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FINANCING CORPORATE RESCUE IN KENYA: THE CASE FOR A CORPORATE RESCUE FUND

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1. Executive summary

Corporate rescue in Kenya contributes to the survival of the economy as it allows for the restructuring of struggling businesses. Its success is dependent on financing to provide liquidity and stabilise operations. Rescue finance is availed to businesses to assist restructure operations in times of financial distress. This paper explores the legislative framework and practice on corporate rescue financing in Kenya, the gaps, global best practices and proposes reforms to improve corporate rescue financing. This paper answers three questions: 1) Are the existing modes of corporate rescue finance sufficient? 2) Is a corporate rescue fund necessary?; 3) What lessons can be drawn from best practices? This paper's key recommendation is the establishment of a corporate rescue fund by each commercial bank which is to be financed by an allocation of profits from the lending business, allocation of additional interest charged in the event of default and insurance payouts for defaulted loans. The same is to be regulated by the Central Bank of Kenya **(CBK).** The fund will then be utilised to finance formal corporate rescue processes once commenced in accordance with the existing legal framework.

Administrations and company voluntary arrangements are the key corporate rescue options in Kenya.[1] To implement the objectives of these processes, financing is key. Financing is traditionally sourced through equity injections, new borrowing, additional borrowing, governments and institutional investors, venture capital and private equity firms. For corporate rescue in Kenya, the most common source of funding is additional borrowing. These financing options are explored and availed on a need basis thus offering no certainty as to whether they will be available when required to meet the funding requests of corporate rescue. This paper explores these options and provides justification why a corporate rescue fund would create efficiency in rescue financing. Additionally, this paper takes a comparative perspective which reviews the Singaporean and Ugandan jurisdictions where the framework for rescue financing has been legislated in relation to; what is deemed as rescue finance, which businesses qualify for it, the limitations, and the oversight mechanisms. Against the analysis of options available for corporate rescue in Kenya and the legislative framework on corporate rescue in Singapore and Uganda; this paper argues that a corporate rescue fund will ensure that the existing financing options, especially additional borrowing, are adequately and timely funded, thus avoiding delays currently experienced which lead to assets wasting away and value for creditors depreciating, beating the entire purpose of corporate rescue. Therefore, the paper recommends that the adoption of a corporate rescue fund will ensure that funds are available for businesses to efficiently and effectively implement formal corporate rescue processes.

2. The Legislative Framework on Corporate Rescue in Kenya

The Insolvency regime in Kenya is primarily governed by the Insolvency Act, 2015[2] **(the Act)**, the Insolvency Regulations, 2016 and the Insolvency Regulations, 2018[3] (**the Regulations).** Prior to the enactment of the Act, insolvency matters were dealt with under the Companies Act, CAP 486 (now repealed). The only rescue mechanism envisaged under the repealed law was an arrangement/compromise with creditors. The coming into force of the 2015 law was part of efforts to promote business rescue and provide for a robust legislative framework for dealing with distressed corporate entities. The Act provides for administration and company voluntary arrangements which are rescue mechanisms aimed at turning around struggling businesses. Both processes offer the company a moratorium allowing the company 'breathing space' to organise its financial affairs.

2.1. Administration

Part VIII of the Act provides for administration of insolvent companies. The key objectives of administration are to (a)maintain the company as a going concern; (b) to achieve a better outcome for the company's creditors as a whole than would likely to be the case if the company were liquidated (without first being under administration) and; (c) to realise the property of the company in order to make a distribution to one or more secured or preferential creditors.[4] These objectives are to be explored in that order with the key objective being to maintain the company as a going concern, with the aim of turning it around to profitability.

To achieve these objectives, once an administration has taken effect, the Act precludes any application for the liquidation of the company and any pending application is suspended.[5] Additionally, a resolution for the liquidation of the company may not be made and the Court cannot make an order for the liquidation of the company.[6] The moratorium also prevents any person from taking any steps to enforce a security over the company's property or take steps to repossess goods in the company's possession under a credit purchase transaction unless approved by Court or consented to by the administrator.

The powers and functions of an administrator are provided under the Fourth Schedule of the Act.[7] These include the power to borrow money for the beneficial realisation of the company's assets and to give security over those assets for the borrowing.[8] This power may be exercised without the consent of secured creditors of the company provided approval for the exercise of the power is supported by creditors holding at least 75% in value of the total amount that is owed by the company to its creditors and the priorities of the secured creditors are preserved in relation to the assets of the company so that those creditors would be in no worse position than would be the case if the company were liquidated.[9] This is the key provision of the Act as relates to corporate rescue financing in administration.

1 'Insolvency Act of Kenya, 2015'. Part VIII and IX http://kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=CAP.%2053
2 *Ibid*
3 'Insolvency Regulations.' http://www.kenyalaw.org/lex//sublegview.xql?subleg=CAP.%2053
4 Insolvency Act, 2015, Section 522.
5 *Idem, s 558.*
6 *Idem, s 559.*
7 *Idem, s 576.*
8 *Idem, Fourth Schedule, Paragraph 3 (1).*
9 *Idem, Fourth Schedule, Paragraph 3 (2).*

The Regulations also provide for post commencement credit and empowers the administrator to enter into a contract for a loan or other credit facility for the benefit or continuation of any business of the company after the commencement of the administration process which shall be paid in priority over the rights of other creditors.[10] This provision which was introduced by a 2019 amendment clarified the ranking of post-commencement finance giving lenders the comfort to fund the operations and working capital of distressed businesses working towards a turnaround through new or additional borrowing.

2.2. Company Voluntary Arrangements (CVAs)

The Act also provides for Company Voluntary Arrangements which allow directors to make a proposal to the creditors for a voluntary arrangement under which the company enters into a composition in satisfaction of its debts or a scheme for arranging its financial affairs.[11] Once the proposal takes effect as a voluntary arrangement, the supervisor, who must be a licensed insolvency practitioner, takes responsibility for its implementation in the interest of creditors while ensuring compliance of the company with the terms of the proposal. There is a moratorium available to companies once they enter into voluntary arrangement where the company is an eligible company. Additionally, there is a restriction on the company obtaining credit during the moratorium period.

CVAs ideally involve an agreement of the company with its creditors to satisfy existing obligations otherwise than by payment in full. The proposal may entail immediate payment of a certain percentage of the amounts owed and discharge of securities in return or restructuring of existing debt to allow for future payments without necessarily leading to a default or a proposal to convert the existing debt into equity. Whichever proposal is brought by the directors often requires additional funding to implement. It is important to note that the legislative framework on CVAs does not provide for the mode of implementing the arrangement but places a responsibility on the supervisor to implement the proposal. The assumption then is that the proposal shall contain a clear structure for its implementation. Data from the regulator shows that since the Act came into force, there have been only two CVAs in Kenya.[12] The CVAs were mostly financed through the sale of non-core assets as in the case of Uchumi[13] and injection of capital by shareholders in the case of Kaluworks[14].

3. The practice in corporate rescue financing in Kenya

Administration has become the most popular corporate rescue option for lenders and businesses. The 2023/2024 fiscal year reported the highest numbers of companies in administration in Kenya.[15] This is a clear indication that the market is keen on corporate rescue as opposed to traditional liquidation of distressed corporate entities.

Although an administrator is an officer of the court; an agent of the company and owes a duty to all creditors, in practice, the appointing authority normally provides funding for administrations. This can be attributed to the fact that the appointing authority has a significant stake in the outcome of the administration. Additionally, the administrator as a professional whose fees need to be settled (which eventually counts as cost of realisation) will also only likely accept an appointment and enter into an engagement where it is clear who will be settling their fees.

Most administrations result from appointments by lenders holding security over the assets of the corporate entity in financial distress. The lenders provide funding for the administrator to continue trading with the hope that the objective to maintain the business as a going concern can be met. The key to keeping the business as a going concern is being able to generate sufficient cash flows to regularise the debt repayments as well as revive the business to profitability. If this objective cannot be met, then the administrator explores realisation for a better outcome other than would have been in a liquidation or to make a distribution to secured or preferential creditors. Once an administration has commenced and the secured creditor has provided funding, it is imperative that the financier sustains the funding to achieve a reasonable outcome of the process. The funding, including the remuneration of the administrator and the cost of preserving and recovering the assets, ranks in first priority above any other claim.[16] A major reason for the little success in turning around businesses in Kenya is that appointments are often made too late, and lenders typically delay funding or provide insufficient funds to mitigate their exposure. The result of this is a mass failure of administrations, with most companies ending up in liquidation.

Similarly, the success of any CVA will depend on the availability of finances to implement the plan. Once a plan is approved and a supervisor assumes office, funding is required to be able to meet operational costs and generate sufficient cash flows to meet ongoing obligations as well as repayments to creditors as per the plan. Thus, the need for adequate and timely funding arises. The question then is who provides the funding in this circumstance, especially where the secured lenders may have opted for a haircut in a bid to avert a total loss. In the case of Kaluworks CVA, its success could be attributed to the shareholders providing additional funding and the secured lenders writing off part of their debt while the case of Uchumi has been sustained because of the political goodwill, with the government maintaining that the chain stores are a critical investment in the bottom-up economy. The franchising model to derive value from the Uchumi brand is yet to take effect.

10 Insolvency Regulations, 2016, Regulation 131A.
11 Insolvency Act, 2015, Section 625(1).
12 Business Registration Service. 'Office of the Official Receiver.' https://brs.go.ke/office-of-the-official-receiver/.
13 'Uchumi Creditors Vote to Save Retailer – Uchumi Supermarket.' https://www.uchumisupermarkets.co.ke/case-study/uchumi-creditors-vote-to-save-retailer/.
14 'Chandaria Gets Back Seized Firm as Banks Waive Sh6 Billion Loan'. Business Daily, 31 August 2022. https://www.businessdailyafrica.com/bd/corporate/companies/chandaria-gets-back-seized-firm-as-banks-waiver-sh6-billion-3931868.
15 Business Registration Service. 'Office of the Official Receiver.' https://brs.go.ke/office-of-the-official-receiver/.
16 Insolvency Act, 2015, Second Schedule, Paragraph 2.

4. Key gaps

As discussed in Section 3, the critical gaps in the financing models for corporate rescue are in the adequacy of funding and the timely availability of funds. Adequacy addresses the ability of the financier to provide the officeholder with sufficient funds to implement a rescue plan while the timely availability of funds would relate to the timeframes within which the funds are made available from the time the funding requirement is provided to the financier. Although financiers are often already at risk, they still have to provide funding for rescues to avoid greater losses and deterioration of their security, which could leave them in a worse position. The issue of adequacy then arises since the implementation of a rescue plan will require a certain threshold of funds to be able to generate positive cash flows and surplus for repayment. When inadequate funds are provided, it is often difficult for the office holder to fully implement a turnaround plan. The end result is a failed rescue plan and an increase in exposure. While providing adequate funding is ideal, financiers are also faced with other constraints such as regulatory requirements which cap lending to a group of companies at 25% of the bank's core capital.[17] On the flipside, a failed rescue plan and Non-Performing Loans (NPLs) would require the lenders to increase their core capital to comply with the CBK's rations. It is, therefore, a case of 'doomed if you do, doomed if you do not.'

Closely related to adequacy is the timely availability of finances to support rescue efforts. The time value of money is crucial in commercial transactions, particularly in corporate rescue efforts. Any rescue plan often contains options to continue trading or generating cash flows in some form or shape. This is then affected by economic factors such as forex losses and gains, changing tax regimes and the supply chain dynamics. The profitability and return on investment largely rely on swift and commercial decisions. For instance, funds available to import raw materials today when the Dollar against the Kenyan Shilling is trading at Kes 130 per dollar would be more useful than funds available in 14 days when the dollar against the shilling is Kes 160. Thus, it is imperative that funds are availed on time to maximise the return on investment by the financier during the implementation of a corporate rescue plan.

Additionally, the decision-making process on the funding of corporate rescue often involves teams that may not have a fair appreciation of the necessity to support the rescue plan in a timely manner. This can be attributed to the governance structures where the obligation to deal with distressed companies is placed on the workout teams which are often limited in scope as regards decision making on financing since spending decisions are taken at board or shareholder levels. These delays and bureaucracies involved could be cited as a cause of the inadequate and delayed financing for corporate rescue. Thus, one can conclude that the key gaps in corporate rescue financing relate to the decision-making process which impacts on the adequacy and timely availability of funds critical in implementing a successful rescue plan.

5. Comparative analysis

Some jurisdictions have established laws and best practices for corporate rescue financing; defining what qualifies as rescue financing; specifying which businesses are eligible; and strengthening oversight mechanisms. This paper will explore Singapore as a high-income economy with business-friendly regulatory environment[18] and Uganda as a fast-growing economy in Africa[19]

In Singapore, corporate rescue is in the form of informal creditor workouts, schemes of arrangement[20] and judicial management[21]. Part 5 of the Singapore Insolvency, Restructuring and Dissolution Act, 2018,[22] (IRD Act) introduced the debtor in possession restructuring regime which mirrors the US practice and provides for rescue financing. Rescue financing, according to the IRD Act is defined as financing that is necessary for the survival of the debtor and/or financing that is necessary to achieve a more advantageous realisation of the assets of the debtor than on winding up. In the context of judicial management, it is financing necessary for the Court's approval of a scheme of arrangement.

The IRD Act further provides that rescue financing is to be obtained with approval of court and is to be treated as costs and expenses of winding up and shall have priority over preferential debts if the debtor is wound up and can be secured by the debtor's unencumbered assets or subordinate to an existing security.[23] In rescue financing proceedings the debtor is required to prove that they are unable to obtain rescue financing from any other source unless super priority ranking of rescue financing is granted. Singaporean courts[24] have also explored the practice of roll up rescue financing – a financing model that upgrades the priority of a rescue lender's pre-existing debt by applying a portion of the rescue financing proceeds towards paying the pre-existing debt of the rescue lender. The pre-existing debt is, in effect, converted (or "rolled-up") into the super priority rescue financing debt.[25] The framework in Singapore provides for best practice in relation to the qualification of financing to be treated as rescue financing and provides for the courts as an institution of oversight by setting the criteria for the courts to consider before granting super priority.

17 'Banking Act of Kenya, CAP. 488'. Section 10(1) http://www.kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=CAP.%20488.
18 World Bank. 'Overview.'https://www.worldbank.org/en/country/singapore/overview.
19 U.S. Agency for International Development. 'Economic Growth | Uganda,' 23 November 2022. https://www.usaid.gov/uganda/economic-growth.
20 'Insolvency, Restructuring and Dissolution Act 2018, Part 5 - Singapore Statutes Online'. https://sso.agc.gov.sg:5443/Acts-Supp/40-2018/?ProvIds=P15-.
21 *Idem, Part 7.*
22 'Insolvency, Restructuring and Dissolution Act 2018 - Singapore Statutes Online'. https://sso.agc.gov.sg:5443/Acts-Supp/40-2018/?ProvIds=P15-.
23 *Idem, s 101.*
24 'Re Design Studio Group Ltd [2020] SGHC 148'. https://www.elitigation.sg/gd/s/2020_SGHC_148.
25 *Roll-up Rescue Financing – A New Tool for Banks to Salvage Non …*, https://www.wongpartnership.com/upload/medias/KnowledgeInsight/document/10112/LegisWatch_Roll-up-RescueFinancingANewToolforBankstoSalvageNon-performingLoans.PDF.

Notable in the Singapore framework is the need for the debtor to prove that they are unable to secure any other source of funding without the funding being granted super-priority ranking. This is crucial in preventing abuse of the judicial process to gain a more favourable ranking. Rescue financing must create real value for the debtor company by injecting substantial new funds, not just token amounts, and support the restructuring process to benefit the company. This helps address the issue of adequate funding for rescue finance. However, even with adequacy covered, the availability of rescue financing sources in Singapore may still present challenges for debtors.

In Uganda, corporate rescue can be implemented through Administrations under the Insolvency Act of Uganda[26] and a compromise or arrangement under the Companies Act of Uganda[27]. In 2022, the Ugandan Insolvency Act was amended to introduce post-commencement financing in administration and arrangement proceedings.[28] Prior to this amendment, the East African country had no legal framework on rescue financing. The qualification of financing in Uganda to be considered as rescue financing is that it must facilitate the supervisor in implementing an arrangement or help the administrator achieve the goals of administration. To obtain rescue financing, the approval of both creditors and the court is required, and the officeholder can grant security over the debtor's property to obtain rescue financing.

The Uganda Act limits the amount that the officeholder may borrow to the value of the debtor's unencumbered assets at the time of the arrangement order or at the execution of the administration deed. This restriction covers the exposure of the lender for the rescue financing by ensuring that there is sufficient security available to cover the post-commencement debt. This regime offers a three-layered oversight mechanism by the creditors, the court, and the limit of borrowing. Critical to learn from Uganda, is the limit on the amount that the office holder can borrow which is capped at the value of unencumbered assets of the debtor.

The regimes in Singapore and Uganda prescribe rescue financing and lay out robust oversight mechanisms which are necessary in ensuring that the funding is sufficient to address corporate rescue while also monitoring who is eligible for funding and the limits thereon. These can be borrowed and legislated into the Kenya framework as well as adopted as best practice in the rescue financing practice. The question of timely availability and access to the funding, however, remains unanswered in both jurisdictions. In addition to the adoption of best practices and regulation of rescue financing in Kenya, a reliable source of funding, a corporate rescue fund, is necessary to implement rescue efforts. This has the potential to revamp the turnaround and restructuring practice by facilitating more efficient and effective corporate rescues which is key to economic sustainability.

6. Recommendation: the case for a corporate rescue fund.

It is clear that for the success of any rescue efforts, the right amount of funding needs to be availed within the requisite timelines. The big question is then an assured source of financing to meet the two requirements of adequacy and timely availability. With regulated lenders being the key players in the corporate rescue space, it is imperative that the lending business is regulated, structured, and managed to provide for an allocation of an agreed percentage of profits before declaration of shareholders dividends, to be set aside for utilisation in corporate rescue financing. The justification to the shareholders for this allocation is that the ultimate effect of the allocation, which if done regularly is insignificant, would be a reduction in NPLs which means better profitability of the general banking business for return on shareholder value. In the alternative, the additional interest charged, over and above the agreed interest rate, in the event of default of any client should be set aside to be utilised for financing corporate rescue efforts irrespective of whether the interest was charged on the account of the business that is attempting rescue efforts or not. Financial institutions may also consider taking out an insurance policy, in addition to the loan insurance already in place, where for a reasonable premium, the insurer is bound to support an agreed percentage of the rescue financing in the event of a rescue plan under the existing legislative framework. The allocation of profits, additional interests and insurance payouts are then to be consolidated into a fund, the corporate rescue fund which is then readily available for corporate rescue.

To ensure compliance with the allocation of funds towards the pool of funds be known as a Corporate Rescue Fund, this paper recommends that the Central Bank of Kenya **(CBK)** as a regulator oversees the allocation, utilisation and mechanisms to ensure that the funds are only utilised where necessary approvals have been obtained and majorly only to address corporate rescue financing for formal rescue processes as provided under the Act, as amended from time to time. These can be effected through issuance of guidelines as mandated by Section 33(4) of the Banking Act, which empowers the CBK to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system. These guidelines may borrow from the existing framework for loan loss reserves and loan loss provisioning which have already proved to be effective tools that are widely accepted within the banking industry. The Corporate Rescue Fund can be utilised to reduce the actual loan loss, being a more effective way of dealing with problem accounts and achieving a better outcome for the banks. This paper also recommends the establishment of independent corporate rescue finance approval committees within banks to assess requests for financing and ensure that the set criteria under the proposed CBK Guidelines are satisfied. These recommendations will ensure that struggling businesses are efficiently and effectively recycled to preserve jobs and facilitate economic growth.

26 'Insolvency Act of Uganda, 2011.' https://www.ugandalaws.com/statutes/principle-legislation/insolvency-act,-2011.
27 'Companies Act, 2012 - ULII'. https://ulii.org/akn/ug/act/2012/1/eng@2015-07-01.
28 Insolvency Act of Uganda, 2011, Section 164A.

7. Conclusion

In conclusion, corporate rescue financing in Kenya is crucial for preserving businesses and maintaining economic stability, yet it faces significant challenges. The current legislative framework under the Act and the Regulations offers a foundation for corporate rescue through administration and CVAs. However, the effectiveness of these mechanisms is undermined by inadequate and untimely financing, which has led to the failure of many rescue efforts, ultimately resulting in liquidation.

The comparative analysis of Singapore and Uganda highlights how rescue financing frameworks, with strong oversight mechanisms and eligibility criteria, can enhance the success of corporate rescues. Singapore's court sanctioned super-priority ranking for rescue finance and Uganda's limit on the borrowing for post commencement finance offer useful lessons for Kenya. Both jurisdictions emphasize the importance of timely and adequate financing, though gaps still exist regarding the availability of rescue funds.

To address these challenges, the paper strongly recommends the establishment of a Corporate Rescue Fund in Kenya. This fund, regulated by the CBK and sourced from allocation of profits, insurance payouts or default interests, would address the key gaps of adequacy and timeliness, offering a stable and regulated source of finance. Furthermore, the paper recommends the creation of independent committees within banks to oversee the approval of rescue financing requests, ensuring adherence to set guidelines.

The proposed reforms aim to reduce non-performing loans, preserve jobs, and facilitate economic growth by improving the corporate rescue process. Through the Corporate Rescue Fund, Kenya can strengthen its insolvency regime, ensuring that struggling businesses receive the financial support they need to recover, benefiting the broader economy in the process.