

AFRICA RISK CONSULTING**Kenya Monthly Briefing October 2015**

Kenya Summary 13 October 2015

Companies delay investment decisions amid high interest rates. The treasury notably sells a treasury bond with a 21.5% interest rate, the highest in three years. The Central Bank of Kenya (CBK) leaves its benchmark interest rate unchanged at 11.5% as the Kenyan shilling starts to strengthen. President Uhuru Kenyatta (2013- present) approves long overdue business legislation including the Companies Act and the Insolvency Act. The legislation will reassure the private sector after Kenya falls nine places to 99 out of 140 in the World Economic Forum's Global Competitiveness Index. The Ethics and Anti-Corruption Commission (EACC) recommends no charges against Mombasa County governor Hassan Joho following corruption investigation.

Private sector worries about impact of government spending

The private sector is increasingly concerned about the impact of interest rates after the treasury in September sold a treasury bond at 21.5%, the highest rate in three years.¹ For insurance companies, pension and fund managers the main concern is that investor wealth – worth billions of dollars – that has been invested in the **Nairobi Securities Exchange (NSE)** may lose value if the high interest regime is maintained. The NSE has lost approximately 20% in value since the beginning of the year.

*"Businesses fear that the next few months will be tough should the trend continue."*²

High interest rates are affecting investment decision making. Businesses that had planned to increase borrowing are suspending those decisions and those seeking debt are only doing so *"for compelling reasons"*.³ Analysts say that they expect commercial banks to report an increase in non-performing loans and that investors should brace themselves for an extended period without dividends.⁴ Six companies that are listed on the NSE have already issued profit warnings.⁵

Business had expected a lending rate increase since the **Central Bank of Kenya (CBK)** has gradually raised the base rate as a way of stopping the Kenyan shilling (KSh) from rapidly depreciating against a strengthening dollar (see *ARC Briefing Kenya July 2015*). The CBK increased the benchmark rate 150 basis points at an unscheduled meeting in June and by an additional 150 basis points in July. The CBK's incremental approach has allowed some companies to factor the interest rate increase into their planning.

*"Some companies, such as **Family Bank Ltd**, are still optimistic that things will normalise. The bank has gone ahead with its borrowing programme and is raising \$40 million through a corporate bond."*⁶

The CBK has adopted a measured approach and on 23 September left its benchmark interest rate unchanged at 11.5%.⁷ The CBK decision comes amid indications that the exchange rate is stabilising and inflationary pressures abating. Although external pressures have abated, the CBK's measures had only a limited impact on price pressures and the currency weakness. Notably, the **United States (US)**

1 www.centralbank.go.ke

2 Source, journalist, Nairobi

3 Source, journalist, Nairobi

4 Source, journalist, Nairobi

5 Source, journalist, Nairobi

6 Source, journalist, Nairobi

7 Daily Nation, 23 Sept 2015.

Federal Reserve in September agreed to delay a long-expected increase in interest rates until December at the earliest. Kenya – as with all emerging markets – has benefited as investors continue to seek higher returns. As a result, the shilling enjoyed a relatively stable period in September, while low international oil prices have eased inflationary pressures.

The rapid spike of rates on government paper in the last few weeks, heavy state borrowing coupled with revelations of anomalies in the budget are causing concern.⁸ The government has struggled to meet its recurrent expenditure obligations, delaying payments to members of parliament (MPs) and county workers, and failing to release funds to county governments. The CBK on 8 October announced that the government defaulted on two loan payments worth a total of KSh 1.1 billion (\$10.6m) in the last financial year.

“Recent actions by the government have raised the question on whether the government of Kenya has gone broke.”⁹

Despite ratings agencies’ warnings, the government is continuing its strategy of borrowing. On 11 October, the treasury announced plans to launch a \$750m syndicated loan before the end of October to ease the cash shortage. Ratings agencies **Moody’s**¹⁰ and **Standard & Poor’s (S&P)**¹¹ have both warned they will lower Kenya’s rating if the government does not reduce its appetite for debt. **Fitch Ratings** downgraded Kenya’s rating from stable to negative in July.¹²

*“Should the Treasury borrow more funds, it risks downgrading Kenya’s credit rating and in the process making it more expensive for companies that may want to tap into the international debt market. National carrier **Kenya Airways** and private equity company **Centum Investments** have both hinted that they plan to seek external market for their projects.”¹³*

There is increasing concern about both the level of government borrowing and the management of funds. An office of the auditor general report into government spending alleges the misappropriation of proceeds from the 2014 Eurobond launch. The report says that the government deposited the \$2 billion raised in an offshore account whose signatories are unknown.¹⁴ This contravenes the **Public Finance and Management Act** that requires all money meant for the national government to be credited to the **Consolidated Fund**.¹⁵

Regulatory reform should reassure private sector

President **Uhuru Kenyatta** (2013- present) on 18 September approved long overdue business legislation designed to make the economy more business friendly.¹⁶ The laws will reassure investors who are concerned – partly in response to the failed implementation of capital gains tax and delays to the privatisation of state owned enterprises¹⁷ – that the government’s pro-market stance has not resulted in a more accommodating policy framework. Kenya fell nine places to 99 out of 140 in the **World Economic Forum’s Global Competitiveness Index** published on 30 September. Infrastructure bottlenecks and business costs related to terrorism explained the lower ranking, while problems associated with corruption and access to financing remain business challenges. Security and terrorism concerns have largely overshadowed government efforts to simplify the business environment including introducing online procedures.

8 Source, journalist, Nairobi

9 Source, journalist, Nairobi

10 Business Daily, 4 Aug 2015.

11 www.standardandpoors.com

12 Business Daily, 20 Jul 2015.

13 Source, journalist, Nairobi

14 Daily Nation, 10 Oct 2015.

15 Daily Nation, 10 Oct 2015.

16 www.president.go.ke

17 Source, senior lawyer, Nairobi

“The government really has worked to improve the business environment; businesses just haven’t seen it.”¹⁸

The most notable new legislation is the **Companies Act**, which simplifies outdated regulations dating from 1947. Under the new Companies Act, a single individual is able to establish a private company. Under the old legislation, at least two individuals were required to form a private company and a minimum of seven for a public company. A sole director is now able to form a private company and benefit from limited liability. The old legislation resulted in companies either retaining inactive directors or offering directorships to secure commercial or political advantages.¹⁹

“Until now, too often you had directors whose sole involvement in a company was collecting a cheque. Making huge profits for doing very little. Having fewer directors makes each one more accountable.”²⁰

The new Companies Act clearly defines the role and responsibilities of directors, whereas the previous act left them open to interpretation. The act compels international businesses to have at least one Kenyan director in Kenyan incorporated companies. If the Kenyan director leaves the company, the company will have 21 days to appoint a replacement, failing which the company and its officers may face financial penalties.²¹

The new Companies Act and the **Business Registration Service** are designed to encourage the incorporation of smaller companies. As well as requiring only a sole directorship, private companies are no longer obligated to hold an annual general meeting (AGM) each year. Instead, private companies need only file resolutions. State-owned enterprises are still required to hold AGMs each year. Only private companies with paid up capital greater than KSh5m (\$48,513) are required to have a company secretary. Again, this provision does not apply to state-owned enterprises.

The new Companies Act makes the distinction between private and public companies clearer. The limited (Ltd) suffix will no longer apply to public limited corporations but is reserved for non-listed private companies. Public limited corporations can only be registered as a public liability company (PLC). The Companies Act also allows PLCs to conduct share buy backs.²²

The new **Insolvency Act** and the **Companies and Insolvency Legislation (Consequential Amendments) Act 2015** allow private companies facing financial difficulties to implement survival measures to attempt to avoid receivership.²³ These include rescheduling debt obligations. This will constrain banks as the most common creditors during bankruptcy proceedings. Former regulations prioritised the auctioning or liquidation of failing companies.²⁴

“This had contributed to the large number of companies going out of business after a very short life span.”²⁵

The Insolvency Act also discharges debtors from bankruptcy after three years, unlike previous regulations, which allowed an individual to be bankrupt indefinitely. Creditors are, however, able to challenge this three-year limitation in court.²⁶

The **Special Economic Zones (SEZ) Act** sets out regulations for pilot investor zones in the cities of **Kisumu, Lamu and Mombasa**. These zones will contribute to government efforts to diversify manufacturing activities. The legislation exempts the supply of goods and services to companies based in special economic zones (SEZs) from value added tax (VAT) and reduces the corporate tax

18 Source, senior lawyer, Nairobi

19 Source, senior lawyer, Nairobi

20 Source, senior lawyer, Nairobi

21 www.president.go.ke

22 www.president.go.ke

23 www.president.go.ke

24 www.president.go.ke

25 Source, senior lawyer, Nairobi

26 www.president.go.ke

rate to 10% for the first 10 years and 15% for the next 10 years. The SEZs are likely to replace the existing narrower **Export Processing Zones (EPZs)**. The **Kenya Revenue Authority (KRA)** will evaluate revenue collection from the SEZs annually, before determining whether to expand the SEZs. The KRA is under pressure from the government to increase revenue and in April recommended discontinuing the EPZs (see *ARC Briefing Kenya April 2015*).²⁷

EACC clears charges against Mombasa governor

The **Ethics and Anti-Corruption Commission (EACC)** has cleared **Mombasa County** governor **Hassan Joho** following investigations into corruption allegations.²⁸ The implications of an investigation would have been both political and economic. Joho is deputy leader of the opposition **Orange Democratic Movement (ODM)** and a key ally of ODM leader **Raila Odinga**. Joho appeared on the list of government officials suspected of corruption that the EACC submitted to parliament in March. The EACC investigation into Joho related to the allocation of the **Mwembe Tayari Market** in Mombasa to the **Nawal Business Centre**.²⁹ The EACC recommended that public prosecutions director **Keriako Tobiko** not bring any charges against Joho.³⁰ Tobiko can ignore the EACC's recommendations and order the prosecution of Joho.

There are longstanding allegations of corruption against Joho and his family.

*"Joho is well off. Joho has a younger brother widely reputed to be a large-scale drug dealer. Joho himself has no visible means of financing the lifestyle he enjoys."*³¹

Joho is popular in Mombasa for implementing development and infrastructure projects first as a member of parliament and then as governor.³² He is less popular with the Mombasa business community for attempting to increase fees at the **Port of Mombasa**.³³ In September, there were reports that Joho was looking to introduce fees of between \$60-\$300 for vessel inspections and \$40 for container verification.³⁴ The **Kenya Ports Authority (KPA)** warned that these fees would make the Port of Mombasa the most expensive port in the world.³⁵ The KPA is concerned about the threat to its status as the gateway to **East Africa** from the \$11 billion **Chinese**-financed and constructed **Bagamoyo Port**, a short distance north of **Dar es Salaam (Tanzania)**. Completion of the first stage of construction is expected by 2017-2018, though delays are inevitable.³⁶

Implications

Companies will likely postpone significant investment decisions until the shilling strengthens further amid continued regional currency volatility. An increase in the benchmark interest rate is possible at the next CBK monetary policy committee scheduled for November. Kenya's precautionary **International Monetary Fund (IMF)** financing agreement will continue to protect the economy from external shocks. Banks will in the meantime respond to risks associated with increased interest rates by negotiating with customers to extend loan repayment schedules.

While the private sector will welcome the new business legislation, improving Kenya's business environment will depend on its effective implementation. The capital gains tax U-turn raises concerns about the government's capacity in this regard.

²⁷ www.president.go.ke

²⁸ Daily Nation, 6 Oct 2015.

²⁹ Daily Nation, 6 Oct 2015.

³⁰ Daily Nation, 6 Oct 2015.

³¹ Source, journalist, Mombasa

³² Source, journalist, Mombasa

³³ Journal of Commerce, 14 Sept 2015.

³⁴ Journal of Commerce, 14 Sept 2015.

³⁵ Journal of Commerce, 14 Sept 2015.

³⁶ Source, western diplomat, East Africa

A corruption case against Joho would have resulted in political uncertainty around the Port of Mombasa. The tension between the KPA and Joho is indicative of wider tensions between counties and the national government over taxation and revenue, which continue to cause business uncertainty. Regulatory uncertainty and infrastructure bottlenecks mean that the regional flow of trade may begin to shift from Mombasa to Tanzania in 2017-2018.

About Africa Risk Consulting:

Africa Risk Consulting (ARC) is a pan-African consulting company that provides timely, relevant information and advice that enables its clients to take informed investment decisions and to safeguard their reputations.

ARC's core consulting services include integrity due diligence and corporate investigations, political advisory and country assessments, opportunity monitoring and reputation risk management. Most relevant to private equity firms is ARC's integrity due diligence and corporate investigations capability. Specifically, ARC offers pre-deal integrity checks to highlight red flags before negotiations start; full detailed multi-jurisdictional reputation due diligence; and supplier and senior hire vetting and repeat due diligence for compliance programmes. ARC is unique in that it offers a 10-day delivery for a routine integrity due diligence. ARC also offers a suite of corporate investigations services from immediate investigation, evidence gathering, e-discovery, forensic accounting and whistleblower support on one end to crisis media management and regular monitoring on the other.

www.africariskconsulting.com

About ARC Briefing:

ARC Briefing is ARC's essential online business information service.

Companies at any stage in their Africa expansion, whether building or communicating an Africa strategy, investing directly, expanding current operations, financing other investors, doing the legal leg-work or researching the Africa growth trend, need ARC Briefing.

ARC Briefing is an online information service keeping you:

- Up to date with Country Chronologies of business-critical events
- In the know via Country Briefings on political, economic, business and operating trends. Written in-country, ARC experts analyse and comment
- Ahead with Country Planner which details future elections, budgets, regulatory changes etc.

www.briefing.africariskconsulting.com

Getting in touch

Please contact us by email info@africariskconsulting.com or call + 44 (0) 20 7078 4080

Follow us on Twitter: [@ARCBriefing](https://twitter.com/ARCBriefing)