepreneurs still face substantial challenges, including difficulty accessing capital to test their ideas in the market, limited management capacity, informal operations, a lack of realistic forward-looking projections, and limited detail describing ways they would use capital raised. For more detail about the challenges facing early-stage entrepreneurs, see the East Africa regional chapter of this report.

Though these challenges are less common in growth-stage companies, high-potential, rapidly scaling companies are rare even in Kenya. Those who have reached this stage are generally well known. When these businesses seek capital from impact investors, they are generally highly desirable investments and generate competition among impact investors and/or a large number of co-investors.
ENABLING IMPACT INVESTING: THE ECOSYSTEM

Kenya is home to almost 50% more intermediaries, service providers, and other ecosystem players than any other East African country. The broader business environment is becoming more supportive and sophisticated, providing more options to partner with suppliers, distributors, and other commercial entities. It is expected that Kenya’s strong growth will continue as it garners more attention and support.

Regulatory Environment

Overall, Kenya has a welcoming regulatory climate with few distinctions between foreign and local investors. According to the World Bank’s Ease of Doing Business rankings, it is one of the easier places to do business in East Africa, ranking 4th of the 11 countries in the region, and 12th in Sub-Saharan Africa overall.25

The primary regulatory risk in the near future is Kenya’s ongoing devolution process, designed to provide increasing autonomy to local county governments. The new 2010 Kenyan Constitution devolved significant powers from the central government to 47 newly created county governments. The exact division of responsibilities between the national government and the counties is still unclear and is only outlined in broad strokes in the constitution, leading to uncertainty about which level of government to approach for regulation. Devolution has also expanded the number of organizations with regulatory power, opening the door to inconsistent regulations and enforcement in different counties and correspondingly complex compliance requirements.

Despite this, the overall regulatory climate in Kenya supports foreign investment across a number of dimensions:

• **Repatriation of profits and dividends:** Kenyan law actively protects foreign investor exits, guaranteeing capital repatriation and remittance of both dividends and interest. Foreign investors can convert and repatriate profits without difficulty, including un-capitalized retained earnings. The only salient difference between local and foreign investors in this regard is that the withholding tax on dividends distributed to residents and East African Community citizens is 5% compared to 10% for foreign nationals.

• **Foreign exchange controls:** Kenya has open foreign exchange rules. Foreign exchange is freely available from commercial banks and can be acquired at similar rates by locals and foreign nationals. Exchange across East Africa still poses a significant risk, as hedging tertiary global currencies can be prohibitively expensive, especially for smaller transactions. Since 2011, when the Kenyan Shilling lost and recovered more than 25% in the course of a year, Kenya has successfully managed...

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foreign exchange risk, with the Kenyan Shilling depreciating less than 4% on an annual basis using a free-floating exchange.\textsuperscript{26}

- **Leasehold structure for foreign land ownership:** The most prominent regulatory restriction in Kenya is on foreign ownership of land, particularly agricultural land. Land is a charged issue in Kenya and the basis for considerable ongoing political dispute. Land use, management, and ownership were among the key issues that led to the new constitution in 2010. The new constitution mandated that non-citizens can only hold land in 99-year leases directly from the government and automatically converted all previous foreign ownership interests to leases. These leases have no rent, but the leasehold structure permits the government to reclaim the land later if desired.

- **Agricultural land:** Agricultural land is defined as land that is outside the municipality jurisdiction and which has not been approved for another purpose.\textsuperscript{27} All transactions involving agricultural land must be approved by the Land Control Board, which will not approve transactions to non-citizens. To circumvent this sweeping restriction, some non-citizens have formed companies owned entirely by Kenyan citizens while retaining control by appointing non-citizen directors and requiring the shareholders to sign agreements giving the non-citizens control of the shares, if not legal ownership. This allows the formal requirements of the law to be met while enabling non-citizens the use and control of agricultural lands.\textsuperscript{28}

- **Local ownership requirements:** By and large, Kenya does not restrict foreign investors from owning shares in a company except in a few specific industries. These industries include insurance (wherein foreign ownership is capped at 66.7%), telecommunications (80%), mining (65%), shipping (49%), fisheries (49%), and publicly listed companies (75%).\textsuperscript{29} In addition, foreign brokerage companies and fund management firms are only allowed to participate in the local capital market through locally registered companies, which must have Kenyan ownership of 30% and 51% respectively.\textsuperscript{30} This regulation pertains specifically to public markets, and does not apply to private placements common for impact investors. Similarly, there are no prohibitions on the acquisition of Kenyan firms by foreign-owned firms or on joint venture arrangements between Kenyans and foreigners.


• **Government enterprises:** Once occupying a prominent place in the economy, the Kenyan government has largely exited the private sector except in certain key industries, like energy. To the extent that parastatals are still active, they largely compete on a level playing field with the private sector.31

Kenya’s Companies Act makes it clear that enterprises intending to profit from their activities must incorporate using traditional company structures. In addition, it can take significant time and compliance to register a local nonprofit. Many social enterprises have responded by incorporating local for-profit companies that partner closely with international nonprofit affiliates that provide broad support for the activities undertaken by the local company.

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Ecosystem Players

As the center of impact investing in East Africa, Kenya boasts the largest supporting ecosystem in the region. More than 30 different organizations operate to support impact investment and social entrepreneurship in Kenya (Figure 22). Besides having more active organizations in-country, these same organizations tend to focus more on Kenya despite the fact that many operate regionally. Nevertheless, impact investors still believe there are gaps in the support available, in particular for organizations that can produce a large number of investment-ready opportunities.

FIGURE 22: SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS

As elsewhere in East Africa, the support ecosystem is primarily comprised of incubators and accelerators. There are also a number of business consultants, such as Open Capital Advisors, I-DEV International, Dalberg, and Biz Corps, as well as several investor networks and business plan competitions available locally in Nairobi. As many of these players work throughout the region, the same services are generally offered across countries. As in the rest of East Africa, there is a broad gap in the market organizations that can produce detailed market research and data for both impact investors and social enterprises. For more detail on active ecosystem players, their operations, and gaps in the market, please see the East Africa regional chapter.
Other Service Providers

In addition to intermediaries and service providers specifically targeting social enterprises and impact investors, Kenya boasts a wide range of general service providers including accountants, lawyers, recruitment firms, and others. Every company in Kenya must produce annual audited accounts and many providers have developed to serve this requirement. However, quality varies widely and so does the reliability of any accounts produced. Particularly for small companies or family-owned businesses, developing clear financial documentation can be challenging. Similarly, legal representation is widely available, though also of varying quality. There are a few widely known and respected firms that are well-suited for high-quality legal due diligence on larger deals, but they are often too expensive for smaller investments.

Beyond these professional firms, there are a wide variety of marketers, talent recruiting firms, and other business service providers that are available to companies operating in Kenya. Alongside the expanding number of reliable suppliers, distributors, and other commercial partners, these service providers increasingly contribute to a supportive business environment.
CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Despite dramatically increasing interest in raising capital to deploy in Kenya and the increasing number of deals completed each year, impact investors face a variety of challenges. These challenges present opportunities for current impact investors, new impact investors, and other eco-system players to support rapidly growing, high-potential SMEs that drive impact across sectors in Kenya and beyond. The following challenges are commonly faced in Kenya:

- **Insufficient investment-ready opportunities**: Despite robust activity to date, many non-DFI impact investors struggle to place the capital they have raised. This is particularly frustrating in Kenya, where there are a host of entrepreneurs seeking capital with a social purpose, but few who are genuinely investment-ready when they attempt to raise capital. However, many investors believe that active local presence can address this gap (see the opportunities section below).

- **International decision makers**: Many non-DFI impact investors have investment committees based abroad and whose members may not have on-the-ground experience with investments in Kenya and East Africa. These remote investment committees often interpret risk differently than their investment teams operating on the ground, which can result in misalignment between the investment officers forming relationships with entrepreneurs and the investment committees making the ultimate investment decisions.

- **Long diligence process**: Correlated to the lack of investment-ready deal flow and the international decision making common to many impact investors, the diligence process can often stretch 12-18 months for both debt and equity investments. This can frustrate entrepreneurs and put additional pressure on the business, reducing long-term returns as companies must survive without needed capital.

- **Few exit examples**: For new funds looking to raise capital, the relative youth of the impact investment industry means there are few examples of successful exits. As more impact portfolios in East Africa near the end of their tenors, there will be significant pressure on funds to exit investments, though it not yet clear how this will develop in coming years. Without a successful track record of exits, it can be difficult for fund managers to raise a second fund. Some fund managers

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32 Based on primary and/or secondary research conducted during this study; see “Introduction and Methodology” chapter of this report for details.

33 Based on primary and/or secondary research conducted during this study; see “Introduction and Methodology” chapter of this report for details.
interviewed for this report believe it may be easier for a new impact investor to raise new funds than for an experienced one, as the latter are expected to demonstrate a track record before raising a second fund.

- **Insufficient human capital**: Talent is the key constraint for many East African businesses. Companies struggle to find the talented, reliable management needed to plan for and reach scale. Though true for all skilled positions, this challenge is particularly acute for finance professionals with 5-15 years of experience who can serve as a company CFO. Even when a talented, experienced professional can be found, s/he often commands high wages that can be challenging for SMEs or social enterprises to support, especially in their early years.

- **Limited local currency financing**: Many impact businesses engage with disadvantaged populations, often earning the majority of their revenues in local currencies. However, most impact investors track returns in international hard currencies and have little ability to invest in local currencies. This is especially challenging for long-term debt instruments which require repayment in hard currencies that can appreciate 5-10% per year. Hedging options are typically prohibitively expensive, though some impact investors with large funds report effectively using fund level hedges to minimize risk.

**Opportunities**

Despite challenges, there are many opportunities for impact investors to operate in Kenya and leverage return-seeking investments to drive job creation, economic development, and opportunities for disadvantaged populations. Opportunities for impact investors include the following:

- **Leverage technical assistance (TA) facilities for pre-investment pipeline building**: More pre-investment support for businesses is needed to develop a strong pipeline of investible opportunities. Increasingly, TA funders (e.g. USAID, DFID) recognize the importance of pre-investment support to get companies to the point where they can successfully raise capital. Several impact investors have successfully developed TA facilities for portfolio companies. Kenya, in particular, offers a robust intermediary ecosystem, and many of these players operate across the region. Targeted, tailored support requires an upfront commitment of resources, but has proven effective in preparing potential targets for investment and building high-quality deal flow. This process can also dramatically reduce diligence timelines if the investor is able to increase familiarity and visibility into the business pre-investment.

- **Develop sector expertise**: Beyond bringing capital to portfolio companies, impact investors can drive growth, returns, and impact by understanding the specific sectors where their portfolio companies operate. For some investors, this sector focus has allowed them to identify exciting, less well-known opportunities earlier and reduce their diligence timelines by leveraging existing knowledge. Sectors such as agriculture, energy, and financial services present large opportunities where companies often face similar challenges—these learnings can be shared across portfolio companies.
• **Increase local decision-making:** Impact investors have cited significant improvements in their portfolio from increasing local decision-making and local support where possible. This allows investment officers to form meaningful relationships with portfolio companies, where they are empowered to respond to changing realities on the ground. Placing staff and investment committees locally can also reduce diligence timelines, as these individuals are more familiar with local trends and norms. In an environment of increasing competition between impact investors for high-potential deals, designing effective diligence procedures aligned to the region could be a key differentiator for successful impact investors.

• **Source opportunities outside capital cities:** While non-DFI impact investors with staff on the ground in major cities like Nairobi report having an easier time finding investments than those based abroad, many entrepreneurs operating in rural areas do not spend much time in Nairobi. For non-DFI impact investors who see these types of businesses as highly impactful, it will be increasingly necessary to build relationships beyond those made in the capital city.

In addition, impact investors report seeing opportunities across the following sectors:

• **Agriculture:** In Kenya, average smallholder plot sizes are often smaller than one acre, creating an opportunity to consolidate production and significantly increase yields. Given the smallholder landscape, there are also opportunities to aggregate production and create consistent, high-quality supply. This type of aggregation may allow farmers to connect directly with export markets, especially attractive regionally. There is also significant potential in agricultural processing across a range of crops.

• **Renewable energy:** Non-DFI impact investors noted a number of opportunities for renewable energy as Kenya looks to expand power generation capacity. Strong government support for new businesses and approaches opens the door for large-scale projects and improved power purchase agreements. At the same time, there are large segments of the population that lack reliable access to grid power, creating opportunities for micro-grid and off-grid solutions.

• **Consumer goods for the mass market:** With Kenya’s growing middle class, impact investors believe there are increasingly attractive opportunities to supply goods and services to consumers with rapidly increasing disposable incomes. These businesses often create substantial employment opportunities, which may fit impact criteria for some impact investors.
ABOUT THE GLOBAL IMPACT INVESTING NETWORK

The Global Impact Investing Network (GIIN®) is a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing. The GIIN builds critical infrastructure and supports activities, education, and research that help accelerate the development of a coherent impact investing industry. For more information, see [www.thegiin.org](http://www.thegiin.org).

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