FEDERATION OF KENYA EMPLOYERS
The Voice of Employers

Federation of Kenya Employers (FKE)

# ESG and its implications for Kenyan enterprises

## FKE Member Briefing Note

June 2022

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# 1. Background

Environmental, Social and Governance (ESG) investing has become increasingly mainstream in recent years.[1] ESG investing means investing in enterprises that have strong records on environmental issues (e.g. reducing carbon emissions, using resources more efficiently and cutting down waste production and complying with environmental regulations), on social issues (e.g. ensuring workplace safety, decent work, diversity and inclusion, and observing the data and privacy requirements for employees), and on governance issues (e.g. executives' salary levels, composition of the board, shareholder voting rights, the enterprise's stance on bribery and corruption).

Globally this type of investing accounts for somewhere between 1 and 2 out of every US$4 investment. More than 2,250 money managers who collectively oversee US$80 trillion in assets have now signed on to the United Nations-backed Principles for Responsible Investment. A large part of what is driving this interest in ESG is demographic changes and social attitudinal shifts that increasingly demand that enterprises take a more ethical approach to how they source raw materials and enterprises' stances on social and environmental issues.

In Kenya it would be fair to say that ESG investing has not been at the top of the priority list for the business community. However, that is changing and ESG issues will have an increasing important impact on all Kenyan businesses.[2] Sustainability in business is a megatrend and it will continue to grow. That cannot exclude small and medium-sized companies. Companies in Kenya big and small will experience increased demands and expectations regarding how they conduct business. The smart will outgrow the slow.

The African reality is marked by the dominance of extractive industries, high exposure to climate change and pressing developmental needs. The dominance of extractive industries poses a clear obstacle to the rise of 'green' investment strategies on the continent. Sub-Saharan Africa is the world's most commodity-dependent region, and much of its income is a product of the export of petroleum products, coal, metals and minerals.

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1 According to US SIF's 2018 Report on Sustainable, Responsible, and Impact Investing Trends, total SRI assets jumped 38% to UA$12 trillion since 2016 in the United States alone. These assets represent 26% of the total US assets under management (US$1 in US$4). For perspective, when US SIF first measured the size of the market in 1995, it was US$639 billion; the area has increased 18-fold and has since enjoyed a compound annual growth rate of 13.6%. By some estimates, it could reach US$50 trillion over the next two decades. According to predictions from Bank of America, another $20 trillion is set to flow into ESG funds over the next two decades. For context, the entire S&P 500 is worth about $25.6 trillion.

2 Among limited partnerships (LPs), more than 97% of respondents already believe it is important to consider ESG factors when making investment decisions, according to a 2021 [industry survey by the African Private Equity and Venture Capital Association (AVCA)]

Yet there are more opportunities in Africa for investors to make a positive environmental or social impact than in any other region in the world.[3] Extreme climatic events have posed a significant risk to regions in Kenya, and they have contributed to making it one of the most disaster-prone countries in the world. Of particular concern are floods and droughts, with major droughts occurring about every 10 years, and moderate droughts or floods every three to four years. An example is the torrential rains and severe flooding from March to May 2018 that devastated communities already struggling to recover from a prolonged drought.

This FKE Member Briefing is designed to explain to members how trends and legislation in ESG issues have a direct relevance to them and how FKE can support you – our members.

[3] See article here

# 2. The Stick: Why enterprises should take ESG issues seriously

## 2.1 External legal expectations on Kenyan enterprises

- The United Kingdom introduced legislation the Modern Slavery Act in 2015. This legislation makes companies accountable for slavery and labour abuses occurring along their whole chain of operations and it has a range of provisions to increase transparency in supply chains.
- Australia adopted similar legislation – the Modern Slavery Act – in 2019 while the French National Assembly adopted the Duty of Vigilance Law in 2017. Similar legislation has been enacted in Hong Kong, the Netherlands and Switzerland.
- A 2021 German supply chain law holds companies accountable for human rights breaches and will fine companies procuring parts or materials from suppliers that fail to meet minimum human rights and environmental standards (Switzerland and Norway enacted similar legislation in 2021).
- The EU introduced in 2021 a directive which will oblige companies to identify, address and remedy any aspects of their supply chain that could infringe human rights, the environment or good governance. *The rules would apply to all businesses operating within the EU, including those based outside EU member states.*
- The United States is currently considering similar legislation.[4] The Business Supply Chain Transparency on Trafficking and Slavery Act would require public companies to disclose information describing measures taken to identify and address conditions of forced labour, slavery, human trafficking and the worst forms of child labour within their supply chains.
- The EU Sustainable Finance Disclosure Regulation (2019) consists of disclosure requirements on enterprise and product levels and it applies to financial market participants (FMPs) whose business is in Europe and *non-EU FMPs (and their subsidiaries) who do business in the EU or sell products to the EU, and non-EU enterprises that submanage EU assets or funds.* The EU is developing further its sustainable finance agenda with the 'S' parts to feature more strongly.
- The EU Taxonomy Regulation (2022) provides a framework to identify to what degree asset managers' financial products are living up to environmentally sustainable values and it applies to all financial products which set an environmental sustainability objective or promote environmental characteristics. The EU is intending to launch a carbon border tax adjustment, which will see carbon import taxes imposed on carbon-intensive goods.

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4 See link here

When the tax is fully implemented in January 2026, the biggest initial impact will be on the cost of such high-carbon inputs as steel, cement, aluminium, chemicals, and electricity; EU importers and non-EU producers of these inputs will be required to pay an estimated €75 per metric ton of $CO_2$ emissions.[5]

- The Paris Agreement entered into effect for Kenya on 27 January 2017, and, as set out in Article 2(6) of the Constitution of Kenya (2010), the Paris Agreement now forms part of the laws of Kenya. The Climate Change Act (2016) is the main legislation guiding Kenya's climate change response through mainstreaming climate change in Kenya.[6]

## 2.2 Accessing Finance

The Sustainable Finance Initiative (SFI) led by the Kenya Bankers' Association (KBA), established in 2013 the SFI Principles: a Kenya-specific set of harmonised guidelines for sustainable development. Kenyan banks are now required to entrench financial risk considerations in their governance systems, include climate change and environment-related financial risks into their existing financial management practices, and develop a disclosure approach for financial climate-related risks.[7] The Kenyan Capital Markets Authority introduced Stewardship and Corporate Governance Codes in 2017. The Stewardship Code encourages companies to operate with a positive social impact. Investors are encouraged to incorporate social, environmental and ethical initiatives into their investment processes. A Corporate Governance Reporting Template and Corporate Governance Scorecard was developed for reporting, measuring and monitoring the application of the Code.

Additionally, the Kenya Companies Act (Act No. 17 of 2015) requires company directors to specify in their business review a description of the principal risks and uncertainties facing the company. The purpose of this business review is to create an understanding of the development, performance and position of the company.

More recently in November 2021 the Nairobi Securities Exchange (NSE) published an ESG Disclosures Guidance Manual.[8] According to the Guidance all listed companies in Kenya must report on the following ESG topics:

| General | Economic | Social | Environmental |
| --- | --- | --- | --- |
| • Governance<br>• Environmental and social risk management<br>• Stakeholder engagement<br>• Regulatory compliance<br>• Supply chain screening | • Economic performance<br>• Taxes<br>• Anti-corruption | • Human rights<br>• Labour and working conditions<br>• Occupational health and safety<br>• Training and education<br>• Diversity and equal opportunity<br>• Consumer protection<br>• Data privacy | • Environmental compliance<br>• Emissions |

The Guidelines are aimed at improving and standardising ESG information reported by listed companies in Kenya and require compliance within one year from their date of publication.[9] The NSE recommends the adoption of the GRI Standards as the common framework for ESG reporting by listed companies in Kenya. A responsible investment index is planned by the NSE in future.[10] Here are two examples of Kenyan companies disclosures (here and here)

5 See article here

6 National Climate Change Action Plan for Kenya, 2018-2022and the Climate Change Act (2016)

7 Several banks have said no to financing the proposed US$3.5bn East Africa Oil Pipeline running from Uganda's oil fields to ports in Tanzania. See article here

8 Access here

9 For illustration, see example of Kenyan Agri business Kakuzi most recent ESG Report

10 A common set of ESG metrics for reporting is intended to help facilitate comparability of ESG performance of listed companies. Over time, and with improved maturity on ESG disclosures, stakeholders will be able to correlate financial performance with specific ESG indicators such diversity and air emissions, as well as compare the ESG profiles of organisations reporting within the same sector.

The NSE is a member of the Sustainable Stock Exchanges initiative and also part of the UN Global Compact's Target Gender Equality Program. In 2021 the NSE conducted a Board Diversity and Inclusion Survey that examined the impact of diversity and inclusion on organizational performance, decision-making, and productivity in the boardroom.

The Central Bank of Kenya (CBK) in 2021 published its Guidance on Climate-related Risk Management pushing the banking sector to the frontlines of driving Kenya towards a low carbon future.[11] The CBK Guidance contains requirements that ensure banking institutions adapt to effectively integrating climate-related financial risks in their management frameworks as well as business decisions and activities.

The Kenyan Insurance industry has also set up a Taskforce on ESG. In 2021, African insurance organizations signed the Nairobi Declaration on Sustainable Insurance[12] committing to advance the assessment, management, and disclosure of ESG and climate-related risks and opportunities across all lines of business in their insurance practice. Additionally, the declaration commits to *"[a]dvancing the assessment, management and disclosure of climate change-related risks and opportunities, building on the Principles for Sustainable Insurance's project to pilot the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD)"*.

> Over the next five years and beyond, green instruments will play an important but niche role in driving the growth of Kenya's capital markets, in line with the Marrakech Pledge which calls for an increase in the volume, flow and access to finance for climate projects, alongside improved capacity and technology from developed to developing countries.
>
> **Capital Markets Authority (CMA)**
> Chief Executive, Paul Muthaura

The NSE launched its first Green Bond programme in 2019.[13] A Kenyan corporate entity, Acorn Projects Limited, issued in September 2019 a green bond to finance green and environmentally friendly buildings for students in Nairobi. A green bond is a fixed income instrument whose proceeds are used to finance or refinance projects which generate climate or other environmental benefits that conform to green guidelines and standards. Increasingly African stock exchanges are issuing social bonds (similar to green bonds but with a social purpose).

In 2020 the African Development Bank raised US$3 billion in a three-year bond to help alleviate the economic and social impact of the COVID-19 pandemic. Bids exceeded US$4.6 billion. In March 2021 the Banque Centrale Populaire Group in Morocco launched the gender bond programme, the country's first project to finance female entrepreneurs and self-employed women. It is a matter of time before the NSE issues a social bond. Green financing is also rapidly growing. Increased demand for green buildings, for example, can be attributed to the availability of a broad range of financing options for investors and developers such as Housing Finance in Kenya are providing a green mortgage credit line of up to US$20 million.

The bottom line is that if Kenyan enterprises want to access capital markets, either locally or internationally, they will be subject to ESG screening.[14]

| Roadmap for Implementation of Guidance on Climate-related Risk Management | |
|---|---|
| **Sensitization of banks: chief executive officers/managing directors** | October 2021 |
| **Banks' staff sensitization on climate change risk management** | January–March 2022 |
| **Submission of board-approved implementation plan** | June 2022 |
| **Quarterly updates on implementation of board-approved plans** | September 2022 |
| **Disclosures of climate-related information to enhance transparency benchmarked to TCFD Framework** | January 2023–June 2023 |

11 Access here

12 Access here

13 See link here

14 In 2020 the Industrial and Commercial Bank of China (ICBC) abandoned its role as lead financier of the proposed Lamu coal-fired power station in Kenya. ICBC also walked away from a mooted coal-fired power plant in Zimbabwe in 2021.

## 2.3 ESG disclosure – how it affects smaller Kenyan companies

ESG reporting on 'boundary' refers to the range of entities (e.g. subsidiaries, joint ventures, subcontractors) whose performance is represented by the ESG disclosures report. That means if you are a supplier to a listed Kenyan company, you will have to provide them with assurances.

Listed companies also need to undertake a situational analysis and stakeholder engagement. This is a process by which an organization's internal and external environment is analysed in order to evaluate the firms impact. Stakeholders can include those who are invested in the organization (such as employees and shareholders), as well as those who have other relationships to the organization (such as other workers who are not employees, suppliers, vulnerable groups, local communities, and NGOs or other civil society organizations, among others). Organizations also should identify impacts on future strategy, i.e., impacts on future revenues, cash flows and operating costs by emerging trends in ESG.

## 2.4 Sector differences

Different sectors will have different types and levels of ESG impacts, positive and negative, on the economy, environment and society. Below is an example of ESG topics specific to the manufacturing sector in Kenya, publicly disclosed by companies listed in the NSE.

| Kenyan Manufacturing | | | |
|---|---|---|---|
| **General** | **Economic** | **Social** | **Environmental** |
| • Governance<br>• Strategy<br>• Ethics and integrity<br>• Stakeholder engagement<br>• Business context<br>• Political accountability<br>• Resource use efficiency<br>• Sourcing strategy and policies<br>• Supplier screening<br>• Customer portfolio<br>• Product portfolio<br>• Shared value<br>• Sustainable Development Goals | • Economic performance<br>• Market presence<br>• Indirect economic impacts<br>• Government subsidies<br>• Local employment<br>• Taxes | • Labour and working conditions<br>• Occupational health and safety<br>• Training and education<br>• Water use rights<br>• Consumer health and safety<br>• Health and safety impacts of products and services<br>• Consumer protection<br>• Product labelling<br>• Lobbying | • Environmental compliance<br>• Materials sourcing<br>• Supplier environmental assessment<br>• Energy consumption<br>• Renewable and/or alternative energy sources<br>• Product packaging and distribution<br>• Emissions to air<br>• Water and effluents<br>• Waste management |

# 3. The Carrot: Why enterprises should take ESG issues seriously

## 3.1 Accessing supply chains

Companies with large and/or distributed supply chains use social compliance auditing to document suppliers' adherence to its social compliance guidelines. Assorted auditing methodologies and guidelines, in terms of social issues are usually based on ILO principles. The (Kenyan) Code of Ethics was developed through the Kenyan Global Compact Network to promote and enhance the ethics of business conduct in Kenya in line with the ten principles of the UN Global Compact (it has 700 large corporate members). If a business wants to access the commercial opportunities afforded by global supply chains, then they need to be proactive in providing these companies with ESG assurances.

## 3.2 You can make money

Active sustainability efforts can provide a competitive edge in their own right. Branding a positive social or environmental contribution can put your business in the shop window of global supply chains and new export markets, and domestically create a positive image. The speed of reputational damage today is instantaneous. Time for supporting facts and explanations often get short shrift. Yet the opportunities to promote the positive impact an enterprise does often get rabbitholed in managing risk. Enterprises need to do both with equal rigour. Identify areas of risk and deploy mitigation strategies while equally identifying areas of positive impact. [15]

Communication about your enterprises' sustainability efforts raises its reputational cachet. Sustainability branding can help send important signals to investors and banks and it can be easier than you might think. For example, Kenya is the largest producer of renewable energy in Africa, and ninth globally, with a capacity of 700 MW of geothermal energy. The proportion of renewable energy, namely, hydropower, geothermal, wind and solar which is at 70 percent, has now surpassed diesel-generated electricity. This is a positive point that *any* Kenyan company sourcing from the grid can claim.

## 3.3 You can also save money

Being smart about your environmental footprint and integrating leaner, more environmentally friendly business practices can be good for your bottom line. Take the following example: an enterprise wants to promote how it is using water in a sustainable fashion.

15 A development to watch in Kenya, for instance, is a much-anticipated announcement on the commencement of the Public Benefit Organisation (PBO), Act 18 of 2013. Once gazetted, the PBO Act will provide a more enabling context for purpose-driven organisations that pursue economic, environmental, social or cultural objectives.

Water recycling and reuse refers to the total volume of water that an enterprise recycles and/or reuses. Water recycling and reuse can be implemented by almost any industry. Reuse of water can have multiple benefits. Reusing water allows firms to decrease their wastewater discharge to water bodies, thus decreasing their negative impact on communities and the environment. Water reuse can also potentially reduce costs where the price of acquiring freshwater is high or decrease the firm's dependency where water supplies are unpredictable. Water can potentially be reused many times and by other entities, this is one of the most important ways to minimize water consumption. Water can also be reused for different purposes, for example, irrigation (in agriculture), heating and cooling, washing, cleaning, fire protection, and production line needs. In this example, the enterprise has multiple entry points to highlight how it is using water in a more effective way (and probably saving money at the same time).[16]

## 3.4 Accessing government tenders

The government's main priority in procurement is to achieve value for money, but this does not necessarily mean choosing the cheapest option available. Price is no longer the key factor in determining public purchasers' choices. Instead of basing choices on a (lowest) price-only criterion, the evaluation of tenders increasingly takes the so-called 'best value for money' (BVM) approach. Thus, public procurement decisions shift to a multi-criteria approach where various dimensions, such as the environmental and social dimensions, are considered and expressly required in the procurement specifications. Many procurement processes are increasingly referencing sustainability issues and legalisation requiring them to do so, is fast developing.[17]

## 3.5 Government may incentivize engagement

In many countries, the engagement of the private sector in the Sustainable Development Goals (SDG) implementation is part of official policies. Governments and the UN are striving for increased commitment of the private sector to both finance SDGs implementation and engage with the goals. There are lots of opportunities here, for example, the Kenya SDGs investor map identifies investment opportunities across multiple sectors and offers investors actionable intelligence and localised insight into sectors and market conditions with significant profitability potential in addition to social impact. The SDGs are an increasingly important framework for firms to not only utilise in the role they play in society but also for ESG disclosures. There are several UN-Kenya initiatives such as Business Call to Action Kenya (UNDP initiative) launched in 2015; the SDG Partnership Platform Kenya launched in 2017.


16 One of Kenya's largest sugar manufacturers, Mumias Sugar, in response to the high energy prices by using bagasse (a natural, industrial waste product in the industry), is able to produce biogas which powers their electricity generators. It uses only a third of the electricity it produces, and sells the rest to the national grid, earning the company revenue as well as carbon credits. See other company examples here

17 See example here

# 4. Risks are higher depending on the sector you operate in

The sector your enterprise operates in will reveal a lot in terms of your risk. Certain sectors have much higher risk.

- Agriculture has, for many years, formed the backbone of Kenya's economy: The agriculture sector contributes about 30 percent of the gross domestic product and accounts for 80 percent of national employment, mainly in the rural areas. Yet risks abound. The annual US Department of Child Labor and Forced Labor Reports lists the following as high-risk sectors for child and forced labour in Kenya: coffee, fish, khat, rice, sisal, sugar, tea and tobacco (sand and gold also feature).
- Manufacturing with high employee numbers is more likely to run into issues around labour rights.[18]
- For oil and gas and forestry and mining, reputational risk is high due to past human rights violations.[19]
- Tourism, a high employment sector, needs to be especially mindful of social factors such as *migrant workers, trafficking, sex work and abuse, decent work deficits, health and safety, gender and diversity, corruption and bribery, community impact, cultural damage*. These are all high-risk areas across the sector. On the other side of the coin is the economic impact of tourism on local communities. Employment is dispersed around a country, often in remoter areas away from urban centres. It is an employment-orich sector that enables many entry-level and lower skilled positions. From a development perspective, it is a critical industry.
- The coffee and tea sectors are high risk to indebted and child labour but the sectors in Kenya are part of global compliance efforts.[20] Most major tea brands sourcing in Kenya belong to the Ethical Tea partnership. For coffee producers, there are 29 members of the Kenyan platform of the Global Coffee platform.[21]
- The Kenya Flower Council, the principal trade body for growers in Kenya, has been an earlier adopter of sustainability practices and built a recognized ethical national brand for the sector.[22] Enterprises who want to access global supply chains will need to understand what the requirements on their business will be and how they will be assessed and monitored.[23]

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[18] This company case study Athi Steel

[19] See example gold mining here

[20] See example here

[21] Access Kenyan platform here

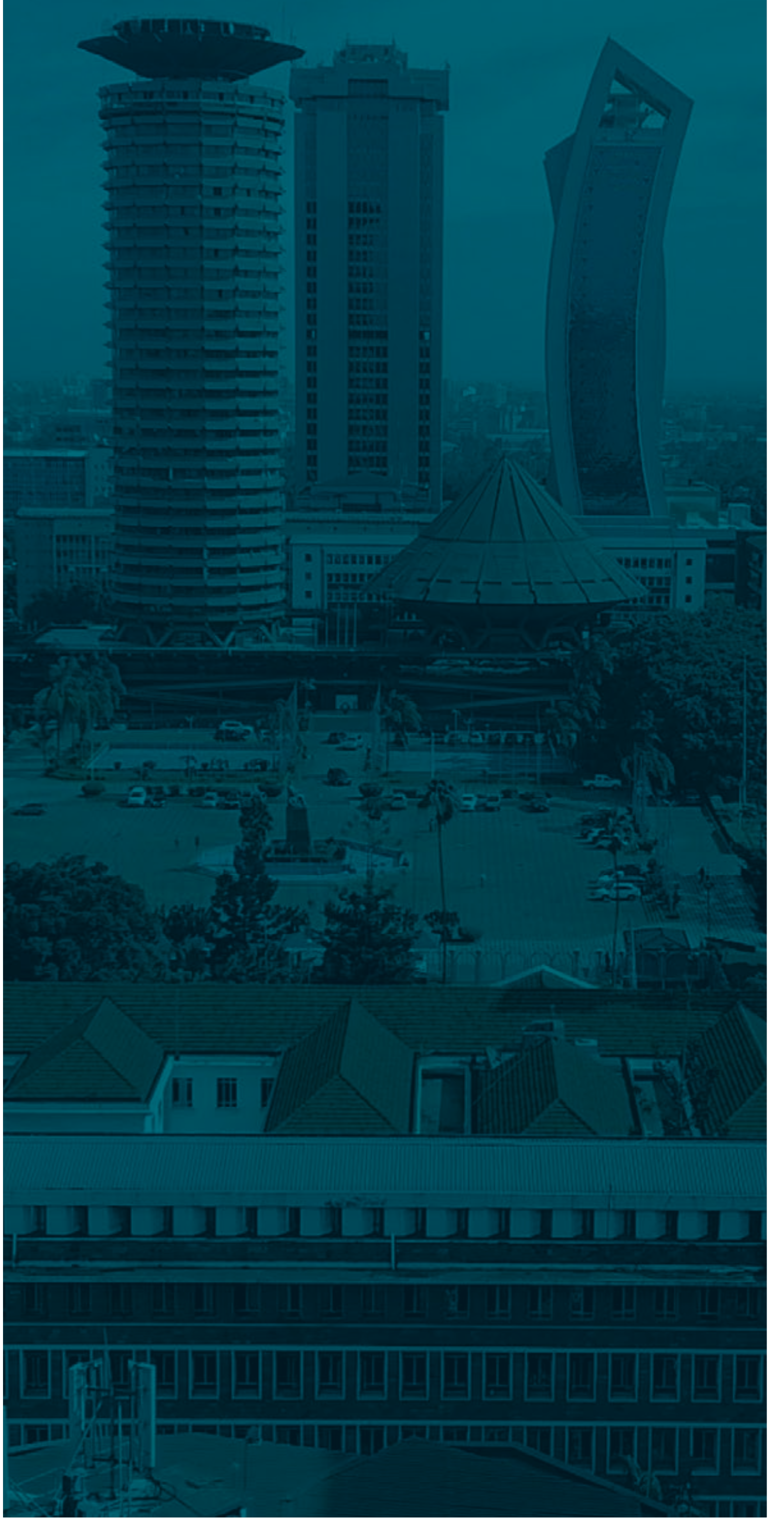
[22] See sustainability report here

[23] Some major global buyers have started offering better supply chain financing terms to their suppliers in exchange for meeting higher environmental, labour, health and safety standards. German footwear and clothing manufacturer Puma recently launched such an arrangement with BNP Paribas Bank and the fintech enterprise GT Nexus. If suppliers get a high score on Puma's social and environmental audit, they get a higher share of the invoice upfront, which can cut suppliers financing fees.

The sector your firm operates in can also be ranked in terms of its contribution to the SDGs. The Food & Beverage sector's overall score is 36.0, higher than Healthcare at 32.6, or Resource Transformation ranked at 28.4, making it the sector with the highest score. The F&B sector can be further prioritized into eight industries: Agricultural Products (49.0); Food Retailers & Distributors (46.8); Meat, Poultry & Dairy (45.3); Restaurants (39.4); Processed Foods (36.2); Non-alcoholic Beverages (32.0); Alcoholic Beverages (31.5); and Tobacco (7.9) (one of the lowest of all 79 industries). [24]

[24] Matrix developed in the following paper mapped the ESG issues in all 79 industries organized into 10 sectors, developed by the SASB, to the 169 targets of the SDGs. SASB has identified the material ESG issues for each industry that are important to shareholders in terms of value creation.

# 5. Why companies have problems grappling with ESG



For enterprises, the range of ESG issues is vast, complex and overlapping. Enterprises are confronted with an ever-increasing alphabet soup of ESG, SRI, SDG and all the rest. The scope to take a wrong turn is ever-present.

While listed companies in Kenya now have regulatory requirements to report on ESG aspects of their business, increasingly all companies will need to be on top of these issues. Even just taking a 'do no harm' approach requires a major investment by a firm to ward off potential reputational damage.

Being successful in this environment will mean anticipating the anticipations of others. Legislation and practice on ESG issues is increasing fast. It is critical to future-proof your business.

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The Federation of Kenya Employers (FKE) has over six decades of experience of dealing with social and labour policies, and has built strong institutional relationships with a wide range of partners such as trade unions. FKE has been engaged in international debates through the ILO and other UN bodies. Critically, FKE has an institutional link to the UN through the ILO where our Executive Director Jacqueline Mugo sits on its Governing Body, representing business from East Africa.

FKE is committed to supporting our members capitalize on the emerging ESG trends, whether it is in terms of legislative compliance or strategic engagement.

**For more information contact**
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