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Foreword
Looking around the corner: growth & change

Technology itself is neither the threat nor the answer. It's a tool that can help financial services organisations anticipate customer needs in new ways

Since the publication of our last** Financial Focus **commentary, a great deal has changed in the financial services industry and general business environment in Kenya. A weakening shilling, rising interest rates, high fuel fuel prices and the currency crisis in Europe have had a profound impact on financial services organisations and their customers.

In the recent past, Kenya has benefited from increasing commitment to innovation and service delivery in the financial services industry. More people are enjoying more services in more places than ever before. To remain competitive, banks and insurance companies have had to invest in expensive systems and innovative service delivery channels to improve customer service, and operational efficiency, even in the face of difficult economic conditions.

In this edition of *Financial Focus,* we look at several developments in the industry that characterise this changing landscape. One of the key developments that we see is the rising threat of cybercrime. Lucy Munga and Paul Agufa each take a look at this threat, Lucy from the perspective of CEOs who can take specific steps to increase their cyber-savvyness while Paul looks at the threat's particular manifestations in Kenya.

Cybercrime is possible because of the intersection of technology and the internet. But it takes fraudsters—people—to actually commit these crimes. Technology itself is neither the threat nor the answer. It's a tool that can help financial services organisations anticipate customer needs in new ways, as Thomas Kong'ong'o persuasively argues in his article on customer relationship management systems.

We've seen a number of proposed changes in the regulatory and commercial environment affecting financial services organisations. In an interview with Richard Njoroge, we've asked him to comment on the proposed amendment to the Finance Act capping interest rates. Many financial services organisations are concerned about the amendment's potential impact, and Richard has various insightful things to say about it.

New bad debt guidelines issued by the Kenya Revenue Authority in April will affect the tax relief that banks can claim for bad debts, and Benson Kamau explains what the changes are and how banks are affected. In general, the new guidelines will increase the amount of tax that banks pay in the short term and require banks to track each debt for tax relief purposes.

Finally, we've seen some significant changes in the growth of private equity in East Africa. In rapidly growing economies, there's a real hunger for capital and private equity can help businesses to expand—if it's managed appropriately. Isaac Otolo provides interesting commentary on this growing regional trend.

I hope that these articles provide you with valuable insights on the changing nature of the financial services industry in Kenya. As always, we look forward to your comments and feedback.

Richard Njoroge

21% of financial services organisations surveyed had experienced cybercrime over the last 12 months, attributed to both internal and external fraudsters

21%

The Cyber-Savvy CEO

Secure information is power

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Information security is more important than ever before. Financial services organisations in Kenya are increasingly aware of information security. They're also more dependent upon technology, which both exposes organisations to security threats as well as improves detection. And they're more connected than ever before—to mobile customers, within expanding branch networks and systematically, as their services expand.

In our recent Global Economic Crime Survey, we asked 93 organisations in Kenya—38 in the financial services industry—about economic crimes like cybercrime which threaten information security. For the purposes of our survey, we defined cybercrime as an economic crime committed using computers and the internet.

It includes distributing viruses, illegally downloading files, phishing and pharming and stealing personal information like bank account details. It's only a cybercrime if a computer, or computers, and the internet play a central role in the crime and not an incidental one.

In total, 21% of financial services organisations surveyed had experienced cybercrime over the last 12 months, attributed to both internal and external fraudsters. Internally, 85% identify IT departments as high-risk for cybercrime, while 32% point to finance departments.

Externally, most respondents see the threat of cybercrime coming from Kenya, followed closely by Nigeria. Africa is seen as one of the main sources of cybercrime threats, something that should worry security experts, policymakers and business leaders alike. If we prioritise cyber security, there are a number of structures, actions and capabilities that can help achieve sustainable success in this area.

To defend themselves effectively against increasingly sophisticated cyber threats, many organisations need to overcome a number of entrenched barriers. These include a need for new skills and insights, integrating security into the business. Overall, there are six steps that organisations can take to reshape themselves for the cyber world.

1. Clarify roles and responsibilities from the top down

Leadership by a CEO who truly understands the risks and opportunities of the cyber world will be a defining characteristic of those organisations that realise benefits and manage risks most effectively. Historically, many organisations have pursued cyber security in response to regulatory pressures but the real benefit lies in enabling them to seize opportunities—whether these involve driving growth by selling through new channels or delivering better quality services at lower cost. Leadership by a cyber savvy CEO will enable the organisation to understand these opportunities and realise them securely and sustainably through effective security.

2. Reassess the security function's fitness and readiness for the cyber world

Organisations with IT security functions may already be doing a good job protecting against traditional threats. As new risks emerge, however, the focus needs to be on upgrading or transforming the existing capabilities to deal with them. Rather than creating something new from scratch, this means building on the existing base to ensure that the organisation's responses to its security needs fully encompass cyber security.

3. Achieve 360-degree situational awareness

To align the security function and priorities as closely as possible with the realities of the cyber world, organisations need a clear understanding of the current and emerging cyber environment. Situational awareness is a requirement for well-informed and prioritised decisions on cyber security actions and processes. Large organisations may find this particularly challenging since their operations may span multiple economies and complex environments.

4. Create a cyber incident response team

Many organisations already have an incident response team but the speed and unpredictability of cyber threats mean it may need to be adapted and streamlined, in order to enable information, intelligence and decisions. From the Board level to the IT department and including operations and even other organisations, a well-functioning cyber incident response team will track, assess and escalate information at any level, from any source. Decisions and actions must be made quickly and forensic cyber investigations and/or external specialists brought in as necessary.

5. Nurture and share skills

To make the most of its situational awareness and information, an organisation will also need to invest in cyber skills. There's no doubt that these are in short supply. A recent survey by the SANS Institute found that 90% of companies had difficulties recruiting people with the cyber security skills they needed and yet amongst the same employers, nearly 60% said they planned to create more jobs in cyber security in the next few years. Given the short supply of cyber-savvy talent, it is up to employers to find new ways of inspiring those with the skills and desire to keep businesses safe.

6. Take a more active and transparent stance towards threats

The unpredictable and high-profile nature of cyber threats tends to engender a defensive mindset. But a number of cyber-savvy organisations have started adopting a more active stance towards attackers, pursuing them through legal means and communicating more publicly about their cyber threats, incidents and responses. The CEO and the Board should be clear about the organisation's stance on prosecuting or suing attackers, and must be sure the business has the necessary evidence to support any legal action. By taking a more active stance against attacks on its commercial or national interests, the organisation can show that it takes attacks seriously, bringing offenders to justice.

More Kenyans today rely on the internet to do business and carry out their daily activities. There is an increasing need to be vigilant and aware of the threats that exist

Looking at economic and cybercrime in Kenya

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Asset misappropriation, accounting fraud and money laundering are just a few of the economic crimes perpetuated by individuals and businesses in the world. Economic crimes account for more than $200 billion dollars annually and as they become more complex and sophisticated, they can cost us dearly. The rising threat of cybercrime also poses a real risk to financial security.

Two thirds of businesses and other organisations in Kenya were victims of economic crime in the last 12 months, according to our 2011 Global Economic Crime Survey. Overall, 66% of respondents in Kenya said their organisations were victims of economic crime, nearly double the global average of 34% and a 9% point increase since 2009. Kenya recorded the highest level of economic crime among all 78 countries surveyed. It was ranked second highest in 2009 behind South Africa.

Among financial services organisations in Kenya, 87% reported having experienced economic crime at least once over the last 12 months, much higher than the average for Kenya overall. The most common types of economic crime were asset misappropriation (74%), accounting fraud (24%) and cybercrime (22%).

Many financial services organisations have invested significantly in technologies to detect fraud, so the incidence level may be higher among them simply because they're more aware. But we also know that a high dependence on technology can contribute to an organisation's vulnerability to economic crime—particularly cybercrime.

Cybercrime is committed using computers and the internet and it encompasses a variety of methods. Identity theft, data espionage, hacking, social engineering, phishing, pharming, virus attacks and improper file downloads are just a few cybercrimes that can result in asset misappropriation, accounting fraud or money laundering for example.

Financial services organisations are well aware of this threat. Nearly half of them (47%) say that they have the in house capacity to detect and prevent cybercrime, and 35% are confident in their ability to investigate these crimes. Over half (53%) have access to forensic technology investigators. Even so, 71% are concerned about the financial impact of cybercrime and it's not clear whether they are well prepared for the evolving nature of cybercrime.

Increased media coverage of cybercrime and Kenya's rising role as a regional technology powerhouse have put cybercrime in the spotlight, particularly in the media. For financial services organisations, this means that the pressure is rising to stay a step ahead of cybercrime fraudsters. A lot can happen in between quarterly risk assessments. Relegating cybercrime to the domain of the Chief Information Officer, the Technology Officer or Security Officer may not assign enough importance to the threat.

In reality, cybercrime does not only affect the IT department but is an organisation wide problem. Anyone on Facebook is vulnerable to the "Ramnit" malware, which steals usernames and passwords and transmits malicious links to users' friends. Fortunately, there are a number of ways that organisations can deal with the problem of cybercrime.

One way is to set the right tone at the top and take cyber attacks more seriously. This means dealing effectively with fraudsters. Sometimes due to the high profile nature of cyber crime, pursuit of the perpetrators may be challenging. However, organisations must be willing to take a firm stance and communicate more publicly about their attackers, incidents and responses. Organisations can also employ IT savvy staff, who have relevant skills and capabilities to function as dedicated cyber security/response teams trained to deal with threats. This will increase the response levels to cyber threats and reduce attacks in the long run.

Another measure is to carry out regular and deliberate fraud and cybercrime risk assessments, ensuring that security strategies fully encompass cyber security. It may also mean upgrading or transforming existing IT capabilities to deal with new risks as they emerge.

Organisations can also team up with external experts qualified to deal with the problem of cybercrime. In house, organisations may not have the capacity or the resources to acquire necessary equipment to fight cybercrime. Liaising with external experts will facilitate a quick response when an incident occurs.

In addition, CEOs need to come to grips with internet threats so as to better differentiate and protect organisations from future risks. They must understand the current and emerging cyber environment which is a prerequisite for well informed decisions on cyber security actions and processes. Employees too must be educated and a 'cyber awareness' culture perpetuated throughout the organisation. This can be done through training that imparts relevant knowledge and skills that can be shared with all employees.

Financial services organisations need to be more proactive in identifying, preventing and detecting economic crimes in general. Because more Kenyans today rely on the internet to do business and carry out their daily activities, there is an increasing need to be vigilant and aware of the threats that exist.

With limited resources or experience, preventing cybercrimes may be much easier said than done. Nevertheless, without a strategic plan in place, they are extremely vulnerable—as most of them well know.

Building customer intimacy through CRM systems

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The availability of suitable and mature information technologies has provided unprecedented opportunities for growth and competitiveness within financial services globally. All areas of the sector have been impacted including product development, information management, regulatory reporting, risk management, customer relationships and even financial inclusion.

They require the support of information technology not only to be effective, but also to ensure service differentiation.

Financial inclusion, the focal point for most banks in Kenya presently, is hugely dependent on technology to facilitate services cost effectively in remote areas. However, there is still the need to create a sustainable service delivery model, which can evolve to embrace the enhanced capacity provided by fast changing technologies.

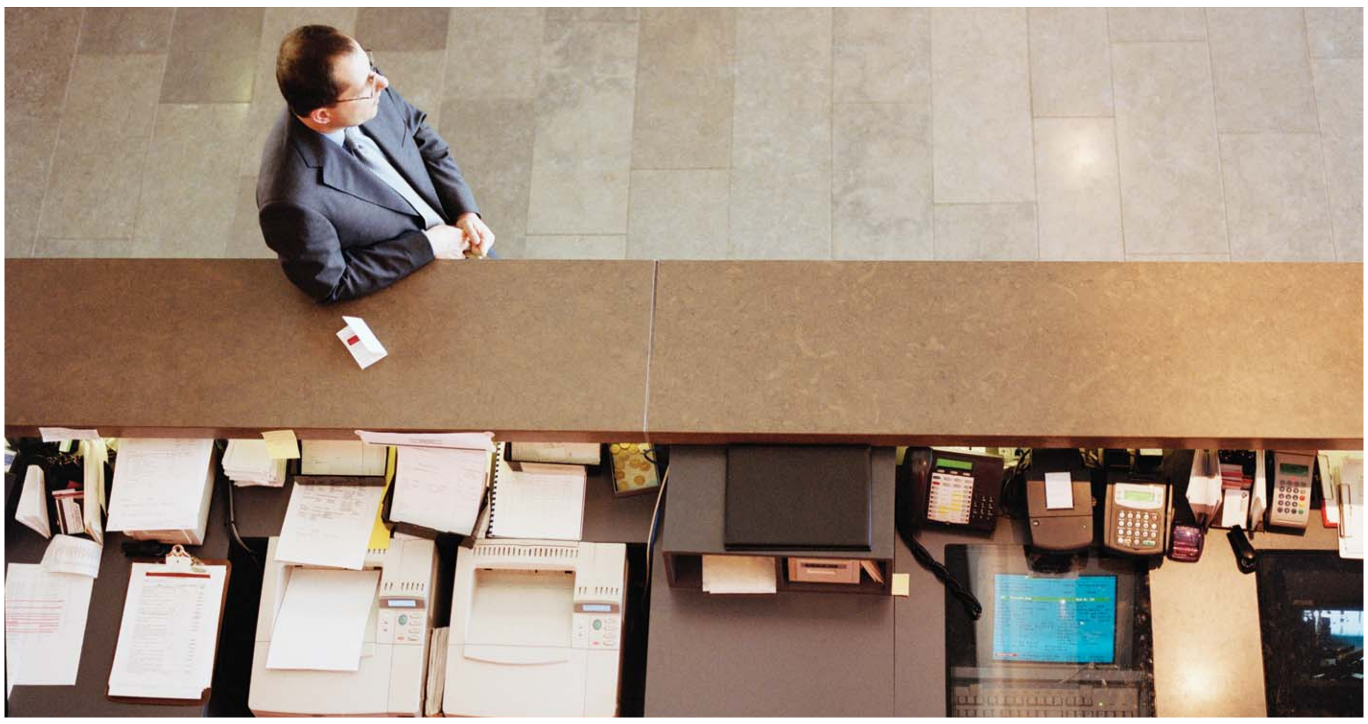
With the increasing diversity of channels and customers, delivery of consistent and quality services and the ability to target these services based on analysed customer profiles remain some of the biggest challenges among financial services companies. A recent PwC survey of bankers in markets similar to Kenya, where financial inclusion is also a focal point, indicates that three factors will change the rules of the game in financial services.

These are:

- Effective management of customer experience – 45%;
- Emerging disruptive technologies – 33%; and
- Emerging innovative products and services – 22%.

These factors all point to the deployment and effective use of information technologies for end to end delivery of financial services and management of the customer experience, while reducing the cost of service delivery.

Financial institutions which get the customer experience formula right through all their channels will experience customer growth while deepening quality interactions with their existing customers



Only financial institutions which get the customer experience formula right through all their channels will experience customer growth while deepening quality interactions with their existing customers. The process of providing a positive customer experience must start with understanding and tracking the financial behaviour of your customers.

The first step is to capture the demographic information of customers and conduct a progressive analysis of their credit history, savings and investment patterns over time through appropriate information technology tools. You'll need a clear strategy to profile and understand the financial needs of various customer segments and institutions through their lifecycles. This will enable you to match customers with customised products and services. These capabilities will also help you to develop a robust credit analysis framework that ultimately reduces fraud and the cost of credit. At the same you will improve access to your financial services among the unbanked.

Second, getting your customer experience right will depend on achieving the right balance of people and processes. This improves the quality of interaction and consistency of service delivery. The use of customer relationship management systems (CRM) to achieve personalised product and service experiences to customers is a key technology pillar.

The majority of large banks and insurance companies in Kenya have a CRM system of some kind but most of them only utilise a limited range of the full capabilities inherent in their systems. CRM systems have three key components: operational components for everyday business processes such as sales; analytical components that allow analysis of data to enhance customer relationship and collaborative components that facilitate interaction with customers across multiple channels.

Collaborative components are important for enriching customer experience and capturing the product access preferences of different customers. Despite this our research shows that fewer financial institutions use collaborative components as compared to operational or analytical components, even though the collaborative ones offer opportunities for greater channel integration.

Unlike other information systems which are inwardly focused, effective deployment and use of CRM systems must be done within a clear customer service transformation roadmap. This roadmap should include a current understanding of customers and services and a vision for the future.

It should also include a core acknowledgement of the processes, people qualities and behaviours that will deliver that vision. Systems and technologies will support processes and unlock underlying customer information for service customisation. They will also provide a platform for an integrated communication and service delivery system.

Unfortunately, many CRMs are implemented with little or no thought beyond the improvement of sales information and tracking. That's why CRM projects often fail to deliver their full potential—when they could enable much greater customer intimacy.

Interview:
Capping interest rates

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In November, 2011, the Central Bank of Kenya raised the Central Bank interest rate significantly in response to an unprecedented weakening of the Kenya shilling and spiralling inflation. This move has in turn resulted in banks raising their interest rates to levels of 23% and above. The country had enjoyed a relatively low interest rate regime for some years and the current level of interest rates threatens to slow down economic growth. This has increased the clamour that has always been to control interest rates.

An amendment to the Finance Bill has been proposed, capping interest rates to 4% above the central bank rate (CBR) and minimum interest rates on deposits to 70% of the CBR. The amendment has since held up passage of the Finance Bill, and has generated considerable debate and commentary.

To get beyond the rhetoric and understand the impact this amendment would have, we asked Richard Njoroge, an Assurance Partner with PwC Kenya and an expert in the financial services sector, to share his thoughts.

Richard, why has this amendment come about?

This is not the first time that an attempt has been made in Parliament to control interest rates. I think partly it's driven by perception. The amendment strikes a chord because of the common perception that banks profit at the expense of their customers by overcharging them on loans and paying too little in interest to depositors. So when interest rates go up, there's increased pressure on the government to do something about it.

The fact of the matter is, in absolute terms, the banking sector does seem to make more profit than other sectors of the economy. But banks by their nature also have a lot more capital employed than most other companies. It's important to look at a bank's return on capital employed and return on assets so that you're not just looking at the absolute figures.

Also, the proposed cap on interest rates on its own will not actually reduce rates—it will only cap the amount above the CBR that banks can charge. If the economic circumstances are such that the CBR rate is high, interest rates will remain high, albeit capped at a certain level. The biggest determinant of interest rates will remain the macro-economic factors in the country.

Our challenge is to look beyond the politics of this and examine the impact of the proposed amendment on the economy.

What impact would the amendment have on Kenya's economy?

The main reason given for control is to protect the consumer; and there are a number of countries that already have interest rate caps. However, we need to look at our particular circumstances; as such caps could have an undesired effect.

There's currently intense competition in Kenya's banking sector, which is good for the economy. In the last few years we've seen a lot of strides made in extending lending to previously unbanked populations and small and medium-sized enterprises (SMEs). I fear the amendment could reverse some of these gains. Let me explain.

When a bank decides how much interest to charge to a customer, one of the factors it considers is risk. If you're lending to an "A" rated company, you can accept a much lower premium because the risk is low. If you're making an unsecured loan to an individual with little credit history , you'll need to ask for a much higher premium, and will therefore charge a higher interest rate. Placing a limit on the risk premium that bank can charge, may mean that the bank will not be able to lend to the more risky customers; and here you are talking about the lower income households. You may therefore shut out the poorer income strata from bank credit.

We know that a rising middle class and SMEs are the real engine of Kenya's growth. This amendment may make it harder for them to borrow money.

You may also find a lot of hidden charges coming into play. Banking is a business. If banks can't make money on interest, they're going to look at other ways of earning it and you will probably see an increase in fees, commissions and other non funded income charges.

Additionally, I'm concerned about the effect that the amendment would have on innovation. Financial institutions have undertaken tremendous innovations in services recently. I don't think we want to stifle innovation by imposing a significant operational challenge on them.

We should also consider the impact that the amendment would have on foreign direct investment by global banks. If their ability to make returns to shareholders is severely curtailed, you may see a reduction in investment in the sector.

Is there an historical or regional context to consider?

Until the 1990s, the CBK used to publish maximum lending rates and minimum deposit rates. The window of deregulation has therefore been fairly short in relative terms, but it has seen tremendous growth in the sector and extension of banking to previously unbanked segments of society.

There was an attempt some 10 years ago, through the so called "Donde Bill" to control interest rates. The "in duplum rule", which provides that total interest charged on a loan cannot exceed the principal amount, came into effect a few years ago, but some other aspects of the bill were not enforced.

As I said before, there are countries that have established interest rate caps. In South Africa, for example, The National Credit Act, which came into force recently, contains interest caps for various types of lending. The Act has some complicated formulae to compute the caps, which take into account various factors affecting pricing. The caps are also different for different types of lending, reflecting the different levels of risk. The proposed rates in our Finance Bill appear arbitrary and are not based on any scientific consideration.

What do you see coming around the corner in terms of interest rates?

The Monetary Policy Committee was forced to increase interest rates to check rising inflation and the weakening shilling. Inflation is affected heavily by the weather (through food prices), the price of petrol and exchange rates. With the good rains we have just had and with the stabilising of the shilling, I expect to see inflation come down in the coming months. The high interest rates will reduce credit availability and therefore demand for imports. I am not sure for how long the MPC will let the high interest rates "bite", but in my view, it is a question of when, not if, interest rates come down.

In conclusion, there will always be some pressure to try and protect the consumer in some way. The pressure will be less when you're in a low interest regime like we've had for the last few years. In my view, though, trying to control interest rates will cause more harm than good to the economy.

Banks however must be seen to be acting responsibly, otherwise the pressure will increase. Proponents of control will point to the fact that much of the global economic crisis was caused by reckless behaviour by banks and that Governments have had to step in and impose more regulation.

There will always be some pressure to try and protect the consumer in some way. The pressure will be less when you're in a low interest regime like we've had for the last few years

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New bad debts guidelines: impacting Kenya's banking institutions

In April 2011, the KRA issued guidelines on the deductibility of bad debts. These guidelines are applicable from FY 2011 and taxpayers including banks will be required to apply them when computing their FY 2011 taxable income.

The guidelines set stringent criteria on deducting bad debts. Banks will now determine their bad and doubtful debts under the CBK prudential guidelines, the *International Financial Reporting Standards (IFRS)* models and now the Commissioner's guidelines.

Under the guidelines, the Commissioner has to be satisfied that all reasonable steps to collect a debt have failed before a deduction for the bad debt can be granted. Specifically, a debt shall be deemed to have become bad where:

The creditor has lost the right to the debt through a court order, no form of security or collateral is realisable whether partially or in full, the security has been realised but the proceeds fail to cover the entire debt, the debtor is pronounced bankrupt, the cost of recovering the debt exceed the debt or where efforts to collect the debt have been abandoned for a reasonable cause.

Under IFRS and CBK prudential guidelines, banks are required to be prudent and immediately provide for a debt once there is objective evidence that a debtor is likely to default on a loan. The CBK guidelines and IFRS models are designed to ensure that banks maintain adequate reserves against probable losses and in this way depositors' money and the bank's capital base is protected.

Before a debt fulfils the KRA criteria, it would have already been provided for under the prudential guidelines and IFRS. This means that the bulk of provisions arrived at under IFRS and CBK guidelines will not be deductible for tax purposes.

Prior to these guidelines the KRA generally accepted as deductible specific provisions arrived at under either CBK prudential guidelines or IFRS. General provisions are not allowed for tax purposes.

Under IFRS, banks are required to assess at each balance sheet date whether there is any objective evidence that a financial asset is impaired. These models take into account the discounted cash flows and security values for collateral held by the banks. Based on these computations, banks are required to make provisions for the loans that are considered to be impaired.

Compared to IFRS, the CBK's prudential guidelines are more strict. For CBK, a loan's performance is the key consideration. For example, with regard to loans considered to be in the 'doubtful' or 'loss' categories, a provision of at least 100% of the gross loan amount is required.

The impact of the new rules will be to increase the amount of tax that banks pay in the short term by disallowing the bulk of their provisions for specific bad debts. In the past, banks would get tax relief for any specific bad debts but under the new KRA guidelines tax relief is likely to be granted in subsequent periods once a bad or doubtful debt fulfils the KRA criteria.

Banks will therefore be required to track each specific bad debt for tax relief purposes to make sure that they do not miss a tax deduction once a debt fulfils the KRA criteria.

The tracking will be critical since banks have a significant number of doubtful debts in any one period and although they track each debt's performance for CBK and financial reporting purposes, they do not (but will now have to) track each debt for tax relief purposes.

The banks can however lobby the Treasury to have these rules amended to take into account the specific circumstances of the banking business and to have these rules aligned with IFRS and CBK prudential guidelines.

The impact of the new rules will be to increase the amount of tax that banks pay in the short term by disallowing the bulk of their provisions for specific bad debts

Helios Investment Partners' invested USD179m in Equity Bank in 2007, for a 24.99% stake

USD 179m

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The growth of private equity in Kenya

They typically have the buzz word 'capital' in their exotic-sounding names, a giveaway to their preferred investment route. Their principals are usually investors who have cut their teeth in the world of corporate finance and investment banking. This is private equity, and it is becoming a powerful player in Sub-Saharan Africa economies.

Private equity is not new to the region. CDC, Actis, Aureos, African Development Corporation (ADC) and Emerging Capital Partners have long had investments in Africa. They have also gone through multiple rounds of fund raising, holding and exit. A number of home grown players have emerged over the years, such as Transcentury, Centum and East Africa Capital Partners in Kenya.

But it was the global financial crisis that raised the profile of our region among investment hungry funds from overseas. Many investors who diversified their portfolios to include investments in Africa were at least partially insulated from the global crisis, since our markets—excluding South Africa—are less integrated with the global economy.

In East Africa, private equity firms are on the lookout for potential investments, particularly established family owned businesses with high revenues (over USD10m), strong profitability (over USD3m) and potential for growth. Popular sectors include technology, manufacturing, agroprocessing, services, construction, retail, power infrastructure and the ever popular financial services sector.

Private equity has been increasingly viewed as an alternative to the traditional forms of expansion capital available on the markets. In Kenya, for example, interest rates have nearly doubled over the past year. Private equity offers an alternative for companies looking for relatively cheap growth capital in exchange for Board seats or some control.

Private equity funds are usually structured as a pool of funds targeted at investments that are not publicly traded. Investment funds are sourced through a fundraising process. The key players are the general partner (the private equity firm itself) and the limited partners (investors who usually include pension funds, insurance companies, development finance institutions, other private equity firms or funds, high net worth individuals, etc).

Together the private equity firm and the limited partners take ownership of the fund with management left to the private equity firm. The fund is not publicly traded although ownership may change over its life through sale to other general and/or limited partners.

Funds are invested according to certain criteria like sector focus, performance indicators such as minimum revenue, EBITDA and asset base and other governance and political factors. Minority rather than controlling stakes are preferred although they invest enough to secure a presence on the Board. In recent years a number of private equity funds are increasingly taking controlling stakes and active participation in the management of their investee companies.

Investments are retained for a holding period of between three and ten years, after which the fund seeks to exit potentially through a variety of avenues including listing (IPO), trade sale or sale to another financial investor. It is not unusual for private equity funds to offload investments to other funds upon exit.

Perhaps the largest investment by a private equity house into the region has been Helios Investment Partners' USD179m investment in Equity Bank in 2007, for a 24.99% stake. Leapfrog's USD14m investment in Apollo Investments, the holding company for insurers APA and Apollo Life, in early 2011 is another recent example.

There was also the reported KES750m investment for a 20% stake in AAR Health Services by the Investment Fund for Health in Africa (IFHA). A number of other transactions have been executed within the past 12 months, showing an increased appetite in the region. Aureos invested in an IT firm Seven Seas Technologies in 2008. East African Capital Partners and ECP have invested in technology over the years, with stakes in the Wananchi Group that have helped grow the business. ECP's investment has also contributed to the expansion of Spencon, a large regional construction industry player.

However, there are a number of factors that could slow the growth of private equity. Reluctance by family owned businesses to surrender control of high performing companies is one of them. A small number of available targets that meet criteria in terms of size, turnover and profitability metrics and the often unfavourable perception of external investors seeking to benefit from the efforts of the business founders continue to limit the number of opportunities and put off larger funds from investing.

Lack of confidence in the legal, economic and political frameworks where targets are located may also discourage investment. The prevailing economic environment, the slump in the capital markets, and resulting low valuation multiples may mean that the investments that do occur are expensive for the sellers, who would get less than they want for stakes in their companies.

Since their investment horizon is relatively short and their main motive is to maximise returns in that period, private equity firms are also well known for demanding as much cash as possible from their investments over the holding period either by way of technical/management fees or shareholder dividends, which may starve the company of investment capital.

Target companies and firms debuting in the region, should seek professional advice and an experienced transaction adviser to hold their hand through the process.

Despite the challenges, however, continued socioeconomic development, particularly a growing middle class, will continue to drive private equity interest in the region. Deals are expected to increase, with exciting opportunities for both investors and investees.

We will work with you

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Richard Njoroge is an Assurance partner at PwC Kenya. He is a member of our specialist financial services group. He has worked closely with financial services clients throughout East Africa and has been involved in special assignments in banking institutions such as financial due diligence, special investigations and the audit of initial International Financial Reporting Standards (IFRS) accounts for privatisation purposes.

He joined the firm in 1988, having graduated from the University of Nairobi with a first class Bachelor of Commerce (Accounting) degree. He is a UK qualified chartered accountant, with over 20 years experience in the profession, five of them in the UK and five in Tanzania.

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Kang'e Saiti is an Assurance partner with PwC Kenya. He specialises in providing services to clients in the banking and capital markets sub sectors, with an emphasis on corporate, retail and private banking as well as consumer finance, leasing and off shore investment management.

Kang'e has also been involved in a variety of other roles in the firm including technical training for clients and staff as well as quality control for the Kenya firm and across PwC's Africa Central network of firms.

He joined PwC Kenya in 1997 after graduating from the University of Nairobi with a Bachelor of Commerce (Accounting), having qualified as a Certified Public Accountant. Kang'e has also worked in the UK and Tanzania on secondment and is a member of our specialist financial services group.

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Simeon Cheruiyot is a Tax partner in PwC Kenya and a member of our financial services specialist group. He has 18 years experience having joined the firm in 1994. Simeon specialises in general corporate tax matters, international tax planning, group restructuring, tax optimization schemes, VAT reviews and executive remuneration structuring in Kenya. He is conversant with the Kenyan tax system and has extensive transaction support experience gained by carrying out a number of tax due diligence reviews and advising on tax structuring of transactions.

He runs tax seminars for clients and has facilitated seminars for the Parliamentary Finance Committee on the Finance Bills 2007 and 2008. Simeon graduated from the University of Nairobi with a Bachelor of Commerce degree and is a Certified Public Accountant of Kenya.

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Lucy Munga is a Senior Manager at PwC Kenya. She has over 15 years experience in work related to Information Systems Security Audits, Programme Assurance Services, business processes and Controls reviews, development and implementation of Business Continuity Plans (BCPs) as well as in detection and deterrence of white-collar crime.

The audits that she has carried out have identified deficiencies in system controls and security or operational problems in information systems. She has also performed infrastructure security reviews covering such areas as physical security, logical security access and change management processes for government and financial institutions for clients in East and Central Africa. In addition, Lucy has performed Computer Fraud Investigations for various organisations in East Africa.

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