KENYA

Charles Maina, CFA
Founder and CEO, Invest Bantu, Inc.

Francis Mwangi, CFA
Executive Director, Kestrel Capital (East Africa) Limited

Sarah Atieno Wanga, CFA
Investment Manager, WAICA Reinsurance

Brian Opiyo Yalla, CFA
Capital Markets Specialist, Financial Sector Deepening Africa (FSD Africa)

Key Data Points (as of October 2024, unless otherwise stated)	
Total population	52.44 million
National currency and exchange rate	Kenyan shilling, KES129.49 per USD1 (20 November 2024)
GDP	USD116.32 billion
Real GDP growth rate	5.0%
SME contribution to GDP	34%
Annual average inflation	5.1%
Unemployment rate	5.7% (2021)
Total government debt outstanding	USD82.11 billion (KES10.58 trillion; June 2024)
Private debt, loans, and debt securities (% of GDP)[51]	29.99% (Dec. 2022)
Primary stock exchange	Nairobi Securities Exchange
Number of publicly listed companies	63
Equity market capitalisation (% of GDP)	13.84% (Dec. 2023)
Mutual fund assets under management	USD1.97 billion (June 2024)
Gross debt position (% of GDP)[52]	69.87%

[51]Total stock of loans and debt securities issued by households and nonfinancial corporations as a share of GDP.

[52]All debt of the public sector as a whole, which includes financial and nonfinancial public enterprises and the central bank.

Key Data Points (as of October 2024, unless otherwise stated)	
Number of marketable corporate debt issuers	5 (Sep. 2024)
Key private market investment firms	AfricInvest, Adenia, Ascent Capital, Phatisa, Zoscales, Centum Capital Partners, Metier

Sources: IMF, World Bank, the National Treasury, CMA Kenya, KNBS, CBK.

1. Introduction and Context

Kenya's capital market plays a crucial role in the country's economic development, serving as a platform for raising capital and facilitating investment. The Nairobi Securities Exchange (NSE) is the primary venue for equity and debt trading, showcasing a diverse range of listed companies across various sectors, including agriculture, telecommunications, and financial services.

The history of Kenya's capital market dates back to the early twentieth century, with the establishment of the East African Currency Board in 1900 and the formation of the NSE in 1954. Initially limited to a few listed companies, the market focused primarily on government securities. The postindependence era in the 1960s marked a watershed, when the government started to encourage private sector participation and foreign investment.

In the 1990s, the capital market underwent substantial reforms aimed at enhancing regulatory frameworks and improving market infrastructure. The introduction of the Capital Markets Authority of Kenya (CMA) in 1989 was pivotal, establishing a regulatory body to oversee and promote capital market development. This led to an expansion of the NSE's offerings, which now include a wide array of financial instruments, such as bonds, derivatives, and real estate investment trusts.

Recent regulatory reforms and initiatives aimed at enhancing transparency and investor confidence have contributed to increased market participation, both domestically and internationally. The NSE's efforts to modernize its operations have included the implementation of automated trading systems and mobile trading platforms, making it more accessible to a broader range of investors. Furthermore, the introduction of innovative financial instruments reflects the evolving landscape of Kenya's capital market, positioning it as an attractive destination for investors seeking growth opportunities in the East Africa region.

Despite its growth and potential, Kenya's capital market faces several challenges that could impede its progress. Market volatility remains a critical concern, often driven by economic fluctuations, political instability, and external factors, such as shifts in the global economy. Liquidity issues also persist, stemming from a relatively narrow investor base and limited participation from institutional investors. Furthermore, regulatory challenges, including the need for improved transparency and corporate governance, continue to create obstacles to attracting foreign investment. Addressing these challenges is essential for sustaining investor confidence and ensuring the long-term stability and growth of Kenya's capital market.

The following sections will delve deeper into these challenges and propose corresponding recommendations aimed at enhancing regulatory frameworks, increasing market access, and fostering innovation. As Kenya addresses these barriers and continues its development trajectory, its capital market is well positioned to contribute to the country's economic growth and stability in the years ahead.

2. Raising Funds in the Public Markets

Overview

For equity or for debt, the process of raising funds from the public markets mostly depends on the potential issuer's understanding of capital markets. The process for multinational firms, which continue to represent a large percentage of total equity capitalisation, mostly commences at company level, whereas for large locally owned businesses, the process is mostly triggered externally by financial or legal advisers.

Once the decision to tap the public markets is made, the process converges for all potential issuers. The first step entails appointing a transaction team that takes the issuer through a holistic business review. The goal is to assess the level of preparedness but more importantly to ensure the issuer meets the regulatory requirements.

If the issuer passes this evaluation, the transaction team applies to the necessary regulatory authority. In Kenya, at a minimum, this includes the CMA and the NSE. Upon approval, the issuer starts to engage potential investors; the mode depends on the approval received, the size of the offering, and the jurisdictional registration of the offer.

Book building is not prevalent, but it is starting to gain traction as issuers seek greater transparency regarding fundraising outcomes.

The overall timeline for the process—from inception to completion—spans a minimum of six months, with equity issues often requiring even longer durations. To accelerate the process, regulators have streamlined the application procedures for issuers. The market is also starting to leverage technology to allow for more efficient processing of investor applications.

Key Fundraising Challenges

The first key challenge of raising funds in the public markets is the lack of awareness and understanding of the capital markets among issuers. More than 75% of the equity market capitalisation in Kenya has consistently been dominated by multinational firms and state-owned enterprises, leaving locally owned businesses trailing behind.

The second and third key challenges are the time it takes to complete the process and the uncertainty around raising the intended sums. Private market capital providers have positioned themselves to address these two factors.

The cost associated with raising capital from public markets, versus banks or private markets, is the fourth notable challenge. For equity, the cost has averaged between 7% and 10% of the offer amount, while for debt, it is between 4% and 7%. Besides normal transaction advisory fees, the range depends on the level of credit enhancement applied, which can impact the perceived risk for investors.

Funding Infrastructure

Owing to the longstanding absence of clear legal frameworks, funding of infrastructure projects in Kenya has mostly been the responsibility of the government, facilitated directly and via bilateral financing agreements with developed countries' governments and development finance institutions.

To address the lack of clear laws and in hopes of boosting private and public market participation in funding infrastructure projects, in 2021, Kenya enacted the Public Private Partnerships Act. The landmark legislation established a transparent framework for collaboration between private sector investors and both national and county governments. It clearly stipulates the procurement process and the tax incentives available to participants, thereby creating a more favourable environment for private investment in infrastructure.

Commencing the journey of tapping private capital for infrastructure projects, in 2009 Kenya issued its first infrastructure bond. Subsequent bond issuances have mostly been successful, highlighting the importance of broadening the investor base by offering tax incentives: Unlike regular bond issues, infrastructure bonds are exempt from the 15% withholding tax on interest.

From the policy side, regulation has continued to adjust asset class allocation thresholds for pension funds. The main aim has been to diversify investment options and increase caps on nontraditional assets. This shift is intended to enhance the flow of capital into infrastructure projects by encouraging institutional investors to consider a wider array of asset classes.

On the private sector side, a key strategy of mitigating fundraising risks among emerging infrastructure developers is to partner with specialised infrastructure initiatives that act as core investors. Examples include Kenya Railways Corporation and the Kenya National Highways Authority.

Together, these efforts signal a progressive move toward a more inclusive and robust infrastructure funding landscape.

Encouraging the Development of SMEs

Similar to many other developing markets, SME participation in Kenya's public markets remains notably low. Key challenges include a lack of awareness among SMEs regarding the opportunities available in public markets and the perceived or actual high-risk nature of investing in these businesses.

On the policy front, the CMA and NSE have continued to simplify the capital raising requirements for SMEs, facilitating their access to public markets. Recent and upcoming initiatives include reducing the minimum paid-up capital, lowering the minimum operational tenure required for businesses, decreasing the minimum number of board of directors and board committees, and expanding the use of private placements. In 2021, in addition to its existing Growth Enterprise Market Segment, the NSE set up its Unquoted Securities Platform to encourage SMEs to raise capital from the public market. This platform offers SMEs a dedicated avenue for raising capital while benefitting from these streamlined requirements.

For SMEs to meet investor requirements, however, significant improvements in corporate governance and the development of robust business cases are essential. As SMEs seek to tap public markets for debt financing, the emergence of credit guarantee funds offers backstops against potential credit losses. These initiatives not only enhance the attractiveness of SMEs to investors but also contribute to a more diverse public market ecosystem.

The Impact of COVID-19 on Fundraising

The disruptive effects of COVID-19 significantly impacted public markets, primarily through diminished investor confidence, which led to a shift in capital flows towards "safe" assets. In Kenya, however, as in several other African countries, public markets had already begun to lose their appeal well before the pandemic struck.

One notable outcome of COVID-19 was the accelerated adoption of technology in the capital-raising process. This shift has paved the way for greater automation, lowering the costs associated with raising capital from public markets, which ultimately makes the process more attractive for issuers in the future.

The Role of Foreign Direct Investment in Fundraising

As noted previously, a sizable portion of Kenya's equity market capitalisation is attributed to the local subsidiaries of multinational corporations. As Kenya establishes itself as a prominent investment hub, more subsidiaries continue to be set up, thereby expanding the pool of potential future equity and debt issuers. This influx of FDI not only enhances market capitalisation but also brings expertise and best practices to the local market.

Familiarity with capital markets is a key determinant of the starting point of the capital raising process. Multinational firms often have established knowledge and experience in navigating capital markets, which can serve as a model for local businesses.

3. Debt

Kenya's public debt has been on the rise but is stabilising. Although the current levels are sustainable, they remain at a heightened risk of distress.

The total nominal public and publicly guaranteed debt stock as of the end of March 2023 stood at KES9,390.69 billion (64.7% of the country's GDP). Breaking this figure down, the domestic stock was KES4,539.59 billion (31.3% of GDP), equivalent to USD34.30 billion, while the external debt stock was KES4,851.09 billion (33.4% of GDP), equivalent to USD36.66 billion. Domestic and external debt stock accounted for 48.3% and 51.7% of total debt stock, respectively (National Treasury 2023a).

Domestic Debt

The government raises domestic debt primarily through public auctions. Occasionally the government also engages in private placements, selling bonds directly to preselected investors, including banks, mutual funds, insurance companies, and pension funds.

- *Treasury bills:* These are weekly short-term discount instruments. The 91-day, 182-day, and 364-day average interest rates were 9.76%, 10.25%, and 10.75% in March 2023 and 9.62%, 10.06%, and 10.62% in February 2023, respectively. The total outstanding treasury bill debt was KES3,631 billion, accounting for 15% of domestic debt.
- *Treasury bonds:* These are medium- to long-term instruments that typically offer interest payments every six months throughout the bond's maturity. They are issued monthly with tenors of 2, 5, 10, 15, 20, and 25 years. The government occasionally issues tax-exempt infrastructure bonds. The total outstanding treasury bond debt was KES3,631 billion, accounting for 83% of domestic debt (National Treasury 2023b).

According to the IMF, about 50% of domestic debt securities are held by commercial banks, followed by pension schemes at 47%.

Between December 2019 and June 2023, the yield curve shifted upwards, resulting in a higher cost of borrowing, and flattened, signalling expectations of rate hikes in the near term and loss of confidence in the economy's growth outlook (National Treasury 2023d).

The authorities successfully implemented their strategy to lengthen the maturity profile for government domestic debt securities from 5.75 years in December 2019 to 8.9 years in March 2023.

External Debt

External debt is denominated in five major currencies: the US dollar (67.3%), the euro (20.6%), the yen (5.3%), the yuan (4.3%), and the sterling pound (2.3%; National Treasury 2023c). Between 2013 and 2023, total external debt more than doubled as a percentage of GDP (from 16.5% to 33.4%). The structure has also changed, with nonconcessionary bilateral and commercial debt increasing tenfold and fourfold, respectively, to USD9 billion each (National Treasury 2023a). The characteristics of the external government debt outstanding are illustrated in the following paragraphs and in **Exhibit 37**.

Eurobonds

These are exchange-listed/traded tax-free instruments with a semi-annual coupon payment sold to investors largely in key source markets outside Kenya.

Bilateral Loans

Of the total external debt, 24.72% is bilateral. China is Kenya's biggest creditor, with a total debt of USD6.83 billion (17.2%) in March 2023. Paris Club members account for 7.0%, with France and Japan each holding 2.0%.

Exhibit 37. External Government Debt Outstanding

Name	Issue Date	Maturity Date	Coupon (%)	Amount (USD millions)
Kenya 24	24 June 2014	24 June 2024	6.875	2,000
Kenya 27	22 May 2019	22 May 2027	7	900
Kenya 28	28 February 2018	28 February 2028	7.25	1,000
Kenya 32	22 May 2019	22 May 2032	8	1,200
Kenya 34	23 June 2021	23 January 2034	6.3	1,000
Kenya 48	28 February 2018	28 February 2048	8.25	1,000
Total				7,100

Source: National Treasury of Kenya.

Multilateral Loans[53]

Of the USD16.9 billion (46.26%) of external debt outstanding, the IDA (World Bank), the African Development Bank, and the IMF hold 28.9%, 9.8%, and 4.6%, respectively.

Cost and Impact of Servicing

Kenya's debt service, although high, is not excessive compared with that of its peers. Except for maturing eurobonds and external bank loans in 2024, 2025, and 2026, Kenya has a relatively smooth debt service profile and is on a clear declining trajectory, which signals a strengthening in debt servicing capacity (see Exhibit 37).

Global monetary tightening has reduced the supply of and raised the cost of external commercial funding.

The Ukraine war resulted in supply chain and global trade disruption and a spike in commodity prices, putting pressure on inflation containment and resulting in currency depreciation.

The US Federal Reserve's tightening and the Ukraine war led to a spike in the yields of eurobonds, putting pressure on serviceability. This dynamic forced the cancellation of the USD1 billion eurobond[54] in 2022, putting pressure on foreign exchange reserves and causing a rapid depreciation of the Kenyan shilling, pushing up the cost of foreign debt servicing (Economist Intelligence Unit 2023). The changing structure of external debt to higher commercial debt as a proportion of external debt increased the cost of capital and puts a strain on debt service.

The COVID-19 pandemic and the slowdown in economic activity with reduced household purchasing power dampened GDP growth, reducing potential tax revenues that would be used to service debt.

Lengthening the maturity profile of domestic debt reduced short-term rollover risks and helps the local market absorb shocks (National Treasury 2022).

Recommendations

Based on our analysis of Kenya's debt situation, the following actions are recommended to foster greater fiscal sustainability and reduce vulnerabilities:

[53]Under the multilateral sources, the terms are concessional (i.e., long grace periods and maturities and low interest rates). They are focused on economic development and social welfare. Such institutions include the IMF, World Bank, and African Development Bank. See National Treasury (2023c).

[54]A eurobond is a debt instrument that is denominated in a currency other than the home currency of the country or market in which it is issued.

- *Increase borrowing capacity via the debt-to-GDP ratio through GDP expansion:* The statutory limit is set as 55%.[55] To access more capital to develop the economy without the associated risk of financial distress, GDP needs to grow. This growth can be achieved through fiscal policy interventions of widening the tax base, investing in high-impact projects, and eliminating the waste of public resources.
- *Achieve investment-grade (BBB–) status by international rating agencies:* In order for Kenya to graduate to investment-grade (BBB–) status and attract cheaper debt from global markets, there is a need for actualising the long-planned fiscal consolidation; improvement of export sector performance and expansion of foreign reserves accumulation; promotion of economic growth to boost GDP per capita; and improvement of food production, access, and affordability in order to lower and stabilize the Consumer Price Index and the Real Effective Exchange Rate, among others (National Treasury 2023a).
- *Improve credibility via enhanced transparency and accountability in fiscal discipline, which could expand access to concessionary multilateral funding:* By demonstrating their commitment to prudent and responsible fiscal management, governments can build trust with international financial institutions and lenders. This can be achieved through closely monitoring spending, adjusting tax brackets or the base to increase revenue, curbing unnecessary government spending and focusing only on essential programs, prioritising debt repayment, and issuing new debt at favourable interest rates to manage the debt levels as a percentage of GDP. Rigorous accountability mechanisms help ensure that funds are directed towards projects that yield tangible social and economic benefits. These measures would improve economic stability, increase investor confidence, and hence lower the cost of debt, decreasing the risk of debt crises or distress.

Corporate Bonds

Corporate bonds are debt securities issued by companies to raise capital. Investors lend money to these companies and receive regular interest payments for the tenor and capital repayment at maturity. Corporate bonds are considered riskier than investments in government debt, and therefore, they generally command a premium over treasury bonds of similar tenor. These bonds are regulated by the CMA and traded on the NSE.

Relative to the government bond market, Kenya's corporate bond market is currently considered underdeveloped and sluggish, with significantly lower trading activity, because of such factors as past company collapses, information asymmetry, and high and volatile interest rates. This situation results in a market dominated by bank-issued bonds rather than diverse corporate issuances, further hindering its growth potential. The recent proposal to tax green bonds

[55]Previously, the debt ceiling was set at a limit of KES8 trillion. It has now been capped at 55% of GDP (present value) to conform with the international best practice in setting debt limits based on payment capacity.

and the current high yields on government bonds may further dampen growth for this moribund sector.

Most corporate bond issuance in Kenya comes from banks and nonbank financial institutions; nonfinancial companies hesitate to access the market. This dynamic leaves a small pool of diverse corporate bonds available for investors.

As of September 2023, KES28 billion worth of corporate bonds was outstanding, from a small list of eight issuers, two of which collapsed in the mid-2010s (Capital Markets Authority 2024). **Exhibit 38** illustrates the details.

Exhibit 38. Issued Corporate Bonds and Commercial Papers in Kenya as of September 2023

Issuer	Arranger	Approved Amount (bn)	Issued Amount (bn)	Approval Date	Issue Date	Maturity Date	Outstanding (bn)
East African Breweries Fixed MTN	ABSA Investment Bank	KES11.00	KES11.00	Aug 2021	Oct 2021	Oct 2026	KES11.00
Real People MTN	NCBA Investment Bank		KES1.63	Jun 2015	Aug 2015	Feb 2025	KES0.39
Acorn Project	Stanbic Bank	KES5.70	KES5.31	Jan 2020	Nov 2019	Nov 2024	KES0.28
Chase Bank Fixed MTN	Genghis Capital and NIC Capital	KES10.00	KES4.82	May 2015	Jun 2015	Jun 2022	KES2.88
Centum Real Estate Limited	Private Wealth Limited	KES4.00	KES2.95	Nov 2020	Dec 2020	Dec 2022	KES4.82
Imperial Bank Multi-Currency MTN	Dyer and Blair Investment Bank	KES2.00	KES2.00	Oct 2014	Oct 2015	Dec 2020	KES2.02
Family Bank	NCBA Investment Bank	KES8.00	KES4.00	May 2021	Jun 2021	Dec 2026	KES2.00
Kenya Mortgage Refinance Company	NCBA Investment Bank	KES1.40	KES1.40	Jan 2022	Mar 2022	Dec 2029	KES4.00
						Total	**KES28.38**

Source: CMA.

4. Raising Funds in the Private Markets

Private Capital Market Overview

Private capital markets have gained prominence in Africa during the last few years as various categories of stakeholders have taken an interest in the sector. Over the last decade, the total fundraising in private capital markets in Africa was about USD50 billion, compared with more than USD16 billion raised in IPOs in public markets. These figures highlight the potential of private capital markets as a primary source of finance. East Africa remains a top investment region in Africa, and Kenya is the top investment destination among the East African countries, attracting on average 62.5% of deals by investment value between 2019 and 2021 and 85% between 2017 and 2018, according to recent reports by the East Africa Private Equity and Venture Capital Association (EAVCA).

The investor base in private capital markets in Kenya and in East Africa generally is currently dominated by development finance institutions (DFIs) and international investors (including international pension funds, high-net-worth investors, and family offices), with little participation by local investors.

Some of the main challenges hindering investment by local investors are as follows:

- *A knowledge gap wherein investors generally have limited knowledge or understanding of private capital markets.* Domestic institutional investors, however, are becoming more aware of the asset class and its diversification potential and are beginning to consider it more intently.
- *Regulatory oversight.* Domestic investors, particularly some institutional investors, consider regulatory oversight as a prerequisite for investment in private capital markets. Private capital markets tend to have minimal regulatory oversight, which is associated with low transparency—perceived or real—and therefore are riskier than other available alternatives.
- *Competition from other savings/investment products.* For instance, government debt instruments in Kenya offer very attractive rates of return with relatively low risk compared with private capital markets.
- *Low liquidity and few exit opportunities.* This situation affects investors' initial investment decisions because the availability of exit options provides an incentive for investors.
- *Relatively less developed public capital markets.* These markets could serve as a viable avenue for exits, and their underdevelopment exacerbates the problem.
- *Lack of clarity in tax treatment.* In some cases, this situation reduces the value proposition of investing in certain private capital market asset classes.

- *Limited investment analysis capabilities in private capital markets.* This limitation often stems from a lack of readily available and standardized data on private companies, making it challenging for investors to conduct thorough due diligence and assess potential returns and risks. The issue is compounded by a shortage of experienced professionals at local investment firms who possess the specialized skills required to analyze these complex, illiquid assets.
- *Difficulties in valuation and complexity in determining fair value.* Unlike publicly traded companies with observable market prices, private capital assets lack such transparency, making its price discovery process challenging for investors.

Private capital markets are increasingly being embraced, with innovative structures, such as guarantee facilities and blended structures, expected to support market growth. This trend—coupled with the unique predisposition of the private capital markets to help actively address emerging challenges and financing deficits related to climate finance, adaptation, and mitigation; SME financing and infrastructure; and urban development—is increasing the value proposition of investment in these markets.

Kenya faces big financing deficits in these areas. Given the increasingly tight fiscal space, the role of private capital is expected to become more critical. Kenya required USD61.7 billion between 2020 and 2030 to meet its global commitment for climate change adaptation and mitigation (Ministry of Environment and Forestry 2020), while according to the World Bank (2024), the annual infrastructure financing gap stands at USD2.1 billion. The country also requires approximately USD27 billion in incremental investment by 2050 to finance sustainable clean urban development (FSD Africa and Coalition for Urban Transition 2024). Additionally, according to the International Finance Corporation (2022), the country faces an MSME financing gap of approximately USD19.3 billion. This situation, coupled with traditional financing types that may not work well for SMEs, as well as risk aversion by traditional lenders, results in a strong case for private capital markets, which potentially offer the flexibility to design instruments and structures that meet the needs of both SMEs and investors.

Investment Activity

A total of 332 deals valued at USD6 billion were recorded in Kenya over the eight-year period from 2015 to 2022. The highest deal values were recorded in 2017 and 2019, according to various reports by EAVCA, whereas 2020 and 2022 saw the highest number of deals recorded. There was a high total reported value of deals in 2017, driven largely by one large-ticket investment of USD2.6 billion in a telecommunication company. The dominant sectors in terms of investor interest over the period were consumer goods; financials; and technology, media, and telecommunications.

Main Forms

Equity, debt, and mezzanine financing are the three dominant forms of private capital in East Africa and Kenya, according to EAVCA. Equity leads the group, accounting for 90% of all transactions, with debt and mezzanine financing accounting for 5% each.

Exits

During the last decade, trade sale and secondary sale remained dominant as preferred modes of exit in Kenya. Eight exits were reported in 2022. Collectively, between 2015 and 2022, there have been about 27 exits versus 332 deals, resulting in an exit rate of 8%.

The Impact of COVID-19 on Private Capital Markets

Because of the economic uncertainty and decline in investor confidence caused by the pandemic, investors became more risk averse and funding for startups was reduced. These factors also drove down valuations in the market. The deal-making process was also disrupted by the restrictions on movement, making it challenging for investors and entrepreneurs to meet, conduct due diligence, negotiate deals, and close transactions. The disruption of deal flow affected both early-stage and later-stage investments. The tourism, hospitality, transportation, and logistics sectors experienced significant declines because of travel restrictions and reduced consumer demand. Businesses in these sectors faced greater challenges in attracting investment during the pandemic. The pandemic also prompted a shift in investment focus towards sectors that investors perceived as having the potential to adapt to the "new normal" and sectors that proved more resilient during the crisis, such as health care, technology-enabled solutions, e-commerce, and fintech.

The pandemic accelerated the adoption of digital technology and innovation in Kenya. Investors became more interested in businesses that offered solutions for remote work, online learning, e-commerce, and telemedicine, which drove investment activity during this period. There was also increased support from governments and DFIs, with the Kenyan government introducing an initiative to support businesses affected by the pandemic. DFIs also supported many efforts to curb the pandemic, especially in the health care sector. The government introduced financial relief programs, tax incentives, and business development support to mitigate the impact of the pandemic on the private capital market ecosystem and fast-track economic recovery.

5. The Challenges to Capital Market Formation

The development of Kenya's capital markets has been relatively slow, hindered by a range of complex challenges that have limited their growth and competitiveness. These challenges, which affect both the regulatory framework and investor confidence, have constrained the ability of the markets to fully support economic development and long-term financial stability.

Next, we discuss key challenges to capital market formation in Kenya.

Legal and Regulatory Challenges

A sound legal and regulatory framework is vital for the growth and development of capital markets. Unfortunately, the Kenyan legal system has had instances of slow enforcement of financial laws and regulations. Delays in court proceedings, especially those related to financial malpractice and fraud, have often resulted in a lack of timely resolutions, creating a climate of uncertainty for investors. Additionally, the absence of strong deterrents in the form of punitive measures for those who violate securities laws is a cause for concern.

The CMA works with the Capital Markets Fraud Investigations Unit (CMFIU), a specialised unit of the Kenya National Police Service, to investigate fraud in the Kenyan capital markets. **Exhibit 39** provides a summary of cases that have been handled by the unit.

In addition, some regulatory limitations have had a stifling effect on the capital market's dynamism. For example, stringent listing requirements on the NSE have discouraged potential companies from going public, while the regulation of fintech startups by various regulators limits the sector's growth. Although these

Exhibit 39. Summary of Cases Handled by the CMFIU, 2014–2022

Year	PBC	PUI	PAKA	Referred to DMO for Enforcement	Total	Decrease by	Increase by	Finalised	Closed, NFPA
2014	5	20	3	2	30			3	
2015	6	22	4		30			4	
2016	6	10	2	1	19	11		5	
2017	4	13	2	2	21		2	0	
2018	7	14	5	1	17	4		14	
2019	3	16	2	1	22		5	11	2
2020	6	18	3	2	29		7	3	1
2021	7	17	6		30		1	5	1
2022	9	22	1		32		5		3

Notes: PBC = pending before court. PUI = pending under investigation. PAKA = pending arrest of known accused. Referred to DMO for Enforcement = referred to the Directorate of Market Operations for administrative action. Finalised = files that have been closed after judgement from court. Closed, NFPA = files closed, no further police action.

Source: Capital Markets Authority (2023).

regulations aim to ensure investor protection, they inadvertently limit the breadth and depth of the market.

Financial Infrastructure

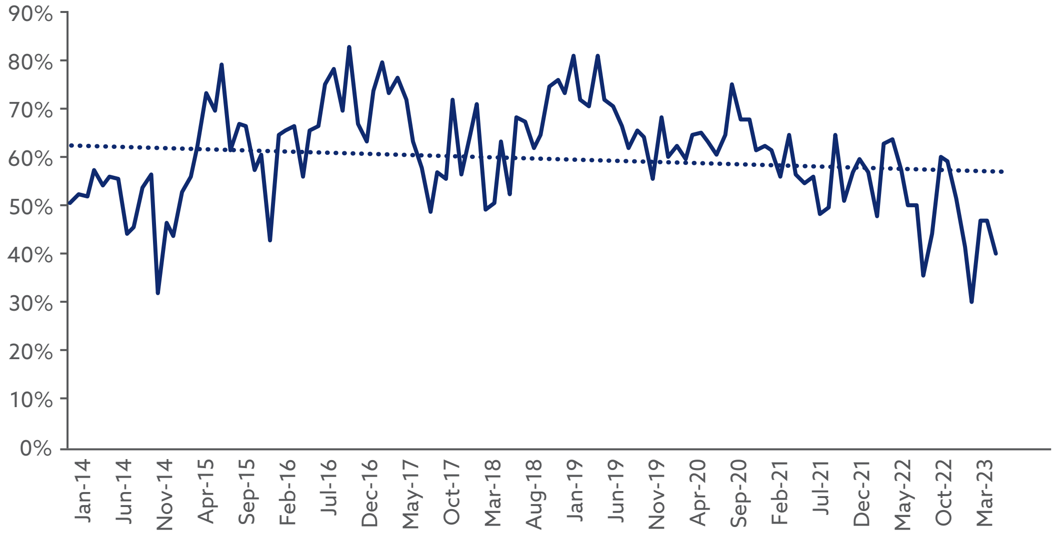
There is a lack of diversified financial products. The Kenyan public market is dominated by equities and government bonds. The slow adoption of other financial products, such as derivatives and ETFs, limits investment options and hampers overall market liquidity.

Liquidity

A major issue is the limited number of listed companies on the Nairobi Securities Exchange. Currently, the NSE has significantly fewer listed companies compared with other exchanges of similar economies and thus provides a limited range of options for investors. This shortage of investment alternatives has inevitably resulted in overconcentration of trading in a few blue-chip companies, thus creating a skewed market that is not entirely representative of the broader economy.

Additionally, local participation in the Kenyan capital market has historically been relatively low, as illustrated by the dominating foreign investor participation rate in **Exhibit 40**. Although foreign investors play a vital role in enhancing market liquidity, overreliance on foreign investment can lead to volatility, particularly during periods of global financial uncertainty, as witnessed by the increased foreign investor outflows recorded in the market since 2020. Encouraging greater local participation is therefore important for fostering a more balanced and stable market.

Exhibit 40. Annual Participation of Foreign Investors in the NSE



Sources: Capital Markets Authority (2015, 2017, 2019, 2021, 2022, 2023b).

Further compounding the liquidity problem is the lack of market makers—financial institutions that commit to buying or selling a particular security at publicly quoted prices—to ensure that trading can continue smoothly even in times of uncertainty or market stress.

Limited Market Depth

The Kenyan capital market, despite its growth, remains relatively small and lacks the depth found in more mature markets. This limited depth results in less liquidity, which can deter potential investors and impede the efficient functioning of the market. Market illiquidity can increase the cost of capital and create hurdles for businesses seeking to raise funds.

Capacity

A key issue in Kenya is the lack of sufficient financial literacy among potential and existing investors. Despite the efforts of regulatory bodies such as the CMA to promote investor education, a large proportion of the population remains unaware of the workings of the capital market, the risks and rewards of different financial products, and their rights as investors. This lack of knowledge discourages participation and limits the capital market's growth potential.

According to the 2014 S&P Global Financial Literacy Survey, 38% of adults in Kenya at the time of that survey were financially literate. Seven years later, a 2021 survey by Financial Sector Deepening Kenya (2021) found that 49.3% of Kenyans were financially literate.

In the private markets, local investor participation remains low because of limitations in capabilities around certain aspects of investment in private markets, such as due diligence and financial analysis.

Investor Trust

Investor confidence in Kenya's capital markets remains relatively low. A history of corporate defaults and financial fraud in the Kenyan market has severely undermined public trust. High-profile cases such as the collapse of Chase Bank and Imperial Bank, as well as the allegations of financial impropriety at Uchumi Supermarkets, have left a damaging legacy.[56] Investors, particularly retail investors, are wary of potential losses caused by corporate malfeasance or market manipulation.

The challenge is further compounded by perceived weaknesses in the regulatory and legal framework. Delays in the prosecution of financial crimes,

[56]Chase Bank was placed under receivership on 7 April 2016, and Imperial Bank was put under receivership by CBK on 13 October 2015. In June 2015, Uchumi sacked its chief executive for alleged gross misconduct, and an audit uncovered the loss of funds raised through a rights issue. Since 2018, the company has been trying to reach an agreement with its creditors (Global Financial Literacy Excellence Center 2014).

perceived inadequacies in investor protection mechanisms, and a perceived lack of transparency in market operations have all contributed to this climate of distrust.

Policy Formulation and Implementation Challenges

Policymaking plays a pivotal role in shaping the trajectory of capital market development. Although numerous policies have been formulated to develop Kenya's capital market, implementation has often lagged. For instance, the *Capital Market Master Plan 2014–2023*,[57] which outlines strategies for the growth and development of the Kenyan capital market, has seen slow execution. The sluggish pace of implementation can be attributed to bureaucratic hurdles, lack of political will, or inadequate resources.

Additionally, Kenyan regulatory policies have, at times, appeared to be reactive rather than proactive. There have been instances where regulatory interventions were made in response to a crisis instead of being preventive measures. This reactive approach undermines market confidence and does little to prevent future crises.

Moreover, Kenya, like many other economies, has grappled with striking a balance between fostering innovation and ensuring market security. Although the regulatory authorities are mandated to protect investors, overly stringent regulations can stifle innovation and market dynamism. For instance, the slow acceptance and integration of innovative financial products and technologies into the capital market can be traced to regulatory conservatism.

The government's fiscal policy has remained expansionary, and the government's borrowing limit and targets have repeatedly been revised upwards. The increase in government borrowing continues to crowd out the private sector, thereby negatively affecting the country's economic growth.

Lastly, there is a need for coordination between different regulatory bodies. There are instances where regulatory overlap or conflict has led to confusion, potentially discouraging participation in the capital market.

6. Possible Solutions to Accelerate Capital Market Formation and Policy Recommendations

Given the challenges we have highlighted, the following policy recommendations and approaches could be adopted to alleviate the current barriers and challenges.

[57]For more details, see the *Capital Market Master Plan 2014–2023*, 2nd Edition (30 April 2016), developed by Kenya Capital Markets Authority: www.cmmp.or.ke/assets/documents/cmmp-2014-2023.pdf.

Encourage and Facilitate the Formation of Public–Private Partnerships

A synergetic public–private collaboration can substantially contribute to capital market formation. PPPs can harness the financial resources and technical expertise of the private sector while benefitting from the regulatory support of the public sector. We recommend the creation of platforms to facilitate such collaborations, thereby fostering a conducive environment for investment.

In the infrastructure space, the government has set up structures to operationalize PPPs and encouraged local pension funds to participate. These moves are a step in the right direction.

In Kenya, the first policy intervention in this space happened in 2011, when the government released the PPP Policy Statement and later the Public Private Partnerships Act 2013. Some projects that commenced during this period are the first three berths of the Lamu Port–South Sudan–Ethiopia Transport Corridor Project, which began in 2018; the Nairobi Expressway, which began in 2020; and the Kenyatta University Hostels (10,000 beds), which began in 2015.

In 2021, the Public Private Partnerships Act 2013 was revised in a bid to streamline project processes and expand procurement options. The Directorate of Public Private Partnerships was established with a mandate to facilitate implementation of the Public Private Partnerships programme and projects in Kenya.

The public sector's contribution can be provided in the form of cash or equivalents, such as land, development rights, revenues (rents/tariffs) generated from land, infrastructure and building assets, taxation relief, or a share in the equity generated over a fixed period.

Implement Comprehensive Regulatory Reforms

To foster a flexible, innovative, and resilient capital market, there is a need to continually revisit existing regulations. Regulatory bodies should aim to strike a balance between protecting investors and allowing room for innovation. This process would involve regular reviews and modifications of financial regulations, adapting them to contemporary market trends and international best practices.

There is also a need for innovative policies that explicitly promote capital formation. Such policies could involve incentives for companies to go public, tax benefits for investments in certain sectors, or initiatives to promote financial literacy.

The dynamism of the private sector often drives innovation and growth. However, unregulated private sector activities can lead to systemic risks. Therefore, it is vital to devise a regulatory framework that accommodates private sector innovations while safeguarding public interests. Such a framework could involve flexible regulations that encourage private sector participation and competition, coupled with robust oversight to prevent market manipulation and fraud.

Launch Financial Literacy Programs

The importance of financial literacy cannot be overstated. Policies should aim to enhance public knowledge of capital markets, equipping potential investors with the necessary skills to make informed decisions. This could be achieved through public awareness campaigns, educational programs, and collaboration with educational institutions and financial literacy companies.

In addition, policies that increase financial inclusion could also benefit the industry. Strategies aimed at digitising financial services, promoting mobile banking, and reducing transaction costs can help bring more people into the formal financial sector. Such inclusive growth would provide a broader base for capital market expansion in Kenya.

Invest in the Development and Modernisation of Financial Market Infrastructure

Infrastructure plays a pivotal role in the functioning of both private and public markets. Policies aimed at enhancing financial infrastructure—such as payment systems, digital platforms, and trading systems—will boost both private and public markets.

Efficient market infrastructure enhances transparency, visibility, and information symmetry for market participants and boosts confidence of the market participants, particularly investors.

Policymakers should prioritize infrastructure development, considering its impact on market efficiency and accessibility. Increasing fees and transaction charges would negatively affect the sector.

Additionally, policy should aim to incentivize private sector investment in capital markets because it can provide the much-needed capital necessary for infrastructure projects, innovation, and overall economic development. To effectively promote private sector participation, Kenya could implement several strategic measures. First, offering targeted tax incentives, such as tax breaks or credits for investments in priority sectors, can make capital markets more attractive to investors. Second, streamlining regulatory requirements can reduce barriers to entry, making it easier for SMEs to engage in capital market activities. This might include simplifying complicated processes or providing clear guidelines that enhance transparency. Moreover, initiatives aimed at mitigating investment risks are essential. These could involve the creation of insurance mechanisms that protect investors against potential losses.

Promote Continuous Training and Modernisation of Financial Market Infrastructure

Investment professionals play a critical role in shaping capital markets. They bring to bear their expertise in managing investments, pricing securities, and assessing market risks. Strengthening the professionalism of investment professionals through continuous training, adherence to ethical standards, and certification programs can significantly enhance the growth and development of capital markets.

Investment professionals' insights and experiences can be invaluable in developing and implementing effective policies for capital market development. Their input can help tailor policies to the realities of the market, thus increasing their effectiveness.

Over the past few years, the CFA Society East Africa has engaged regulators, employers, and industry practitioners in a bid to support professionalism in the investment industry. As a result, the number of Kenyans registering for the CFA Program has increased as industry practitioners and those seeking to join the industry seek to improve their financial knowledge.

The formation of the Institute of Certified Investment and Financial Analysts, a regulatory body that seeks to promote ethics, integrity, and professionalism in the investment and financial sector in Kenya, is one step in the right direction. There remains, however, a need for regulators and industry practitioners to engage further.

Strengthen Investor Protection Mechanisms

The absence of strong deterrents in the form of punitive measures for those who violate securities laws is a cause for concern. Regulators put in place policies and procedures that ensure that investors are protected. Regulation should, however, not be too stringent to discourage innovation. To strike the right balance, regulators should engage industry practitioners.

Bibliography

Capital Markets Authority. 2015. "Capital Markets Soundness Report CMSR Q2 2015."

Capital Markets Authority. 2017. "Capital Markets Soundness Report CMSR Q2 2017."

Capital Markets Authority. 2019. "Capital Markets Soundness Report CMSR Q2 2019."

Capital Markets Authority. 2021. "Capital Markets Soundness Report CMSR Q2 2021."

Capital Markets Authority. 2022. "Capital Markets Soundness Report Q2 2022." www.cmarcp.or.ke/images/Docs/2024/2024/Capital-Markets-Soundess-ReportCMSR-Vol-XXIII-Q2-2022.pdf.

Capital Markets Authority. 2023a. "Annual Report 2023—Version 26: May 2023." www.cma.or.ke/download/11/annual-reports/4060/cma-annual-report-2023-version-26-may-2023.pdf.

Capital Markets Authority. 2023b. "Capital Markets Soundness Report Q2 2023." www.cmarcp.or.ke/images/Docs/2024/2024/Capital-Markets-Soundness-Report-Vol-XXVII-Q2-2023.pdf.

Capital Markets Authority. 2024. "Statistical Bulletin—Q3 2024." www.cmarcp.or.ke/images/bulletin/Statistical%20Bulletin/Capital%20Markets%20Authority%20(CMA)%20Quarterly%20Statistical%20Bulletin%20-%20Q3.%202024.pdf.

Economist Intelligence Unit. 2023. "Kenya Faces a Potential Debt Repayment Crunch in 2024" (28 March). www.eiu.com/n/kenya-faces-a-potential-debt-repayment-crunch-in-2024.

Financial Sector Deepening Kenya. 2021. "Financial Literacy Survey 2021."

FSD Africa and Coalition for Urban Transition. 2024. "Financing Africa's Urban Opportunity Report." https://fsdafrica.org/wp-content/uploads/2021/09/FinancingAfricaUrbanOpportunity-FINAL-REPORT.pdf.

Global Financial Literacy Excellence Center. 2014. "S&P Global Financial Literacy Survey 2014." https://gflec.org/wp-content/uploads/2015/11/3313-Finlit_Report_FINAL-5.11.16.pdf.

Government of Kenya. 2024. "National Determined Contribution Report."

International Finance Corporation. 2022. "Supply Chain Finance Market Assessment Kenya Report." www.ifc.org/content/dam/ifc/doc/mgrt/202210-supply-chain-finance-market-assessment-kenya.pdf.

International Finance Corporation. 2024. "Kenya SME Financing Report 2024."

International Monetary Fund. 2024. "World Economic Outlook: October 2024."

Kenya National Bureau of Statistics. 2024. "Kenya Economic Survey 2024."

Ministry of Environment and Forestry. 2020. "Kenya's Updated Nationally Determined Contribution (NDC)." https://unfccc.int/sites/default/files/NDC/2022-06/Kenya%27s%20First%20%20NDC%20%28updated%20version%29.pdf.

National Treasury. 2022. "Debt Sustainability Analysis." www.treasury.go.ke/wp-content/uploads/2023/06/Debt-Sustainability-Analysis-December-2022.pdf.

National Treasury. 2023a. "March 2023 Monthly Bulletin." www.treasury.go.ke/wp-content/uploads/2023/05/March-2023-Monthly-Bulletin.pdf.

National Treasury. 2023b. "Outstanding Treasury Bonds as at May 31, 2023." www.treasury.go.ke/wp-content/uploads/2023/06/Outstanding-Treasury-bonds-as-at-31st-May-2023.pdf.

National Treasury. 2023c. "Public Debt Management." www.treasury.go.ke/public-debt-management/.

National Treasury. 2023d. "Treasury Bonds Yield Curve." www.treasury.go.ke/wp-content/uploads/2023/06/Treasury-bonds-Yield-Curve.pdf.

World Bank. 2018. "Enabling Private-Sector Participation in Infrastructure and Social Services." https://www.worldbank.org/en/about/partners/brief/kenya-enabling-private-sector-participation-in-infrastructure-and-social-services.

World Bank. 2024. "Kenya Economic Update: Sustaining Economic Growth."