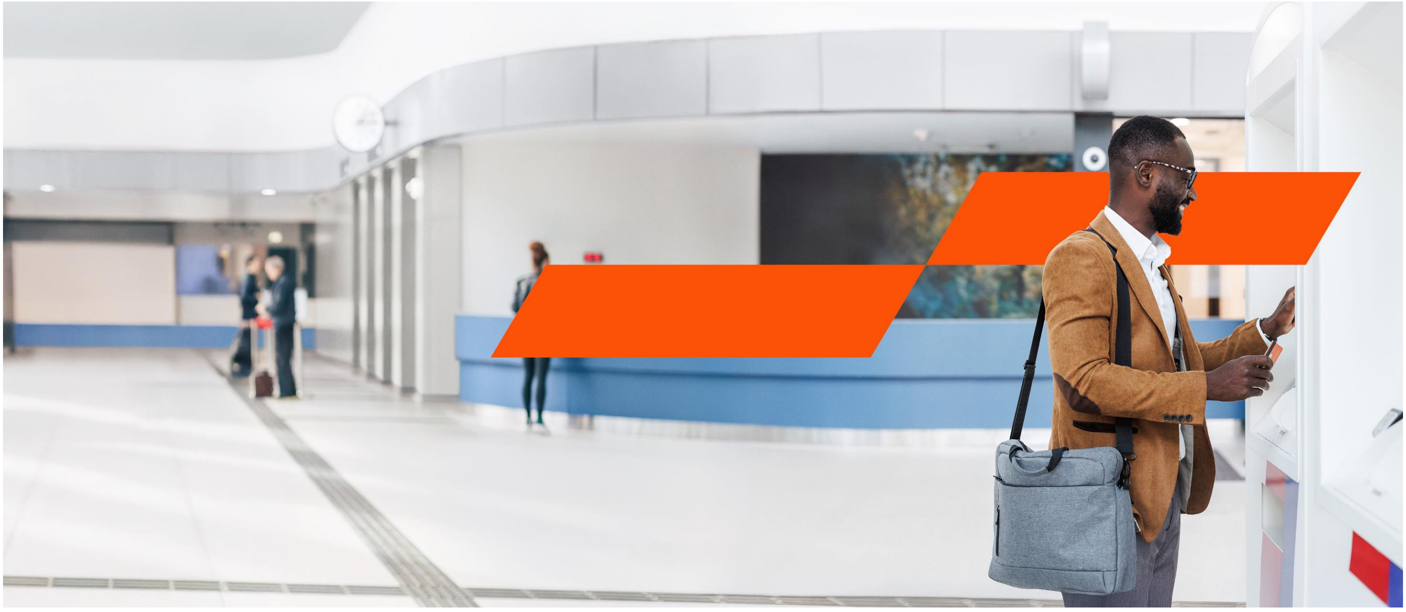


Reframing Insolvency Frameworks and Ecosystems:

Misunderstood and overlooked pillars of business resilience and efficient (re) allocation of resources

Part 1

November 2025

> **Insolvency refers to a situation where a person or business is unable to meet their financial obligations**

Introduction

The Kenyan macroeconomic environment continues to grapple with tight monetary conditions, higher cost of credit, unpredictable fiscal policies and high taxes —pressures that are straining Liquidity, raising non-performing loans, and tipping more firms across cash- low insolvency thresholds.

In an ideal economic system, insolvency framework's function as safety nets and revival mechanisms— supporting innovation, encouraging responsible risk-taking, and enabling business continuity through structured resolution of severe distress and insolvency.

What is insolvency?

Insolvency refers to a situation where a person or business is unable to meet their financial obligations. Whilst this article focuses on corporate insolvency (i.e., insolvency of companies or businesses), the same considerations are relevant for personal insolvency (i.e., Bankruptcy or Insolvency of natural persons).

It is also important to distinguish distress from insolvency. Distress is often a precursor to insolvency, but does not always lead to it. With timely intervention, distress can be addressed and the business repositioned without triggering the prescribed remedial insolvency procedures.

Insolvency can be attributed to unforeseen shocks – e.g., health crises such as the COVID-19 pandemic, political instability, natural disasters etc. - that cause significant business disruption

While avoiding formal insolvency is desirable, it is worth noting that some of these procedures can also be used as tools for restructuring and turnaround – for instance, through arrangements such as Company Voluntary Arrangements (CVAs).

Insolvency manifests in two forms:

- **Cash Flow Insolvency:** The inability to pay debts as and when they fall due. This is despite, potentially, having valuable (but illiquid) assets.
- **Balance Sheet Insolvency:** Where total liabilities exceed the total value of assets held suggesting that even if all assets were sold (at book value, which if often higher than fair/realisable value), amounts realized would not be sufficient to settle creditors in full. This is despite, potentially, being able to meet current obligations.

In simple terms, insolvency is a situation in which a business does not have enough liquidity or value for its stakeholders. If such a situation is not managed in a structured process, there is likely to be a scramble for the little that is available, and the outcome to different stakeholders is not likely to be equitable.

Tools like CVAs and Administration available to companies faced with insolvency, can serve as a structured platform for rethinking strategy, reorganizing obligations, and reviving operations—especially where stakeholders take early, decisive action.

What causes insolvency?

The risks of distress and insolvency are inherent in all business. Insolvency is not simply a punishment for businesses that get it wrong - a business can do everything within its control right but still find itself faced with headwinds, say, due to external factors.

Failure is also a key component of innovation - even when insolvency reflects failure, decisive corrective action can turn insolvency into an opportunity for self-correction and renewal or, at the very least, facilitate value preservation and extraction.

Occasionally, insolvency can be attributed to unforeseen shocks – e.g., health crises such as the COVID-19 pandemic, political instability, natural disasters etc. - that cause significant business disruption.

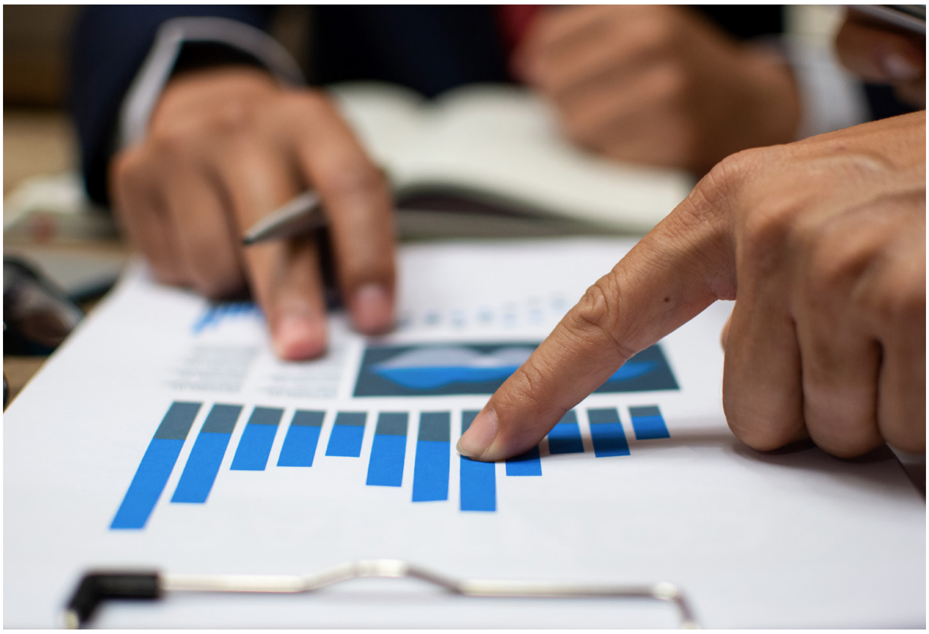
If not properly managed, distress and insolvency can have significant adverse effects on an entity (and its stakeholders) and the wider economy

However, from experience, insolvency often stems from sustained deterioration in the financial performance and position of a business. While the root causes of this deterioration vary across businesses, some of the broader categories of causes include, but are not limited to:

- **Poor governance:** The right governance frameworks and capacity are key to preventing, or when need be, navigating, distress and insolvency. Poor governance can take various forms including, but not limited to, lack of appropriate oversight and controls and conflict of interest. Poor governance often results in suboptimal allocation of resources or even extraction of resources from the business, thereby, weakening financial position and undermining performance.
- **Operational Challenges:** E.g., Inefficiencies in operating processes and in management of operating costs and working capital etc, leading to loss making products or services and, over time, weakening profitability and cash flow to unsustainable levels.
- **Inadequate Financial Management**: E.g., poor budgeting, suboptimal debt accumulation and lack of internal controls which often result in overleveraging, missed obligations, and financial structures that cannot support the business in times of strain.
- **Economic Volatility:** E.g., Interest and exchange rate fluctuations, inflation and inconsistent (tax and other) policy environment that increase input costs and disrupt planning, exposing businesses—especially those with limited buffers—to liquidity shocks and solvency risks.
- **Market Disruption:** E.g., Technological shifts, increased competition and changing consumer preferences typically erode relevance and market share, leaving businesses unable to generate sufficient revenues and profitability to sustain operations and service obligations.

In most instances, once insolvency sets in, it deepens over time. Timeliness of any intervention measures is, therefore, of great essence in resolution of insolvency. The intervention needed

Poor governance can take various forms including, but not limited to, lack of appropriate oversight and controls and conflict of interest



to arrest insolvency and prevent a bad situation from getting worse requires formulation and implementation of comprehensive plans that address all relevant operational, financial and legal aspects. These plans often involve difficult decisions, which some may avoid due to sentimentality, denial, fear or, in some cases, lack of capacity.

If appropriate plans are formulated and implemented effectively and efficiently, insolvency can be turned around to recovery and renewal.

What are the adverse effects of insolvency?

If not properly managed, distress and insolvency can have significant adverse effects on an entity (and its stakeholders) and the wider economy.

The impact of insolvency can extend to the wider economy. Over time, rising insolvencies can result in tightening lending criteria and a higher cost of credit as banks try to manage and price risk appropriately. Insolvent businesses often cease or scale down their operations, resulting in reduced production. Reduced lending and production, alongside other potential adverse effects, can hinder economic growth.

At a micro level, insolvency can result in loss of value for the owners and creditors of a business. Insolvency often results in dissipation of brand and asset values and a fall in business valuations (due to various factors such as reduced revenue and profitability). For employees, insolvency can easily result in job loss.

The need for effective insolvency frameworks and robust insolvency ecosystems

Given the potential macro and social-economic effects of insolvency, economic systems require robust mechanisms to help businesses manage distress and insolvency.

Some of these mechanisms can be informal – i.e., private arrangements between a business and its creditors.

However, situations involving severe distress and insolvency are often very complex – they involve a varied basket of stakeholders with competing interests and rights. This necessitates

If appropriate plans are formulated and implemented effectively and efficiently, insolvency can be turned around to recovery and renewal

Insolvency procedures provide platforms for recycling of capital by transferring underutilized/ unproductive assets to parties with ability to utilize them more efficiently

development of a statutory (insolvency) framework for managing insolvency to ensure there is structure and transparency in situations that can, otherwise, be very adversarial, fluid and opaque.

An effective insolvency framework has various key components, key amongst them:

a. Clear laws and regulations;
b. Robust turnaround/reorganization and liquidation procedures; and
c. Global view – Considering the prevalence of cross-border business and investments, it is important to consider and address cross-border insolvency matters.

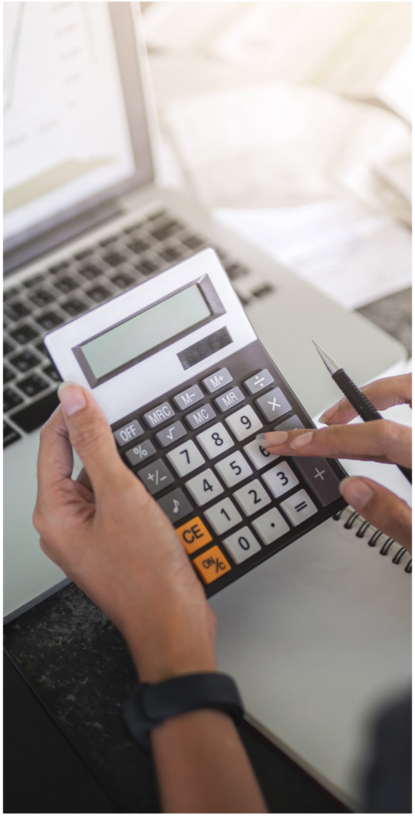
On the other hand, a robust insolvency ecosystem ensures that insolvency matters are handled with utmost diligence and efficiency. Some of the key components of a robust insolvency ecosystem include:

a. Adequate institutional capacity – judiciary, regulator(s) of the insolvency practice and advisors (insolvency practitioners, lawyers etc.);
b. Suitable financing (and other support) options; and
c. Well informed and active/supportive stakeholder base (investors, creditors, debtors and public).

Benefits of an effective insolvency framework and a robust insolvency ecosystem

An effective insolvency framework and a robust insolvency ecosystem can serve as a catalyst for financial discipline, business renewal, and broader economic efficiency and capital reallocation. They accord businesses and the wider economy with various benefits, including:

- **Business renewal:** Insolvency frameworks provide tools and mechanisms that viable enterprises facing temporary distress can leverage to restructure operations and financial obligations, with a view to regaining competitiveness. This is, for example, through tools that grant temporary relief from debt service and creditor action, as well as tools that provide frameworks for collective creditor participation in restructuring transactions.
- **Legal clarity:** Clear laws and consistent application promotes predictable outcomes in the event of distress and insolvency procedures, protecting the respective rights of various stakeholders and promoting transparency and fairness. This promotes investor confidence - domestic and foreign investors alike are more likely to commit capital where exit risks are well-governed.



- **Efficient resource allocation:** Where need be, insolvency procedures provide platforms for recycling of capital by transferring underutilized/unproductive assets to parties with ability to utilize them more efficiently. In the process, stakeholders also unlock capital that was locked up (usually in the form of unpaid debts) in the underutilized assets.
- **Behavioural discipline:** The risk of insolvency encourages responsible borrowing, lending, investment and governance. Insolvency frameworks also provide for investigation of causes of insolvency and, where appropriate, pursuit of sanctions against parties found culpable for wrongdoing leading up to insolvency.
- **Access to finance:** Credit markets benefit from the assurance that losses will be mitigated predictably, which increases lending confidence, especially for small and growing enterprises. This facilitates more affordable pricing of credit

Conclusion

Insolvency, properly understood, is not a verdict on failure but can be a core pillar for attaining resilience and efficient capital reallocation. In Kenya's testing macroeconomic environment, timely, structured use of tools such as CVAs and Administration can preserve value, protect jobs and sustain productive capacity, while providing orderly exits where recovery is not feasible. What turns distress into renewal is not mere improvisation but clear laws, predictable procedures, capable institutions and advisors, access to rescue and working capital, informed stakeholders and, where relevant, crossborder coordination.

A robust framework and ecosystem do more than save companies; they help rescue viable enterprises, redeploy underutilised assets to more productive owners, reinforce governance and market discipline, and support more accurate pricing of risk—outcomes that deepen investor confidence and broaden access to finance. Realising these benefits requires destigmatising early engagement with formal processes, strengthening governance and financial management, and investing in judicial, regulatory and practitioner capacity.

In the next part of this series, we move from foundations to application—how success in insolvency should be measured case by case, and how culture shapes outcomes. The aim is practical: embed a rescue and redeploy mindset that gives good businesses a second chance, recycles capital swiftly where rescue is impractical, and, in doing so, strengthens the bedrock of long term, inclusive growth.

Get in touch

George Weru
Partner
george.weru@pwc.com
LinkedIn

Kimathi Mutethia
Senior Manager
kimathi.mutethia@pwc.com
LinkedIn

Moses Wachira
Senior Associate
moses.wachira@pwc.com
LinkedIn

www.pwc.com/ke