PD ABH-966

EVALUATION OF THE KENYA TRUST FOR PRIVATE ENTERPRISE DEVELOPMENT— EQUITY CAPITAL COMPONENT

Project No. 615-0238
Delivery Order No. 13
Contract No. PCE-0001-I-00-2051-00
IQC for Worldwide Technical Assistance
in Private Enterprise

Prepared for:
U.S. AGENCY FOR
INTERNATIONAL DEVELOPMENT
Nairobi, Kenya

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February 10, 1994

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EXECUTIVE SUMMARY

A. Project Profile

The purpose of the Kenya Trust for Enterprise Development Program (the Program) as stated in the U.S. Agency for International Development (USAID) Project Authorization dated May 8, 1987 is "[t]o strengthen institutions that can improve Kenya's business environment and to encourage growth of businesses directly through the financial and advisory assistance those institutions provide."

The equity capital component of the Program was aimed at both institutional change and at supplying direct benefits. On the institutional side USAID's assistance was expected to lead to the establishment of a new equity capital company in Kenya, the introduction of equity investing through an intermediary, improvements in the equity capital market, and increases in the number of skilled Kenyans in these areas. Direct benefits from the component were expected to include the creation, expansion and/or restructuring of 25 to 40 businesses, with increases in total new investment, employment, output, foreign exchange, and tax revenue.

The institutions involved in the Trust Agreement are Kenya Equity Management Ltd. (KEM), Industrial Promotion Services Ltd. (IPS), and Standard Chartered Bank Ltd. (the Trustee). For the equity capital component, the Trustee was established to channel money to IPS, the existing company, and KEM, a new company designed to operate as fund manager for the Kenya Equity Capital Ltd. (the Fund).

B. Purpose of Evaluation

The purpose of this evaluation, as stated in the Scope of Work (see Annex H), is "to provide USAID/Kenya with an independent assessment of the progress made thus far in meeting the objectives for setting up and funding the respective institutions under the Trust (Agreement)." Upon review of the ability of these institutions to meet their obligations as outlined in the Trust Agreement, the evaluation team was to determine if the Trust Agreement was a viable instrument for the provision of equity capital and to recommend improvements to the implementation of this project.

C. Methodology

The methodology consisted of 1) a review of project-related USAID documents, files and agreements, reports produced by USAID-supported financial institutions, and reports and accounts of Portfolio Companies; 2) interviews with USAID and Trustee officers and related personnel, KEM and IPS officers and related personnel, the management of the Portfolio Companies, senior officials of financial institutions including banks and insurance companies, and owners of non-Portfolio private companies in search of additional equity financing; and 3) visits to IPS and KEC Portfolio Companies.

D. Findings and Conclusions

Although all except one of the Program's quantitative goals of increased investment, total employment, output as measured by revenue increases, foreign exchange earnings, and tax revenue to the Government of Kenya were achieved, the evaluation team believes these are misleading criteria by which to judge the success of the Program. Moreover, there is evidence that the environment is unfavorable for a venture capital experiment in Kenya, and that the Program should be reoriented or discontinued (see Section III.B).

More specifically, this evaluation found that the market is not mature enough to support a firm or activities devoted primarily to venture capital investments. There are many reasons why the principal players in Kenya have not supported the development of a venture capital market. There is little incentive for companies to seek equity when they have reasonable access to debt and are unconcerned with the risks of maintaining a weak equity base. The pervasive practice of maintaining two sets of books—double bookkeeping—for tax purposes inhibits companies from sharing financial information that investors need to make responsible investment decisions. Insufficient market information and inexperienced company management compound the difficulties faced by investors and contribute to their belief that there is a dearth of advantageous investment opportunities. From management's perspective there is little interest in creating a new venture capital firm, as the belief persists that it is better to enter the financial market later when the need for equity services has been established than before such a need is clearly identified.

Although by sound financial standards Kenyan companies generally may have too much debt and too little equity, this does not necessarily indicate that there will be support for a commercial market for venture capital. There is no more evidence today than at the inception of this Program that either local private institutions or individuals will consider private equity investments, except on a selective project-by-project basis where the investor has personal knowledge of the business and the management. Donor financing cannot create a venture capital equity market if companies do not perceive the need for venture capital or are unwilling to accept the constraints involved in obtaining it. These findings and others contained in this evaluation indicate that much more than "changes in implementation of the current project" are needed. If continued, the Program needs a thorough restructuring.

The pre-established goals concerning the number and size of investments that could be made substantially exceeded the historic results of venture capital, even in developed countries like the United States. This discrepancy between what was projected for IPS and KEM and what was achievable created an unrealistic benchmark for judging the Program and impeded proper understanding and implementation of the Program by participants.

Neither IPS nor KEM is operating as a venture capital company, as outlined in the Trust Agreement, nor is there any indication that either can or will operate as a venture capital company in the near future.

IPS was and is a holding company, not a venture capital institution. Venture capital companies typically monitor their Portfolio Companies. In contrast, IPS actually manages its Portfolio Companies, thereby giving it the ability to solve directly the management, financial, and operating problems of its Portfolio Companies. In its 30 years of business activities, it has divested itself effectively of fewer than 25 percent of its businesses. Nonetheless, IPS is a successful well-managed holding company and is fulfilling a need for good commercial management skills. Efforts by IPS to broaden its investment and management base beyond the Ismaili community have not yet achieved significant results. However, there are positive indications that with the right USAID incentives, encouragement, and cooperation, IPS could play an expanding and beneficial role in Kenya, both socially and economically. The evaluation team believes that USAID and IPS could benefit from a restructured relationship that both furthers USAID's goals and provides IPS with financial support.

Although KEM was established to operate as a management company for KEC, it is actually operating as a merchant banking company. It currently provides financial structuring and organizational advice to other equity and debt investors for a fee on a project-by-project basis, as well as a modest KEC equity investment if necessary. KEM was initiated with insufficient management and equity capital, without historic ties to the Kenyan business community, and with serious questions as to the local appetite for venture capital. This has contributed to its lack of success as a venture capital institution. Nonetheless, the initial positive results of KEM's merchant banking activities may indicate a need for such institutions in Kenya and should be explored further. KEM would welcome USAID support for a merchant banking institution. It is recommended that USAID and KEM try to restructure fundamentally their relationship so that it furthers both USAID's goals and KEM's objectives.

USAID Program-related investments are not large enough to support the operation of two private investment companies. It is unlikely that these investments could even support one private investment company. USAID's financial support was insufficient to attract the minimum management resources needed by KEM to direct a successful private equity investment activity. USAID's interaction with and monitoring of IPS and KEM has been inadequate. Lack of information exchange has hindered the development of a constructive relationship between USAID and IPS and between USAID and KEM. In fact, IPS believed it was receiving only financial assistance from USAID and did not anticipate or receive any USAID input into project selection or operating methods. USAID's lack of monitoring and guidance to the two institutions also adversely affected the implementation of the Program. In particular, the lack of an adequate market, adequate management capabilities, and sufficient capital for KEM were all problems USAID was aware of at the inception of the project. This should have prompted USAID to rethink this part of the Program as it was originally designed.

In reinvesting the reflows from Trust Loans, the Trustee has not been able to keep up with the devaluation of the Kenya shilling. Although the latest Trust account shows a modest increase in the shilling market value of investments held over costs, continuing high inflation in Kenya is dissipating the Trust in dollar terms because its assets are in shilling-denominated debt securities. This dissipation will occur without even the benefit of meeting the principal objectives. Unless USAID can redirect trust investments toward equity participation in export-oriented projects, the Trust is likely to remain a rapidly depleting asset in dollar terms.

E. Principal Recommendations

The evaluation team recommends that USAID discontinue the IPS and KEM components of the Program at their present expiration dates if the relationships, as presently delineated in the Trust Agreement, cannot be fundamentally restructured. If USAID is able to restructure the role of IPS and KEM according to information learned thus far in the Program so that its social and economic goals are furthered, the evaluation team recommends that USAID do so. Recommendations on this issue appear in Sections IV and V.

F. Lessons Learned

1. To properly evaluate any project, its intrinsic nature must be established. The focus of this Program is on creating sources of "venture capital" in Kenya. In 1986 when the Program was designed, venture capital in developing countries was embryonic, and as of yet there appears to have been little success in Africa to advance venture capital. Given these conditions and the lack of prior financial, managerial, and technical experience of the designers and administrators of the Program, the intrinsic nature of this project should be classified as experimental. Therefore, a restatement of the purpose of the Program "To *discover* and to *strengthen* institutions that can improve Kenya's business environment..." would help to clarify its objectives.

2. Programs designed to fill institutional gaps in the financial markets must by definition be viewed as experimental. Therefore, the evaluation of the Program reflects both its experimental nature and the fact that as an experiment it cannot have preset, quantitative, anticipated results. Additionally, rather than focusing on failure/success questions, the evaluation should stress the design and implementation of the experiment, and the meaning of the results. Negative results can be almost as important as positive ones.

3. Economic need in Kenya or elsewhere must not be confused with commercial markets—the later will always be much smaller. If Kenyan companies do not perceive a need for a commercial equity capital market, or are unwilling to accept the constraints involved in obtaining equity capital, no amount of donor support will be sufficient to create a market. USAID can correct flaws in implementing its Program and can support fledgling venture capital institutions, but it cannot create a market where none exists.

SECTION I
INTRODUCTION

A. Purposes

The purpose of the Kenya Trust for Enterprise Development program (the Program) as stated in the U.S. Agency for International Development (USAID) Project Authorization dated May 8, 1987 is "[t]o strengthen institutions that can improve Kenya's business environment and to encourage growth of businesses directly through the financial and advisory assistance those institutions provide."

Specifically, the equity capital component of this Program was aimed at both institutional change and at supplying direct benefits. On the institutional side USAID's assistance was expected to lead to the establishment of a new equity capital company in Kenya, the introduction of equity investing through an intermediary, improvements in the operation of the equity capital market, and increases in the number of skilled Kenyans in these areas. Direct benefits from the equity capital component were expected to include the creation, expansion and/or restructuring of between 25 and 40 businesses, with increases in total new investment, employment, output, foreign exchange and tax revenue.

The purpose of this evaluation, as stated in the Scope of Work (see below and Annex H), is "to provide USAID/Kenya with an independent assessment of the progress made so far in meeting the objectives for setting up and funding the respective institutions under the Trust."

B. Methodology

The lists of persons interviewed, documents scanned, and files read are attached as Annexes A and B. In most cases, the evaluator conducted his interviews one-on-one without the presence of outside parties. Each interviewee was reassured that his/her comments would not be directly attributed except where they specifically related to a contractual agreement the interviewee had with USAID. In this manner, the evaluation team obtained the most candid commentary possible.

Despite the sensitive nature of the assignment, the team was pleased by the universal cooperation by all designated interviewees, not one of whom declined to meet with the team or failed to provide the information requested. The interviews were not intended to challenge the performance or integrity of the interviewees, although in addressing the key participants in the Program some questions undoubtedly bore on such matters. Emphasis was placed on learning what did happen as it bears on the future rather than what was supposed to happen.

C. Scope of Work

Under the Scope of Work, described in Private Enterprise Development (PED) Project No. 615-0238, the evaluation team's primary objectives in this evaluation were to:

- Determine how successfully the equity component is contributing to meeting the goals of the private enterprise project and equity ccmponents. In so doing the evaluator will analyze the impact of the loans made under the project on the Kenyan businesses as well as the Kenyan equity market.

- Determine whether the Trust arrangement is a viable instrument for the provision of equity capital, and whether it should be repeated in future USAID projects.

- Recommend changes in implementation of the current project.

- Provide general lessons learned for equity capital as a development tool in Kenya.

SECTION II
THE MODEL

This section presents a brief outline of the organizational structure of the Program as originally conceived, with its four operating partners—USAID, the Trustee, IPS, and KEM. The Program set forth in the Project Paper called for USAID to provide financial assistance to two private institutions: one existing, Industrial Promotion Services Co. Ltd. (IPS), and one new, Kenya Equity Management (KEM). Financial assistance by USAID was to be in the form of a grant channeled through a Trust Fund (the Trust) managed by the Standard Chartered Bank Ltd. (the Trustee). The Trust Agreement was signed June 30, 1987. The Trust is intended to last 18 years, following which all assets will revert to the Kenyan government.

Standard Chartered Bank was to perform three functions. First, it was to serve as the Trustee for a Trust to be set up with grant funds received from USAID for purposes of the Program. It was to make Trust Loans to IPS and to KEC Portfolio Companies, and to pay management fees to IPS and KEM as called for in their agreements with USAID. Second, the Trustee was to reinvest interest and principal repayments from Trust Loans until they are needed to fund additional Program outflows. Third, the Trustee was asked in vague terms to ensure that all loans, especially those to KEC Portfolio Companies, are in conformity with USAID guidelines. All three functions came to rest in the area of the Bank that normally manages the investment of trust funds in liquid securities.

The Management Agreement between USAID and IPS, signed January 28, 1988, called for the expansion of the "venture capital" activities which IPS had been successfully pursuing for more than 25 years. IPS was entitled to borrow from the Trust up to $3 million as required (Trust Loans), to fund "Subloans" IPS made to and in conjunction with its equity investment in private Kenyan companies (its Portfolio Companies). The Trust Loans, denominated in Kenya shillings, carry an annual interest rate 5 percent below the local bank lending rate so that Subloans can be made at prevailing lending rates, effectively leaving IPS with a 5 percent spread—or fee—for its efforts on behalf of the Program. The maximum maturity of the Trust Loans is eight years from initial takedown, with up to two years' grace period prior to commencement of principal repayments. The principal amount of the Trust Loans and the Subloans was not to exceed three times the amount of IPS' equity investment (about $1 million in total) or the total equity of the Sub-borrower.

IPS was also to receive from the Trust an annual technical assistance grant of $275,000 for a period of three years to permit expansion of its in-house project development capabilities.

KEM was a new entity established in Kenya by Equator Advisory Services Limited (Equator) and International Resources Group Ltd. (IRG) to serve as the management company for a new Kenyan venture capital fund, Kenya Equity Capital Ltd. (KEC). USAID supported KEM/KEC by providing through the Trust a $4 million loan facility, denominated in Kenya shillings, from which KEM could direct loans (Trust Loans) at prevailing local bank lending rates to companies in which KEC made equity investment (KEC's Portfolio Companies). Neither KEM nor KEC was liable for the repayment of these Trust Loans, as the Trust has a relationship with KEM by which it lends directly to the Portfolio Companies. The financial terms of these Trust Loans was to be virtually identical with those to IPS, with the exception that the principal amount of these Trust Loans was not to exceed 1.5 times the equity invested therein by KEC (which was to be about $2.67 million in total).

KEM was to receive an annual fee from the Trust of 3 percent of the principal amount of Trust Loans committed and projected, as well as operating expense subsidies equal to $1.35 million over three years (the company has actually received a total of $2.19 million to date). The Implementation Agreement for Trust Loans was signed by the Trustee and KEM on February 13, 1989.

To fund all Trust Loans and the fees due IPS and KEM, USAID has made a grant of $9.644 million to the Trust to date. Payments on Trust Loans from IPS and from Portfolio Companies as well as additional amounts that may be granted to the Trust by USAID, may be used during the life of the Trust for the further support of IPS and KEM operations, as well as for other projects that meet the purposes of the Trust.

SECTION III
VIABILITY OF THE EQUITY CAPITAL MODEL

The Program was modeled after a description of U.S. venture capital contained in a USAID-financed study, "Kenya Equity Finance Study," completed in January 1986 by IRG and Price Waterhouse (the '86 Report). IRG joined Equator in establishing KEM. The '86 Report presented only general parameters for successful venture capital investments; it was an insufficient blueprint for the establishment of a venture capital company in Kenya. *Significant findings and conclusions in this and subsequent sections appear in italics.*

A. Features Basic to Venture Capital Projects

Venture capital is equity—not secured debt. Debt is a loan agreement that is a liability of the firm. It is an obligation to repay a specified amount at a specified time, based on terms agreed upon by the parties. If the enterprise that borrows the funds prospers, the grantor of credit is limited to repayment of the amount of loan that was contracted. Equity is the basic risk capital of a firm. It is exposed to all of the risks involved in ownership, and provides a cushion or shield for the liabilities, loans and payables, that are senior to it.

Investment in secured debt is risk averse, whereas venture capitalists seek significant returns on investment in line with the acceptable risk of losing one's entire equity investment. Venture capital business involves building and financing successful self-sustaining companies, often from scratch. Venture capital investments are most commonly made in situations where the timing of future revenues and profits growth are particularly difficult to predict. Hence the need to avoid incurring obligations with fixed charges (e.g., interest and principal repayments that may fall due when the borrower is not yet in a position to repay). A venture capitalist company expects to liquidate each investment in its Portfolio in five to seven years, the goal being to generate a substantial return on the investment, commensurate with the risk involved, during that time.

Assuming a market for venture capital is identified, the following are some features basic to venture capital projects:

1. *The natural evolution of venture capital is from larger, more mature private companies toward smaller companies, including start-ups.* Venture capital should be defined in relation to the current risk/reward parameters of a given capital market. Japan has a venture capital market about one-quarter the size of and far less developed than the U.S. market, and the emphasis of its 55 active venture capital funds is almost exclusively on investment in mature private companies. The same is true in developing countries throughout Southeast Asia. In Kenya, where there is modest institutional interest in equity investing and even less beyond "blue chip" stocks listed on the Nairobi stock exchange, equity investing in relatively mature private companies is the next logical step in the development of the Kenyan equity markets. Investment companies may accept less mature

investment opportunities, but only after they have developed a sound base among larger private companies.

2. *Venture capitalists are highly specialized professionals and are usually supported by a managed fund equal to at least $8-10 million per professional.* Donor efforts to support private equity investing in developing countries in Southeast Asia have found that to attract proven managers a fund needs at least $10-15 million with donor subsidies of the overhead, and that a minimum of $25 million under management is needed before such funds can generate enough management fees to obviate the need for donor subsidies. By these standards, the Program in Kenya did not have sufficient capital to support even one professional venture capitalist.

3. *There are four steps in assembling a management team, and because each relies on the accomplishment of the previous it is almost impossible to do these tasks simultaneously.* Step 1 is to assemble a management team with a track record. Step 2 is for the management team to back its belief in its own abilities by subscribing to up to 10 percent of the desired size of the fund. Step 3 is to raise at least a minimum size for the fund and have a first closing. Step 4 is to open the doors and wait for prospective investees. Failure to complete these steps in order should lead to the suspension and reevaluation of the business activity. KEM failed to complete steps 1 and 2, yet tried to move ahead to steps 3 and 4. Failure to complete the initial steps contributed to its lack of success as a venture capital institution. IPS, in contrast, did accomplish all four steps.

4. *To attract outside institutional capital (donor and private) in developing countries, a fund manager must have a record of successful investing and should be prepared to back its investment judgment by subscribing to up to 10 percent of the total fund from its own resources.* IPS had a 25-year record of investing in Kenya and elsewhere in Africa and was willing to use its entire capital base to back its investment judgment. Neither KEM's corporate owners nor its initial project manager had experience as equity investors—nor were they willing to make a significant subscription to the capital needs of the fund. In addition, it takes time to generate institutional capital. U.S. venture capital projects often take a year to generate the necessary capital. KEM did not allow itself enough time to generate the necessary capital before diverting itself into other business activities.

5. *The time and effort needed to properly investigate, evaluate, negotiate, and bring added value to portfolio investments requires a minimum equity investment of about $500,000.* In the United States, this figure is probably at least $1 million per portfolio company. USAID set a target of $200,000 for IPS and $300,000 for KEM. KEM realized a profit of about 45 percent (very attractive percentage wise) on its equity investment (about $255,000) in Punchlines, a computer stationary company, after almost one year of preparation and 18 months of actual investment. This profit did not even cover KEM's overhead for one year. In contrast, IPS was and is able to cover its overhead from management fees and dividends on 22 investments made before the Program began and from similar income sources on the next six new Portfolio Companies that were subsequently added. Even with the advantages of this large seasoned Portfolio and its management contracts, IPS has now raised its minimum equity investment requirements to about

$200,000. According to IPS managements it "can not afford to do another small project such as Ukulime Tool."

Of IPS' six Portfolio Companies, the average equity investment is about $190,000, ranging from $280,000 to $52,000. IPS was able to operate with a substantially lower equity investment than was recommended because it is not functioning as a venture capital company, but as a holding company. As such, it is able to spread its management costs over a large Portfolio of companies from which it derives significant additional management fees. If IPS were to operate as a venture capitalist company this evaluation team believes that it would require a minimum equity investment of about $500,000. Of the five KEC Portfolio Companies, the average equity investment is $185,000, ranging between $295,000 and $21,000. Note that although KEM arranged the financing for a sixth company, Central Glass, KEC was not an investor.

6. *A minimum equity ownership of 30-40 percent is normally considered necessary to ensure a fund manager has sufficient influence over the management of a portfolio company.* In Kenya, however, it is not certain that this is sufficient because the minority rights of shareholders are relatively poorly protected. IPS reinforced its equity position by insisting on a management contract giving it the right to insert its own senior operating officers in each Portfolio Company. KEM has no such capability, and therefore has relatively little ability to impact either management or management policies, regardless of its minority shareholding.

7. *A successful venture capital operation requires a full-time, dedicated management team.* A venture capitalist must combine the mental approach of a principal (a personal equity investor) with the integrity of a fiduciary (someone who manages other people's money). The skills for succeeding as a venture capitalist are sufficiently unique that it is difficult to expect a venture capital operation to fill additional responsibilities as well. Fortunately, KEM's first managing director did dedicate himself exclusively to KEM affairs operating under the KEM name. IPS follows each of the strictures shown above, but is nevertheless seen by most outsiders as more linked to the Ismaili community. This may deter prospective investees from approaching the company.

8. *Effective management requires the direction of an experienced venture capitalist, almost always an expatriate (preferably with a tie to an overseas venture capital management company), and the support of a partner with extensive local market knowledge and contacts.* Whether KEM's recent establishment of a local tie with Lonrho Plc will fill this local knowledge quotient and whether it can attract an experienced equity manager remains to be seen. IPS has continued to benefit from the international IPS network of companies from which it has drawn continuously for management skills, market development, etc. The IPS portion of the Program also benefited from the long-term experience of IPS, its shareholders and friends in Kenya.

9. *It is common for new venture capital firms to take at least nine months to complete their first investment.* Some ultimately very successful firms have taken as long as 18 months to complete their first investments. Adequate investigation, evaluation, and

negotiation of each investment makes it unlikely that one investment manager can close more than one or two investments a year. At this pace there is little time left to monitor existing investments. In larger venture capital firms, it is unusual for one investment manager to cover more than four to five investments at once, existing and in progress. KEM's unrealistic projections concerning the number and size of investments that could be undertaken in a given period of time and with a given amount of available resources led to its failure to achieve its investment goals. In addition, it was unreasonable for KEM's managing director to believe he alone was capable of investigating, evaluating, negotiating, and monitoring investments.

10. *To satisfy financial backers, venture capital requires an ability to liquidate investments with reasonable certainty within five to seven years.* Normally the most visible potential exit is the public stock market. The other is the sale of one's shares to another company. A third method is a sale to the other owners of the portfolio company, including management. In Kenya, the stock market is insufficiently developed to convince knowledgeable investors that they can rely on it as the sole vehicle for the liquidation of their investments. The second alternative is usually only attractive for more mature companies. As KEM and IPS experienced, the only exit for small companies is sale to management, and no investor likes to contemplate having only one buyer when it is time to liquidate the investment. This is another reason both KEM and IPS have understandably gravitated toward larger, more mature companies.

B. The Viability of a Venture Capital Project in Kenya

There is sufficient evidence that the environment is not favorable for a venture capital experiment in Kenya. The finding is not that there is no market for venture capital, but that the market is not mature enough to support a firm or activities devoted primarily to venture capital investments—even with the level of support USAID provided in the past. USAID may wish to continue supporting this project in Kenya, as there are potential benefits for all of the parties. If it does, the Program must be fundamentally restructured, taking into account lessons learned thus far.

Each of the principal players in the Kenyan commercial market has unique reasons for not supporting the development of a market for venture capital at this time:

Issuers/Companies Seeking Investors

- There are too few small- and medium-sized companies that appreciate the risks of taking on too much debt, or the benefits of establishing a larger equity base (especially if this involves taking in outside shareholders). In immature markets such as Kenya's, the concept of giving up a share of future profits for an indefinite period to outside investors is alien.

- The alternative to equity is debt. If there is no debt, and one has to depend only on one's own equity, a project or an expansion may not go further.

- As in a number of other developing countries, maintenance of two sets of financial books, one for the tax collectors and one for internal use (double bookkeeping) is standard practice. The fear that information about their financial dealings might be exposed inhibits companies from sharing financial information with outside investors.

- Interest rates on short-term Kenyan government obligations have decreased from a high of 85 percent at the beginning of the year to under 50 percent, with most anticipating a bottom at about 40 percent. At the same time, inflation has not abated, providing the possibility of more negative interest rate lending in the future. This discourages companies from turning to equity financing.

Investors

- The perception exists that there is a dearth of advantageous investment opportunities. The '86 Report noted that "Many of those [prospective buyers] interviewed felt that there are few entrepreneurs and fewer sound proposals in all but a few areas of industry and agribusiness—those which, because of well understood local markets and relatively uncomplicated production processes, African entrepreneurs feel comfortable entering."

- Given the pervasive practice of double bookkeeping, investors are unwilling to invest in companies whose financial situation cannot be definitively ascertained.

- Insufficiencies in market data and management, lack of prior experience, and absolute project size make concentration on smaller investments unprofitable. These investments take longer to investigate, negotiate, and monitor than they do with larger companies. The payoff at the end, even where attractive or on a percentage basis, is too small in absolute terms and/or too slow to cover operating overheads and provide adequate returns to shareholders.

- Although not an issue presently facing the investors given the relatively underdeveloped market, the weakness of the local stock market and lack of a well-defined means to liquidate investments could be a reason in the future for disinterest in a commercial venture capital market. Most investors see the Kenyan stockmarket as lacking in both new issues and trading in the after-market.

Management/Intermediaries

- There is usually a buildup of ad-hoc local activity by financial institutions in financial markets prior to a specific commitment of human and financial resources. Even in developing countries, the common wisdom is that there is greater risk in being ahead of a financial market than in being somewhat behind.

- Given the aversion of companies to share financial information with outside parties, venture capitalists are unable to obtain information critical to their ability to bring added value to their investments, which is their primary role and the one that sets them apart from other types of investors.

Although by sound financial standards Kenyan companies generally have too much debt and too little equity, it will be impossible to develop a commercial market for venture capital if companies do not perceive the need for it in Kenya today. Although donor financing can accelerate the creation of new financial institutions on the leading edge of the market, it cannot create a venture capital equity market where none exists.

To illustrate this situation, Kenya by African standards is still considered a good place to lend. Commercial banks and pension plans are often active lenders to private companies, thereby fueling the propensity toward debt and away from a market for private venture capital. In recent years, even small Kenyan companies have been able to borrow locally on a short-term basis at negative interest rates—i.e., at rates that are lower than the prevailing rate of inflation. Only recently has the government taken measures to deter borrowing by driving up short-term interest rates through its own borrowings. Although there continues to be a strong preference for loans to meet expansion needs, higher borrowing costs may in time increase receptivity to outside equity.

The weakening of the Kenyan economy over the past three years has meant a decrease in attractive investment opportunities for both IPS and KEM and has negatively impacted the KEC Portfolio Companies. This weakness has been offset to some degree by decreases in corporate taxes, lifting of import licenses, freeing up of export revenues, and most recently the convertibility of the Kenya shilling. Nonetheless, KEM itself is a very small presence in the Kenyan market as a provider and arranger of private debt and equity and as such these economic changes do not substantially affect the market.

With respect to generating transactions, venture capital investing in smaller companies is not a commercially viable business in Kenya today. Both KEM and IPS are tending toward larger projects, which in turn typically have greater impact on employment, output, etc., per dollar spent. Nonetheless, because there is so little institutional equity available to private companies in Kenya, even investments in larger companies and projects are unlikely, in the near future, to be in competition with the principal markets of financial investors.

Investor activities have been strengthened by new schemes, some used by KEM, which allow insurance companies to invest in equity. These involve new legal structures, rather than public shareholdership. The commercial banks are expanding slightly their private lending and equity activities in response to projects organized by others. Barclay's also has a one-man investment banking arm focused on arranging initial public offerings.

Additionally, there does seem to be a growing appetite for equity and debt investment in larger export-oriented projects such as Windsor and, eventually, Central Glass and Allpack. Some investors are seeking to balance their portfolios through longer-term investments with the potential to outstrip the rate of local inflation—such as equity in export-related projects. Project organizers have recently suffered from the skyrocketing costs of short-term borrowings and the devaluation of the Kenya shilling. There is also the prospect that privatization may provide a market for private equity investors.

Despite the fact that the PED goals of the USAID program were met and that some initial interest in an equity capital market has emerged, it is the opinion of the evaluation team that the results of the Program do not merit a continuation of the venture capital experiment at this time. Although KEM and IPS investment activities have involved local debt and equity investors on a project basis, the evaluation team was unable to identify a single case where this Program either displaced or served as an example for the creation of existing or new equity or lending activity in Kenya. A careful review of the experiences of IPS and KEM in private equity markets, as detailed in Sections IV and V, is probably the most objective proof that there is an insufficient market in Kenya today to support a private, venture capital type, investment company.

The team is aware that USAID and possibly other donors are considering support for the establishment of regional venture capital funds. Because venture capital requires close monitoring of Portfolio investments (i.e., a local presence), a regional set up would appear to compound the difficulties of venture capital in Africa without providing any benefits. For example, most venture capital funds in the U.S. concentrate their investments within a 200 mile radius of their headquarters until they are large enough to bear the cost of setting up additional offices.

The lack of an adequate market, adequate management capabilities, and sufficient capital were all problems facing the Program from the beginning. This should have prompted a reevaluation of the Program. To appreciate how these and other lessons apply to the KEM and IPS experiences, the next sections present chronological evaluations of the actual performances of the two organizations in meeting the original goals set out for each in the Equity Capital Component of the Program. These evaluations are not designed as audits, legal commentaries or even complete historical records. Only data pertinent to the purpose of this evaluation have been included.

To illustrate the unpredictability of venture capital in Kenya, even for non-technology businesses, attached as Annex G is a letter from a restaurant in which KEC invested.

SECTION IV
THE IPS COMPONENT

A. Design

IPS is a holding company, not a venture capital institution, and has the ability to solve management, financial, and operating problems through direct intervention in its Portfolio Companies at any time. Essentially IPS manages its Portfolio Companies. IPS sought venture capital status in 1983 after having been in business for 25 years, but it was not redesigned to better fulfill the goals of the Program. The only significant change it made after becoming a venture capital company was that it took minority positions, rather than majority positions, in Portfolio Companies. Recognizing the weakness, especially in Kenya, of a minority shareholding, IPS required each of its Portfolio Companies thereafter to sign a management agreement with it with no expiration date. In 30 years of business, IPS has divested itself effectively of less than 25 percent of its businesses. This is not typical of venture capital firms that seek to generate a substantial return on investments and to liquidate them within five to seven years. It is a reflection of the weakness of the local stock market to provide investment liquidity and of IPS' propensity to build on existing investments rather than making new ones. This has clearly been a sound policy for IPS.

B. Management Development

IPS directly manages its Portfolio Companies, which is one of the reasons why it should be considered a holding company rather than a venture capital company. The breadth of control contained in the management agreements between IPS and its Portfolio Companies gives IPS virtually the same control it would have as a majority shareholder, and clearly more control than is normal for venture capital investors. It exercises this authority by placing at least one, and sometimes four, senior operating officers in each of its Portfolio Companies. IPS has a well-developed internal and external management style.

IPS could make greater efforts to strengthen the management skills of indigenous Kenyans—especially Africans—in the day-to-day management of companies, a stated USAID objective. Management is dominated by persons of Asian descent, particularly those from the Ismaili community. Although it is illegal in Kenya to differentiate between Kenyans of different origins, USAID encouraged IPS to train and integrate more African Kenyans into its management. An internal USAID memo from the assistant director to the director in 1987 noted "...a key issue which is not new to you, is the extent to which IPS is successful in extending credit, staff development and technical assistance to indigenous Kenyans." The establishment of two project teams with African professionals was the only documented goal for management development. Although this goal was reportedly met, it appears that more could be done to strengthen the role of African Kenyans.

IPS has made efforts to hire more Africans, or to "indigenize" its staff. At the beginning, IPS had two expatriate managers overseeing the work of two non-African project directors. With the financial assistance of USAID under the Program, IPS instituted a training program, and today there is one expatriate manager, one African manager, and two African project directors. These two teams are responsible for the initial screening of investment proposals, investigations, and evaluations Their recommendations are made to the investment committee, which was and is composed of one African Kenyan and three Ismailies. The IPS investment committee manages Portfolio Companies on a day-to-day basis.

Nonetheless, IPS hirees have largely not progressed beyond middle management levels. In this case, greater numbers of African managers do not indicate a correspondingly greater influence of African managers on IPS activities.

C. Capital Mobilization

The evaluation team found that financial institutions, including banks and insurance companies, are more than willing to lend to IPS projects because of its strong track record. Beyond its own resources, IPS relies heavily on two Ismaili-related local financial institutions, Jubilee Insurance and Diamond Trust, for additional funding. The International Finance Corporation (IFC) has also been a co-equity investor with IPS since 1982, renewing its pledge every two years. IFC has invested with IPS in several other African countries and is pleased with the results of these joint endeavors. Although IFC has expressed concern that IPS has shown only minor interest in liquidating some of its more mature investments, it recently agreed to renew its arrangement with IPS in Kenya through December 1995.

IFC compensates IPS in three ways: (1) a one-time appraisal fee of 3 percent of IFC's equity in each project is paid as IFC invests, (2) an annual management fee equal to 2.5 percent of IFC's investment, and (3) an incentive fee consisting of 10 percent of net capital appreciation (received in shillings upon liquidation of an investment) and 20 percent of net capital appreciation (in dollars), net in both cases meaning after deducting IFC's initial investment. IFC is also a 15 percent shareholder in IPS.

IPS has hinted that IFC's conservative investment approach has discouraged it from pursuing certain projects, especially smaller ones. Of the $1.5 million IFC equity line of credit, $800,000 still has not been used. It is unclear from the IPS-IFC agreement whether IPS could proceed with investments on its own without IFC approval. Since USAID will only lend where both IFC and IPS are not equity investors, this may not be a particularly relevant point. IFC has organized additional corporate equity and debt financing from other local sources on a project-by-project basis.

D. Transaction Flow

IPS has found the task of finding new investment opportunities to be harder than anticipated under the Program. This difficulty may be due in part to the perception in the Kenyan financial community that IPS as an investment company is not open to non-Ismaili *investments.* IPS has turned away from import substitution projects, which were its original focus, to an almost exclusive focus on export projects. This, in turn, has led it to invest in more agro-industrial projects. This is fortunate, given the weakness of the Kenyan economy in the last two to three years and the sharp devaluation of the Kenya shilling.

IPS has also sought investment opportunities among companies in financial trouble. Four of its six Portfolio Companies have been in or near receivership prior to IPS' investment. Its pool of managers and network of overseas offices able to locate new export markets provides IPS with the nonfinancial resources needed to accept nontraditional venture capital investments.

IPS has developed commercial relationships between its Portfolio Companies rather than continuously seek investments in new commercial areas. Not only has this strengthened its Portfolio, but the close relationships allow IPS more flexibility in using its managers. Allpack and Novaskins are examples of investments where the tie to prior IPS investments was an important criterion.

Only two of its six investments have been made with non-Ismaili partners. Institutions interviewed had tremendous respect for IPS' management skills, but would not recommend clients to IPS due to the perception that it is not receptive to non-Ismaili investments.

Fees should not be an impediment to developing attractive investment opportunities. In addition to its 5 percent fee on Trust Loans, IPS also charges each Portfolio Company a front-end financing fee in the range of $10,000-30,000, which covers bringing in other equity investors and lenders. In addition, IPS charges an annual management fee of about 1 percent of gross sales to each of its Portfolio Companies, plus manager salaries. This fee is waived or reduced until a Portfolio Company is profitable, and covers IPS' overseas market development efforts, financial planning, equipment sourcing (used and new) from overseas, and other forms of assistance. Frigoken is an exception, as it currently pays IPS a management fee of 2.5 percent of gross sales to handle all export sales that represent 100 percent of Frigoken's current output.

E. Due Diligence and Transaction Structuring

IPS has acted as a principal in its interactions with its Portfolio Companies, and has pursued a policy of due diligence in both its financing approach and financing structure. It has assumed the role of a principal, meaning that it has shown greater concern and direct involvement in its investments than an intermediary or promoter of investments, and has used its own funds in its investments. The evaluation team reviewed certain of the investment proposals prepared by IPS project teams for its investment committee. Emphasis was on markets and managements first, with financing details positioned to complement the investment proposals. The financing approach reflected the due diligence approach and was relatively simple—debt plus equity—with virtually no convertible securities, options, warrants, etc. A company acting under conditions of due diligence places great emphasis on the suitability of investments it makes, to ensure that its investments responsibly relate to the investment objectives and financial situations of its customers and that in all matters regarding its investments the Company acts with skill, care, and diligence.

IPS has not had problems operating within the parameters of Trust Loans. Because of its own equity and strong institutional backing, IPS has found the USAID debt facility more useful than equity, because of longer-term maturities and the denomination in Kenya shillings. The Trust agreement permits IPS to vary the maturity of a Subloan from that of its related Trust Loan. IPS has taken advantage of this provision by placing a maximum maturity of seven years on Subloans, compared to the eight-year maturity on its Trust Loans. IPS indicates this permits some Subloan rescheduling within the eight-year period, should one of its Portfolio Companies require such assistance—and one apparently has. It also has structured several Subloans without grace periods, thus providing IPS with the use of such borrowed funds at significantly below-market interest rates until they are needed to repay the Trust Loan.

On the following page is an illustration (without tax effects) of the cash flow advantages to IPS in this arrangement. This example assumes a $420,000 Trust Loan to IPS for Subloans to Company A.

For a full review of IPS' Portfolio, please refer to Annex C.

F. Monitoring and Value Added

IPS surpasses typical monitoring by venture capital institutions and actually manages its Portfolio Companies. "Monitoring" of Portfolio Companies is the usual practice of venture capitalists. This typically implies that the venture capital institution supplements the management of its investments on an interim basis to fill gaps in the management's knowledge, experience, and capabilities. To safeguard itself against its desires for the direction of each Portfolio Company being miscommunicated or not received at all, IPS' team actually manages its Portfolio Companies. Based on discussions with each Portfolio Company being miscommunicated or not received at all, IPS not only fills certain functional management needs but also provides assistance in areas where only IPS is capable. This substantially increases the value IPS adds to its Portfolio Companies.

Overseas market development, both in Africa and Europe, is an important contribution made by IPS to all of its Portfolio Companies except Ukulima Tool, and that may change soon. IPS did help Ukulima source used equipment from offshore, which enabled it to modernize its production line at a fraction of the cost of new equipment.

Tight financial controls imposed by IPS are also important contributions. Premier Refrigeration, the only Portfolio Company in which IPS has sold its equity interest, noted that it misses IPS' highly disciplined management approach without which Premier Refrigeration has reverted to cutting corners, usually to its detriment.

Table 1: IPS Debt-Service Cash Flow Analysis

Year	1	2	3	4	5	6	7	8
Trust Loan								
Interest 15%	63.0	63.0	57.8	47.3	36.8	26.3	15.8	5.3
Principal	Grace Period		70	70	70	70	70	70
Payments to Trustee	63.0	63.0	127.8	117.3	106.8	96.3	85.8	75.3
Company A Subloan								
Interest 20%*	78	66	54	42	30	18	6	
Principal	60	60	60	60	39	60	60	
IPS Receives	138	126	114	102	90	78	66	
Net Cash Flow	75	63	(13.8)	(15.3)	(16.8)	(18.3)	(19.8)	(75.3)
Earnings on Positive Cash Balance 20%	7.5	22.8	32.3	35.8	41.5	44.6	49.7	50.1
Cumulative	82.5	168.3	186.8	207.3	232	258.2	288.1	262.9

Note: Before the end of the grace period, IPS has a positive cash balance in excess of its minimum required equity investment in Company A. It could be said that IPS obtained an equity interest in a new Portfolio Company without having to put up any cash. By taking advantage of the difference in terms allowed between Trust Loans and Subloans, IPS is able to realize additional compensation beyond that anticipated in its agreement with AID. A more equitable arrangement is suggested in Section I below, Recommendations.

* Includes the 5 percent fee USAID originally anticipated.

G. USAID Interaction

IPS believed it was receiving only financial assistance from USAID and did not anticipate or receive any input into project selection or operating methods. Since the inception of the Program, there has been little interaction between USAID and IPS. Although USAID set goals and supported IPS through an influx of funds, it did not sufficiently monitor IPS' use of the funds or its activities. USAID neither asked for nor received many reports on the operation and documentation of its Program. IPS has never provided quarterly reports—nor been asked for one, as suggested in the IPS/USAID agreement.

Beyond the security of IPS as the borrower from the Trust, the Trust received IPS shares in the Sub-borrowers as collateral. USAID should revise its procedures to retain in its files copies of all loan agreements in connection with each transaction and to receive such financial statements from the Sub-borrowers as IPS is entitled to receive as a shareholder. The evaluation team found the USAID files lacked this basic information, although the Trust agreement gives USAID the right to request it.

H. Trustee Interaction

The Trustee has high respect for IPS' management skills and the way it has honored the spirit and the letter of the Trust Agreement, and therefore there have been few occasions for interaction between the Trustee and IPS. Trust Loans are issued directly to IPS and not to its Portfolio Companies. This is in contrast to KEM's arrangement, in which Trust loans are issued directly to KEC's Portfolio Companies. IPS, for its part, does not understand why a Trust arrangement is necessary—why not have USAID make Trust Loans directly to IPS as Portfolio projects arise? IPS voiced a minor concern that it is taking the Trustee more than 60 days to process its loan applications, but it adds that other lenders to particular projects are taking even longer, so the delay has not imposed a serious inconvenience to date.

Despite Trustee confidence in IPS abilities, the Trustee needs to maintain a schedule of payments due under the trust loan as compared to the schedule of payments received by IPS under each related subloan. If there are differences in funds flows, USAID and IPS should discuss how to handle the income or cost resulting from such discrepancies.

Additionally, the Trustee is having difficulty meeting the second of its three responsibilities: to reinvest the reflows from Trust Loans. In reinvesting the reflows from Trust Loans, the Trustee has not been able to keep up with the devaluation of the Kenya shilling. Given continuing high inflation in Kenya, Trust assets are also being dissipated in dollar terms because they are invested only in shilling-denominated debt securities. Although the latest Trust account shows a modest increase in the shilling market value of investments held over costs, continuing high inflation in Kenya is dissipating the Trust in dollar terms because its assets are in shilling-denominated debt securities. This dissipation will occur without even the benefit of meeting the principal objectives. Unless USAID can redirect trust investments toward equity participation in export-oriented projects, the Trust is likely to remain a rapidly depleting asset in dollar terms.

I. Recommendations

The evaluation team envisions two courses of action for USAID. It can either discontinue the IPS component of the Program at its present expiration date or work with IPS to fundamentally reevaluate USAID's goals and restructure the role of IPS to meet them.

Discontinuation of program. USAID, unlike the IFC, is not primarily a lender or equity investor and must review its programs in terms of broader social and economic development goals. If USAID were to discontinue the Program with IPS we do not believe IPS would close down or experience more than a minor slowdown in its investment activities.

Reevaluation of program. In an area where good commercial management is unable to satisfy the needs of medium-sized firms, USAID has a good relationship with an important source of such skills, provided it can be moved toward certain social objectives. Nevertheless, because of the serious questions raised about the market for venture capital in

Kenya today, it would be a mistake to push IPS into more of a pure venture capital mode. IPS is a success as a hands-on, well managed holding company. USAID could pursue this avenue with IPS. Additionally, it appears that IPS derives greater value in its investment activities from USAID's loan facility than from USAID's direct subsidization of IPS' operating overhead, although it would obviously like both income sources.

IPS would like the relationship with USAID to continue, with minor adjustments. Having borrowed all but about $300,000 of its original $3 million borrowing facility from the Trust, IPS has asked USAID for permission to borrow against the reflows (i.e., repayments of the Trust Loans). IPS has also requested that the "market interest rate" it is expected to charge in its Subloans be the average of the rates charged by the four leading commercial banks, rather than that charged only by the Trustee, which has been as much as 3 percent higher than the other banks. Given IPS' benefits from USAID, restructuring the relationship between USAID and IPS is both possible and potentially beneficial to both.

Therefore, it is recommended that USAID consider a six-year extension (with modifications noted above) of its arrangement with IPS, providing the parties can agree to the following conditions. If they cannot, the evaluation team recommends that USAID discontinue the IPS component of the Program.

1. USAID and IPS should agree to cooperate on a subprogram to encourage more investments in African-owned businesses. In conjunction with this effort, USAID would co-sponsor with an existing non-Ismaili Kenyan consulting firm the development of a new service to assist medium-sized African-owned enterprises to assemble financing proposals for presentation to IPS. The firm would also represent its clients in negotiations with IPS, so as to assist the African company in obtaining a fair transaction. Too often local businesses that previously depended solely on their own capital have no experience arranging outside capital. With a separate consulting company representing only its interests, the African-owned company can be assured of professional packaging and presentation of its investment needs. Pure feasibility study work and basic business planning should remain the responsibility of the management of the African-owned company. The African Project Development Facility provides this type of assistance but does not feel IPS is a natural equity source for most of its clients.

Before formally accepting any assignment, the local consulting firm, USAID, and IPS would review in broad outline the nature of the proposed investment. This consultation should reasonably reassure all parties that if circumstances prove, after careful review, to be as initially represented, IPS will likely invest. Over time, the local consulting firm should come to be viewed as a friendly gateway to IPS and the more active presence of USAID will ensure a fair hearing for financing proposals.

2. Greater emphasis should be placed on training African and non-Asian managers for key assignments in the IPS structure. Without such a program, it is recommended that further direct operating subsidies cease. The program should be reviewed annually to ensure it continues to meet IPS and USAID objectives.

3. With reference to the earlier discussion in section H above, an equitable method to handle the difference in IPS cash flow between outflows to service its Trust Loans and inflows from Subloans should be implemented. The evaluation team suggests IPS sets aside any positive difference in a special account as against its potential liability in the event companies in its Portfolio default on Subloans. Income in this special account would be credited to USAID.

4. USAID and IPS should agree that IPS remain as an active board member of Sub-borrowers, whether or not IPS continues as a shareholder. This situation has already arisen in the case of Premier Refrigeration, where IPS sold its shareholding and yet both its Trust Loan and its Subloan remain in place. IPS is no longer on the Board of Premier Refrigeration, although the management would welcome its return.

In the event there is no renewal of the Trust agreement with IPS, the Trust Loans and Subloans will still be outstanding. As IPS is the borrower of first resort from the Trust, we do not view its equity ownership in Sub-borrowers to be a conflict of interest. Nevertheless, the recommendation above for the timely receipt of information on IPS and on its investments is important. In any event, the Trustee's responsibilities should be reduced to investment of reflows from Trust Loans and fee payments, if any, to IPS as may be directed by USAID.

SECTION V
THE KEM COMPONENT

A. Design

KEM was established to operate as a management company for KEC. However, it was initiated with insufficient management and equity capital, without historic ties to the Kenyan business community, and with a local market unfavorable to venture capital, all contributing to its lack of success as a venture capital institution. In actuality, KEM is operating as a merchant banking company.

KEM was designed in a general outline in the '86 Report, regardless of whether there was sufficient demand for a venture capital market or institutional interest in funding such an organization. On August 4, 1986, USAID issued a request for proposals to a select group of primarily U.S.-based venture capital firms to "structure" a venture capital fund in Kenya. The request did not commit USAID to support any further program, nor prevent it from choosing the firm that did the initial structuring for the longer-term program. A USAID memo at the time indicated that this would not be a normal USAID technical assistance program. USAID was unable to combine its normal scope of work approach for projects with the actual institutional building needs and experimental nature of the project. Therefore, USAID's emphasis on long-term tasks was clearly not compatible with the objectives of the proposed new firm.

Of the 18 firms asked for proposals, only one replied—International Resources Group Ltd. (IRG), co-author of the '86 Report and the only pure consulting firm on the invitation list. Ultimately, to gain greater credibility, IRG contacted Equator Advisory Services Ltd., a Hartford, Connecticut-based institution providing largely specialized short-term debt financing—particularly related to trade—and consulting services to African financial institutions. USAID continued discussions with the IRG/Equator Group, encouraging them to put together a fund even without a USAID contract. An Equator memo indicated that it was interested in the project because it wished to demonstrate that it could organize and manage financial institutions in Africa, and this was a relatively inexpensive way for it to try.

In spite of its inability to obtain any firm commitments after eight months of effort, the Equator Group was optimistic that equity investments in KEC could be facilitated easily. USAID rewarded it with a six-month contract in July 1987 on the grounds that ". . . this is a new concept in Kenya, [and] it has proven more difficult to secure investment commitments than anticipated," and ". . . this was not the fault of the contractor." Finally, "no other firm could possibly appear at this time that would be qualified to carry out the scope of work."

The agreement called for the Equator Group to assemble a venture management team and to obtain initially a minimum $1.5 million commitment of equity capital from local institutional investors. The group was also expected to identify investment opportunities. Again, these objectives were to be accomplished without a firm USAID promise to go ahead. During the short-term contract, IRG/Equator did not accomplish the tasks set out for the initial engagement period. Nevertheless USAID signed a six-year agreement with them to proceed with the creation of the new fund in June 1988. In December 1990, under pressure from Equator and the other KEM shareholders, IRG's relationship with the Program terminated.

The conception and implementation of this preliminary agreement demonstrates a lack of understanding by the participants of the venture capital process. Unfortunately, the lack of experience and qualified management continue to burden the Program.

B. Management Development

KEM's management suffered from a lack of investment experience, hindering its ability to detect and correct flaws in the Program, and did not receive sufficient support from IRG, Equator, or USAID. Nonetheless, management was successful in generating merchant banking activities.

On being selected to manage KEM, Equator advertised for a managing director with the requisite venture capital skills, but reportedly drew no acceptable responses. Equator then chose a managing director lacking investment experience from inside the company. IRG posted no one to Kenya and did not pay its initial subscription to KEM.

Although KEM's managing director used creative methods, his lack of experience made it difficult for him to recognize from the beginning the inherent flaws in the Program and unrealistic Program projections as to how many projects could be undertaken in a given time period with the resources available. Additionally, he had no local partner or network of contacts to attract potential transactions. This further complicated his efforts to attract additional equity capital—a job that should have been completed before KEM began operations. Waiting to hire staff was another problem, as KEM's managing director could not possibly handle all of the work alone. For example, an operations director was not hired until three years into the Program although an ample staff budget existed and this should have been done in the first year.

Even as KEM's managing director was successful in attracting equity investment capital from local institutions, their disinclination to give KEM full discretion to invest their capital (KEM had no track record and almost no equity from its corporate backers) led the new investors to demand an equity share in the management company (KEM) rather than just a position in the capital company (KEC). This result, which could have been anticipated because it is more the rule than the exception for new venture capital firms, was not helpful to KEM.

As matters deteriorated during 1989 and 1990, KEM's managing director drew no assistance from either Equator, IRG, or USAID. USAID suggested as early as December 1990 that its loan facility should be reduced on the grounds the managing director was spending so much time raising capital that he did not have time to pursue transactions. Realizing that the objectives of the Program could not be met, KEM's managing director discovered a shorter route to generate income in the form of fees derived from putting financing packages together and selling them to outside investors and lenders. The fact that the managing director had success in generating fees from merchant banking activities, despite his lack of experience, may indicate a significant need in the Kenyan capital market for such services.

Starting in late 1990 and continuing into 1991, the managing director began developing a tie with the Kenya office of Lonrho Plc, the London-headquartered multinational conglomerate. Lonrho was interested in KEM as a merchant bank to raise capital for Lonrho ventures and others, and also felt that it might want to buy out KEC's Portfolio after KEC's Companies became larger. Each of these objectives contained the seeds of ultimate conflicts of interest with KEM/KEC's other shareholders.

Lonrho subscribed to purchase IRG's stake in KEM (repurchased earlier by Equator) at original cost on March 26, 1992. The related agreement provides that the managing director can be either an Equator or a Lonrho representative. No mention is made of the need to obtain USAID approval for any such management shift. Each party has a veto on any KEC investment. The lack of any perceivable advantage from the Equator connection led KEM's managing director in the summer of 1992 to make a personal bid to buy out Equator's interest in KEM, an offer Equator rejected.

By 1992, disillusionment came from all sides. The operations director and the managing director were replaced in October and December, respectively. In February 1993, Equator installed an interim KEM managing director with a commercial banking background. There remains the possibility of extending his tour in June 1994.

C. Capital Mobilization

Neither KEM's owners nor USAID provided KEM/KEC with the equity base needed to mobilize additional local institutional capital. To attract local capital, KEM was forced to give up as much as 75 percent of the compensation normally paid to venture capitalists for managing funds from outsiders and let the KEC investors become owners in KEM, thereby further cutting into the compensation and incentives due the day-to-day managers.

To fully utilize the $4 million USAID loan facility, KEM needed to obtain $2.667 million of equity capital to meet USAID's 1.5-to-1 ratio. KEM's managing director made clear in a letter to USAID in February 1987 that Equator was prepared only to "top up" investments made by larger institutions. The '86 Report spelled out the reluctance of Kenyan institutions to invest in equity. Despite this warning, the two sponsors of the new venture, KEM and USAID, put up almost no equity (approximately $80,000) in the first instance and debt in the second.

According to the '86 Report, it was felt that insurance companies would be the most logical source of capital for KEC because of a lack of alternative investment opportunities for them, and the presence of large capital surpluses. By the time this project began, however, the new Kenyan Insurance Act had gone into effect, discouraging insurance companies from investing in private companies. The '86 Report also noted that venture capital companies were unlikely to find capital except on a project-specific basis.

By providing debt financing, USAID created the basis for future conflicts of interest. Lenders look for security in terms of assets or cash flow. The rate of return is fixed and the loan is repaid according to a schedule. Equity investors are willing to accept a higher probability that they will lose their entire investment and that their rate of return is not fixed but supposedly will be far higher than would be the case had they made a loan. The financing conflict occurs when a loan is in default. The lender demands to be paid and may insist on liquidation of the company so as to recover as much of the principal and interest due on the loan as possible. Whereas the chances are reasonably good to recover part of the loan, the process often results in the equity investors losing their entire investment. The equity investor has a bias toward trying to keep the business open in the hopes of a turnaround, whereas the lender may correctly perceive that any delay will only cut into its possible recovery on its loan. Such a situation existed with the KEC investment in Gringos Restaurant during the two years in which it was in default. To avoid such conflicts, it is important that all investors share pro rata the amount of their capital investment in the same security, either equity or debt or a combination thereof.

To date, KEC has received total subscriptions of $717,000, or 27 percent of the amount needed to match the USAID loan facility. Of this amount, only about two-thirds was actually drawn down, even without taking into consideration the depreciated value of the Kenya shilling when such draw-downs take place. At no time was there a concept of a "blind pool" whereby KEC shareholders would grant KEM full discretion to invest KEC funds. Each KEC shareholder has the right on a project-by-project basis not to participate in an investment, and some have not always participated. The auditors recorded some confusion on whether the KEC capital subscription was even equity. Until the KEC 1992 annual report, such subscriptions were recorded as "shareholder loans." Approximately $17,500 additional was invested in KEM by the Equator Group to cover operating costs.

KEM arranged for an ECU 2 million (about $2.25 million) equity facility from the European Investment Bank (EIB) in May 1992. This is not part of KEC, but rather a separate facility tied to the availability of the USAID loan facility. The EIB facility is not discretionary; KEM must submit each investment proposal to EIB for approval within 45 days. EIB limits its investments to between $55,000 and $350,000 per transaction. KEC and USAID must invest *equity* or *quasi-equity* in amounts no less than invested by EIB. KEM is to be compensated by receiving 30 percent of any net capital appreciation on EIB's share of Portfolio investments. There is no annual management fee, but KEM is entitled to a 6 percent fee on each EIB equity investment, payable only out of the proceeds from dividends from or liquidations of Portfolio investments. The EIB arrangement does not provide KEM with immediate help in meeting overhead expenses. To date, EIB has invested only in the Central Glass project.

To resolve the KEC shareholder dispute with Equator, Lonrho recently purchased the interests of two of the three major KEC shareholders at a modest loss to the original shareholders. A new KEC shareholder agreement is being prepared.

D. Transaction Flow

Since investment capital was insufficient for larger projects, KEM focused on the fees it derived from arranging financing for projects to advance its financial objectives. By 1991 KEM was almost completely involved in merchant bank activities. Its shift to merchant banking activities effectively stopped the venture capital experiment. Additionally, KEM's practice of charging overall financing fees on all equity and debt invested probably impeded the involvement of potential investors.

Initially, KEM had no local partner and KEM's managing director had no experience in Kenya. This slowed efforts to find transactions and seriously inhibited KEM's ability to investigate them. Management and market checks were difficult. It became apparent that KEC shareholders did not like start-ups or agricultural projects since they are susceptible to government price controls. However, they did like tourism and financial services.

Available investment capital appeared too small to participate in larger projects, and smaller start-ups were taking an inordinate amount of time to find and qualify. After 18 months of work on the Ombi Rubber project introduced by USAID, the African owner turned down KEC's investment. Even the success of KEC's first investment in Punchlines brought the realization that a 45 percent return on an 18-month investment (as attractive as that might normally appear) was not sufficient to make KEM a success, because of the small size of the investment and the devaluation of the Kenya shilling. KEM's share of the capital appreciation on a dozen Punchlines at less than $90,000 total each was a noncommercial proposition.

As KEM began to look for larger, more mature companies in which to invest, it discovered that fees for arranging financing for projects were a far quicker and more remunerative way to meet its financial objectives with almost no capital risk. The shift in thinking was signaled to USAID by KEM's managing director as early as November 1988, when KEM wanted to play a pure investment banking role in the Silversand's Beach project. Three years later, a KEM strategy paper noted that "in making investments in 1992, we will be looking, on average, for higher value investments that will result in higher levels of both arrangement and management fees." There was no mention of the opportunity for capital appreciation. Similar opportunities were to be sought in Tanzania and Uganda.

In 1991, KEM became primarily a merchant bank, thus effectively ending its efforts to attract nondonor financing for KEC. KEM currently provides financial structuring and organizational advice to other equity and debt investors for a fee on a project-by-project basis. Between merchant banking fees and foreign exchange trading, KEM almost reached a break-even position without USAID subsidies.

USAID had been alerted in the '86 Report that arrangement fees were not uncommon in private financings, but the report recommended that IPS and KEM should bring in local merchant banks to perform such functions. However, it is questionable whether such institutions would have been acceptable to either IPS or KEM Portfolio Companies. USAID did focus to some degree on the question of fee income as early as March 1990, as noted in a memo from a regional legal advisor to the project director. The memo noted that KEM's up-front and ongoing advisory fees "are not warranted" as KEM was "already being well compensated to perform" and these fees "diluted the value of USAID's assistance."

However, the discussions between USAID and KEM seemed to focus on whether KEM was deriving undue enrichment from these fees, not whether KEM's business was undergoing a radical change in direction. The fee question was dropped by USAID when it was determined that KEM would have lost money in its first two years of operations had it not received USAID subsidies.

For KEM, shifting to merchant banking activities created additional strains. Venture capitalism is based on the premise that fund managers and subscribers maintain identical interests. Compensation derived from the management and investment of capital is shared according to pre-established guidelines. Not only did the pursuit of fee-based projects divert KEM from its goal of capital appreciation, but it created a basis for conflicts of interest with its financial backers. How could one be certain that a project was accepted on the basis of long-term growth potential rather than its ability to generate immediate fees shared by only KEM? This should have been a serious issue in the three Windsor projects. In the Central Glass project, KEC had no investment, although KEM collected substantial fees.

The diversion of the time spent by KEM's management is the most serious consequence of the move to merchant banking. However, there are also important financial consequences to be examined. USAID's support to KEM was far in excess of the normal commercial fees paid to fund managers. Usually, fund managers receive less for managing debt capital than for managing equity. Nevertheless, USAID conceded a 3 percent fee to KEM based on the loan capital committed. USAID made even larger payments to KEM to meet its overhead expenses. USAID fully compensated KEM for devoting its time to the success of the venture capital "pilot" project for Kenya. KEM, however, charged each Portfolio Company an additional 1 percent of the USAID loan. In addition, KEM on several projects charged an overall financing fee of 3 percent on all equity and debt capital invested—even on funds provided by the USAID loan. It was therefore being paid twice for the same service. Given the resistance by companies in developing countries to paying advisory fees, it would be reasonable to assume that demands for such fees discouraged some worthy investments. KEM and Equator should have appreciated the significance of the above and conferred with USAID on how to proceed in the fairest manner to all parties. For a full review of KEC's Portfolio, see Annex D.

With respect to generating transactions, the principal lesson is that venture capital investing in smaller companies is not a commercially viable business in Kenya today. Whether it can be blended into an organization with a broader set of operating parameters is addressed at the end of this section.

E. Due Diligence and Transaction Structuring

KEM did not adhere fully to the Trust Loan Agreement from its inception, and its efforts to supplement its own financial resources led to unsound financing. KEM functioned as an intermediary or promoter for its investments, rather than in the principal role IPS assumed, and did not use its own money in its investments. This affected its investment decisions as well as its credibility, since it reflects a minimized emphasis on due diligence in investments transactions.

Investing one's own funds (or those under one's management) for capital appreciation is a different business from arranging one-time financings with other people's money. The mind set, the disciplines, the risks, and the time horizon before payoff are all different. These businesses do not mix well, even in the United States. The most successful venture capital funds have been created by small groups of individuals with experience in investing their own capital and that of those who trust in their equity investing judgment. With rare exceptions, these are stand-alone businesses, not connected to other financial institutions. For this reason, neither investment bankers nor commercial bankers make particularly successful venture capitalists.

Since KEM needed larger projects to survive and larger projects were beyond the resources of KEC/USAID, KEM was obliged to go to the financial markets on a project-by-project basis to supplement its financial resources. Although on occasion the loan nature of USAID support helped attract transactions, it would have been preferable had the support been equity. KEM's financial decisions reflected that equity was in shorter supply than debt. KEM's attempts to obtain equity led to violations of the Trust loan agreement and to unsound financial decisions.

Because KEM was equity short, it eventually found a way in the Windsor transaction to "equitize" the USAID loan. KEM directed the Trust Loan to an intermediary entity, Windsor Investments (WI), which in turn purchased notes in Portfolio Companies. The notes require the borrower to pay a fixed interest rate—significantly below the market rate—plus a dividend based on the amount of dividends reserved for common shareholders. If the total fixed returns and dividends do not equal the market interest rate on the Trust Loan, the shareholders of WI are to make up the difference.

In theory, USAID is being secured by all the assets of WI, including the equity interests of KEC. Unfortunately, there is no assurance that WI (or its shareholders) will have (or provide) the resources to make up shortfalls in interest to pay the Trust Loan. There is concern for the principal as well, because the Windsor project calls for a single repayment of the Trust Loan after eight years. Without adequate interim reports, it will be impossible for USAID to anticipate a default at maturity of the Term Loan and take prior necessary action. This project is particularly acute because the WI represents approximately half of KEM's entire Portfolio. USAID/Trustee should insist on timely accounting of all fund inflows and outflows to WI and between WI and its Portfolio Companies. USAID should also stipulate that no dividends can be paid to WI shareholders until the Trust Loan is repaid.

KEM broke virtually every constraint in the Trust Loan agreement starting with its first investment. We do note, however, that the initial constraints on Trust Loans were not always realistic. In early projects especially, breaches in the Agreement did not lead to sound financings. By using redeemable preferred stock in Punchlines, KEM was able to buy out KEC's interest after only 18 months. In Kenya Crocodile Farms (KCF), KEM arranged for ALICO Insurance Company to convert an outstanding ALICO loan into KCF equity at face value, 80 percent of which equity KEC then purchased from ALICO. This loan was worth only a fraction of par, because KCF had lost considerable money in the prior four years. There is suspicion that this transaction was a factor in ALICO's subsequent investment in KEC. ALICO could afford to buy into KEC because it had recouped at least that amount in the conversion of its troubled loan in KCF.

In addition, the USAID approval system was unable to react to requests for changes, even when advised in advance. The Trustee, which was to act as a buffer in this regard, either chose not to play the role or felt the function had been usurped by direct contacts between KEM and USAID. In the future, USAID should concede, where possible, on discretionary restrictions on the use and applications of its funds for capital investment where its system does not allow for timely changes to accommodate the aims of the Program.

Transaction structuring also suffered because KEM reports paid too little attention to marketing and management and too much to creating complicated financial structures. The investment summary for Punchlines was a careful in-depth review of the key elements bearing on a successful investment, but subsequent reports were not as effective. In addition, each KEM transaction seemed a little more intricate than the last, to the point that some observers felt it lost some transactions due to complex financing structures.

F. Monitoring and Value Added

Monitoring its investments was not prioritized by KEM, as it instead focused on merchant banking activities. As a result, KEM did not interact with the management of its Portfolio Companies and was unable to determine how to bring added value to the equity investments in them. Even as the first KEC investments were being made, KEM was shifting its interest to merchant banking. It is questionable whether KEM ever had the capability to provide managerial assistance to its Portfolio Companies beyond arranging additional financing.

KEM had not remained in close contact with its Portfolio Companies even before its recent legal battle with KEC shareholders. A typical venture capital institution supplements the management of its investments on an interim basis to fill gaps in the knowledge, experience, and capabilities of its Portfolio Companies' managements. In contrast, when the Gringos investment got into almost immediate difficulties, KEM was unable to provide adequate assistance. The majority owners were not amenable either to taking over the management of the restaurant themselves or to seeking new management. Until December 1993 the Trust loan had been in default for two year, without an assessment of its financial situation by either USAID or KEM. This situation demonstrates a serious lack of monitoring and value added by KEM.

KEM has been inhibited from performing its normal role as a minority shareholder and Board member since February, when it was legally enjoined from such activities. With the settlement in September of its shareholder suit, KEM is taking steps to strengthen the management and financial reporting system of Bins Ltd., a garbage company, which may indicate a more active role in monitoring and strengthening its Portfolio investments.

G. USAID Interaction

USAID did not seem to take a sufficiently active role in monitoring the activities of KEM. This lack of interaction adversely affected implementation of the Program, which already had a number of flaws in its design. USAID did try in the design phase to assist KEM in mobilizing outside capital, sponsoring two meetings with prospective local investors in early 1987. Because of investor wariness about the "soft" agendas of donor sponsors, investor meetings could only be effective if aggressively followed up by an experienced KEM management team. By January 1992, when the next USAID-sponsored investor conference was held, KEM was in a better position to talk about its progress. Unfortunately, leads to investors and prospective companies could not be pursued because KEM found itself struggling with existing shareholders.

The original design called for USAID to be represented on the KEM "Advisory Board" which would approve investment projects. This would have kept USAID in closer contact with the KEM project, but it is questionable how much it would have improved matters given KEM's organizational structure. Insufficient USAID oversight of or interaction in KEM's activities is demonstrated in that neither USAID nor KEM viewed the latter's inability to closely monitor its Portfolio Companies since early 1993 as warranting an exploration of other ways to accomplish this function.

There has been an inadequate transfer of information between KEM and USAID. Although KEM did notify USAID of the replacement of its managing director in 1992 and of the shareholder suit in early 1993, and has provided quarterly reports on its activities, USAID has not received many of the required reports on the operation and documentation of its Program. The lack of reports, records, documents, etc., in USAID's files combined with officer turnover have put succeeding USAID project officers at an increasing disadvantage in understanding what is happening. As a result of this evaluation, a good deal of background material has been gathered and is being turned over to USAID/Kenya. It is recommended that this material, together with information already available in USAID files, be carefully organized by participant and individual portfolio transaction.

H. Trustee Interaction

Since monitoring KEM's performance in making loans to Portfolio Companies does not fall naturally under the present jurisdiction of the Trustee, the evaluation team recommends that this function (and the fees associated with it) be terminated, and that USAID or some other party designated by it be assigned this function—an independent local accounting firm appears to be the most natural candidate.

For the first two-three years of the Project, the Trustee's function of ensuring that loans, especially those to KEC Portfolio Companies, conformed with USAID guidelines was not carried out. Recently the Bank became concerned that it may have some fiduciary responsibility for this function. The evaluation team received the strong impression that, whereas the Trustee is concerned with the implementation of the Program as it relates to KEM's operations, it would rather have less responsibility for this situation.

USAID had difficulty designing the role of the Trustee as it involved a sharing of responsibilities, some of which neither party wanted. For example, a March 1987 USAID memo noted that the Trustee agreement would have "to be fleshed out as we go along" including the question of "what the Trustee should do in the event of a default by KEM designated borrowers." Another USAID memo two years later stated that there was "no intended requirement that the Trustee make an independent determination of the credit worthiness of KEM Sub-borrowers."

There is little interaction between the Trustee and KEC's Portfolio Companies, and the Trustee obtains all information about the companies from KEM. The agreement with KEM states "the Trustee shall concur (sic) in and accept any rescheduling or other action recommended by the Manager [KEM] that is acceptable to the borrower and other creditors of the borrower." Therefore the Trustee gives up the authority to call a loan in default.

I. Recommendations

The evaluation team foresees two courses of action for USAID. It can discontinue the KEM component of the Program or it can work with KEM to restructure its role in meeting the needs of Kenya's capital markets. KEM has no sustainable market for venture capital in Kenya today, even with USAID subsidies. If it had not changed directions with USAID's tacit approval and become a merchant bank, KEM would have been forced out of business at least two years ago. If USAID finds merchant banking potentially attractive, a more focused survey of the market for such a service should be made. As this was not part of the initial Scope of Work, the evaluation team was not able to fully address this point.

Discontinuation of Program. Given KEM's financial status, there is high probability that without further USAID support it could become a nonoperating shell serving only as a holder of KEM/KEC interests in Portfolio Companies. The effect this would have on the market would probably be small, given that KEM is a very small presence as a provider and arranger of private debt and equity in the Kenyan economy.

Reevaluation of the Program. Although KEM's financial resources were inadequate for a venture capital firm, they would be adequate for a merchant bank using its capital only as a temporary equity or debt bridge in transactions until other larger investors can be lined up. Whereas KEM might consider smaller transactions, it would have to attract larger private transactions for relatively mature companies to afford considering smaller transactions.

A merchant bank's principal role is to raise debt and equity capital from other investors to match client needs. It uses its own capital as a catalyst to demonstrate to other investors its confidence in the financing and/or to fill minor short falls in the amount of capital it can raise from others. Because, unlike a venture capitalist, it does not expect to be the lead new equity investor, its role as monitor and value adder to the client on an ongoing basis may be less—with the lead new equity investor playing that role. Nevertheless, in Kenya private companies will probably value the role of their merchant bankers more highly than normal. Because of their lack of familiarity with outside investors, the merchant bank would serve as an advisor, buffer, translator, and facilitator, etc., depending on the private company's needs.

In summary, the professional skills of the merchant banker will be very similar to those of the venture capitalist. The mind set will remain that of a principal and a fiduciary. The staff may be slightly larger because of the need to get the most of the capital from other parties rather than simply investing its own capital. In the early years, this should not necessitate more than one additional staff member with a "private placement" background. Because merchant banking normally precedes venture capital in the development of a capital market, it should be easier to attract qualified personnel for such a new enterprise if properly structured.

KEM would welcome USAID support for a merchant banking type of organization. It was able to create a small degree of credibility as an independent merchant bank. Unfortunately, the managers who helped it do so are no longer with KEM and their replacements are scarce in merchant banking and in Kenyan financial markets. The evaluation team did receive the impression that both Equator and Lonrho are concerned with their reputations as cosponsors of KEM and, given the recent management and shareholder problems, would view its demise as a blot on their records.

Any renegotiation of the USAID-KEM relationship requires an agreement on the focus of KEM's activities in meeting the capital market needs of Kenya, and on the commitment of needed managerial and financial resources by its owners. The fact that KEM's owners are concerned about the potential demise of KEM provides USAID with leverage in pressing for changes in the relationship. The following provisions should be requisites of any new arrangement with KEM or any other prospective merchant banking group.

1. The intended market should be carefully defined in terms of the operating approach (i.e., "merchant banking"). Neither activities nor projects should be undertaken outside these parameters without prior USAID approval.

2. The management should have experience executing the particular operating approach. The technical expertise must come from outside Kenya, but there should also be a local partner with excellent contacts and experience in the Kenyan business and financial communities. USAID should participate in the hiring and firing of key managers—although it would be unreasonable for USAID to have a veto.

3. USAID's financing facility through the Trust should stipulate that such funding be identical as to type (e.g., common equity, preferred stock, debt, etc.) and terms with funding provided by other capital managed by the operating entity. The Trustee would independently verify this was the case before making any disbursements from the Trust. This avoids the kinds of conflict of interest problems alluded to before.

4. For having its money managed, the Trust should pay no higher fees than those paid on any other funds managed by the operating entity (i.e., the Trust should have a "most favored nation clause" covering both the present and the future). The Trust would receive a credit against management fees it owes the merchant bank, which are equal to any fees the merchant bank receives from other sources relating to the amount of Trust financing. For example, if the operating entity receives a fee equal to 3 percent of a total financing, and the Trust puts up 20 percent of the financing, then one-fifth of this fee would go to offset the annual management fee the Trust is paying the merchant bank to manage its money. The merchant bank should not be paid twice for investing for the Trust.

5. The Trust's financing should not represent more than 60 percent of the funding used in any transaction, and the managers of the merchant bank should be obliged to invest at least one-sixth of the amount of any Trust funds used. This maintains USAID's 1.5-to-1 ratio, while assuring the operating manager has a financial stake in the transaction.

6. The Trust's operating subsidies should be expressed as a declining percentage of total direct operating expenses over a five-year period, so as to eventually wean the merchant bank from these subsidies.

7. The merchant bank may or may not try to obtain additional funding under management. In KEM's case, other than arranging for the 10 percent matching commitment to the Trust, it may not be necessary to raise any additional funds because KEM will be arranging most of its financing on a project-by-project basis from institutional investors.

8. USAID should insist on the establishment of an Executive Committee by the operating entity on which USAID would be represented. Aside from monitoring operations, the Executive Committee would rule on changes in operating policy or procedures, management changes, and conflicts of interest. A conflict of interest would be any transaction or activity from which the operating entity, its management, or shareholders expect to receive compensation disproportionate to its capital interest in the transaction, as compared to other fund sources (including the Trust).

9. The new agreement should be for at least five years and call for a review half-way through the period, when it would be agreed either to cancel the agreement at the end of the present term or to extend for five years thereafter. USAID's present agreement gives the operating managers inadequate notice as to USAID's continuing involvement, which can impact negatively on the operating entity's activities at the end of the current agreement.

10. The functions of the Trustee should be amended to cover only services as a depository manager and a conduit of funds to KEM, with prior USAID approval.

Despite indications that Kenya needs independent merchant banks as borne out by KEM's brief foray into the field and comments made by interviewees, the development of such a market with institutional support from the Trust should be regarded as an experiment. Legislation has improved the environment for private investing in Kenya and there appear to be no major impediments to the further development of such activities. However, if any financial market were on the threshold of a boom, donors would probably not be the first to recognize it—nor would there be a particular need for donor support. The health of the Kenyan economy remains a serious concern to local business. Despite signs the market is ready for independent merchant banks, this activity must be cultivated over time.

"Independent" is defined as a merchant bank not operating as an adjunct to another business. Because a merchant banker's primary role is to raise debt and equity from other investors on behalf of its clients, any adjunct affiliation with an entity competing with the merchant banker's clients could set up a conflict of interest. This need not preclude Lonrho from being a KEM minority shareholder, but the Lonrho name should not appear on the masthead and Lonrho should not be the managing partner. A five-year term would seem to be reasonable to decide if the experiment can reach this outcome.

The objectives of the merchant banking experiment should be kept as broad as possible. The most favorable outcome would be the creation (and possible local emulation) of an independent merchant bank able, if necessary, to continue operations without USAID support.

This is not a blueprint for a new agreement. It is strongly recommended that USAID seek professional counsel in negotiating agreements for the creation or extension of financial institutions. Whether an agreement provides a sound basis for the parties to reach their individual goals must be viewed as a whole, and not as merely the sum of certain parts.

SECTION VI
IMPACT OF THE EQUITY CAPITAL COMPONENT

This section highlights the direct benefits of the equity capital component. The Project Paper set out measurable objectives for the Program as a whole and not for KEC and IPS separately. The expectations and the actual performance to date are discussed below.

USAID's objectives were in four categories: investment, employment, output, foreign exchange earnings, and tax revenue goals. While all but one of these goals was met they are not considered adequate benchmarks for measuring the actual success of the Program. The evaluation team finds that the Program's overall goal of establishing a commercial equity market for venture capital in Kenya was not fulfilled.

See Annex E for an analysis on the environmental impact of the Equity Capital Component and Annex F for details regarding the impact on existing businesses of the Equity Capital Component.

A. Investment

Objective. "The creation, expansion or restructuring of between 25 and 40 businesses, with total new investment of about Ksh 500 million.

Analysis. To date KEC and IPS have contributed to creating, expanding, or restructuring 12 companies. The total investment (as detailed in Annexes C and D) has been Ksh 1,238 million. Some of this (notably for Punchlines, Kenya Crocodile Farm, Bins, and Central Glass) was not new investment but rather the repurchase and refunding of prior equity and debt.

Summary. The overall investment objective of the Program was met but with fewer investments than contemplated. Two projects, Windsor Investments and Central Glass, in which KEC and USAID were minor financial participants, represent two-thirds of the total investment.

B. Employment

Objective. "Creation or conservation of between 1,200 and 2,000 jobs."

Analysis. Table 2, on the following page, indicates employment (1) before each USAID Trust loan, (2) after October 1993 when all USAID Trust loans had been conferred, and (3) increase to date.

Table 2: Effect of Trust Loans on Employment of IPS and KEC Portfolio Companies

Business		Employment Before Trust Loan			Employment After Trust Loans (as of 10/93)			Increase in Employment		
Name of Business	*Date of Loan*	*Male*	*Female*	*Total*	*Male*	*Female*	*Total*	*Male*	*Female*	*Total*
Punchlines	Nov. '89	30	0	30	49	1	50	19	1	20
Gringos	Dec. '89	0	0	0	90	40	130	90	40	130
Windsor (Golf)	Apr. '90	0	0	0	349	80	429	349	80	429
Windsor (Siana)	Oct. '91	0	0	0	95	2	97	95	2	97
Windsor (Retail)	Aug. '92	0	0	0	N/A	N/A	0	N/A	N/A	0
Bins	Oct. '91	23	2	25	54	6	60	31	4	35
Kenya Crocodile	Nov. '91	72	8	80	120	10	130	48	2	50
Central Glass	Jun. '93	327	38	365	340	40	380	13	2	15
Premier Food	Jun. '88	15	90	105	71	123	194	56	33	89
Premier Refrigeration	Aug. '88	0	0	0	168	2	170	168	2	170
Frigoken	Dec. '89	0	0	0	30	320	350	30	320	350
Novaskins	Jun. '90	0	0	0	34	1	35	34	1	35
Ukulima Tools	Jul. '92	99	1	100	128	2	130	29	1	30
AllPack	Aug. '92	0	0	0	80	10	90	80	10	90
Total		**566**	**139**	**705**	**1,608**	**637**	**2,245**	**1,042**	**498**	**1,540**

Summary. There was an increase in total employment of 1,540 jobs. Based on this analysis the component has met the objective for increased employment. This accounting does not take into consideration jobs created among suppliers and customers of portfolio companies. It should be noted that job creation is incidental to the primary financial and management objectives of the project—capital appreciation that rests in part on attaining higher output per employee rather than maximizing employment.

C. Increased Output

Objective. "Additional output of between Ksh 40 million and Ksh 100 million per year."

Analysis. Output is defined as revenues. The tables below show the increase in annual revenues over the previous year. Where there was a decrease the change is shown as zero. The analysis is done in both Kenya shillings and U.S. dollars to allow for inflation and devaluation. Cumulating the objective over the four effective years of the project gives a restated objective of "additional output of Ksh 160 million and Ksh 400 million."

Table 3
Increase in Annual Revenues (Ksh million)

Business	1989	1990	1991	1992
Punchlines	7.7	7.9	7.5	8.9
Gringos		15.4	0.0	3.1
Windsor (Golf)				121.6
Windsor (Siana				20.1
Bins			1.8	3.9
Kenya Crocodile Farm			1.8	7.1
Premier Food	26.9	0.8	0.5	15.6
Premier Refrigeration		24.4	0.0	25.5
Frigoken		79.6	76.8	10.9
Novaskins			10.1	26.1
Ukulima Tools			20.9	5.9
Annual Total	**34.6**	**128.1**	**119.4**	**248.7**
Cumulative Total	**34.6**	**162.7**	**282.1**	**530.8**

The average exchange rate for 1987 (the year of the project paper) was Ksh 16.45 to the dollar; for 1992 it was Ksh 32.22. The average of these rates is Ksh 24.33. Converting the cumulative objective at this rate gives a restated cumulative objective of between $6,576,000 and $16,440,000.

The actual increases can be converted at the average exchange rate for the year:

	1989	1990	1991	1992
Increase (Ksh million)	34.6	128.1	119.4	248.7
Exchange Rate	20.57	22.92	27.51	32.22
Increase (US $ 000)	1,682	5,589	4,340	7,719
Cumulative (US $000)	1,682	7,271	11,611	19,330

Summary. The cumulative increase in sales over the four years was $19,330,000. Based on this analysis the component has met the objective for increased revenue.

D. Foreign Exchange Earnings

Objective. "Foreign exchange earnings estimated between Ksh 6.5 million and Ksh 10 million per year."

Analysis. An assumption was made that the objective had intended to refer to the increase in foreign exchange earnings from the earnings of the prior year but with the same figures. This makes the objective consistent with the objective for increased output. We note that all foreign exchange earning figures are estimates (as proportion of revenues). The analysis is done in both Kenya shillings and U.S. dollars to allow for inflation and devaluation. Cumulating the objective over the four years of the project gives a restated objective of "additional foreign exchange earnings of between Ksh 26 million and Ksh 40 million."

Table 4
Increase in Foreign Exchange Earnings (Ksh million)

Business	1989	1990	1991	1992
Punchlines	0.0	0.0	0.0	0.0
Gringos		0.0	0.0	0.0
Windsor (Golf)				85.1
Windsor (Siana				12.1
Bins			0.0	0.0
Kenya Crocodile Farm			0.4	0.0
Premier Food	0.0	0.0	2.5	0.8
Premier Refrigeration		0.0	0.0	0.0
Frigoken		79.6	76.8	10.9
Novaskins			9.5	24.5
Ukulima Tools			0.0	1.3
Annual Total	**0.0**	**79.6**	**89.2**	**134.7**
Cumulative Total	**0.0**	**79.6**	**168.8**	**303.5**

The average exchange rate for 1987 (the year of the project paper) was Ksh 16.45 to the dollar; for 1992 it was Ksh 32.22. The average of these rates is Ksh 24.33. Converting the cumulative objective at this rate gives a restated cumulative objective of between $1,069,000 and $1,644,000.

The actual increases can be converted at the average exchange rate for the year:

	1989	1990	1991	1992
Increase (Ksh million)	0.0	79.6	89.2	134.7
Exchange Rate	20.57	22.92	27.51	32.22
Increase (US $ 000)	0	3,473	3,242	4,181
Cumulative (US $ 000)	0	3,743	6,985	11,166

Summary. The cumulative increase in foreign exchange earnings was $11,166,000. Based on this analysis the component has met the objective.

E. Tax Revenue to Government of Kenya

Objective. "Revenue to the GOK from taxes on assisted businesses of Ksh 10 million to Ksh 25 million per year."

Analysis. An assumption was made that the objective had intended to refer to the increase in taxes paid over those paid in the prior year but with the same figures. This makes the objective consistent with the objective for increased output. The analysis is done in both Kenya shillings and U.S. dollars to allow for inflation and devaluation. Cumulating the objective over the four effective years of the project gives a restated objective of "additional tax revenue to the GOK of between Ksh 40 million and Ksh 100 million."

Table 5
Increase in Taxes Paid (Ksh million)

Business	1989	1990	1991	1992
Punchlines	0.0	0.0	0.0	0.0
Gringos		0.0	0.0	0.0
Windsor (Golf)				0.0
Windsor (Siana)				0.0
Bins			0.0	0.0
Kenya Crocodile Farm			0.0	0.0
Premier Food	0.0	0.2	0.6	0.2
Premier Refrigeration		0.0	0.0	0.0
Frigoken		0.0	4.7	1.7
Novaskins			0.0	1.9
Ukulima Tools			0.0	0.0
Annual Total	**0.0**	**0.2**	**5.3**	**3.8**
Cumulative Total	**0.0**	**0.2**	**5.5**	**9.3**

The average exchange rate for 1987 (the year of the project paper) was Ksh 16.45 to the dollar; for 1992 it was Ksh 32.22. The average of these rates is Ksh 24.33. Converting the cumulative objective at this rate gives a restated cumulative objective of between $1,644,000 and $4,110,000.

The actual increases can be converted at the average exchange rate for the year:

	1989	**1990**	**1991**	**1992**
Increase (Ksh million)	0.0	0.2	5.3	3.8
Exchange Rate	20.57	22.92	27.51	32.22
Increase (US $ 000)	0	9	193	118
Cumulative (US $ 000)	0	9	202	320

Summary. The cumulative increase in tax revenue over the four years was $320,000. Based on this analysis the component has not met the objective for increased tax revenue.

ANNEXES

ANNEX A
DOCUMENTS REVIEWED

DOCUMENTS AVAILABLE FROM USAID

A. Design Documents

- "Project Paper" - Private Enterprise Development Project - April 3, 1997.
- "86 Report" - Kenya Equity Finance Study - Final Report - January 30, 1986.

B. Agreements: USAID/SCB/KEM/IPS

- "Trust Agreement" - Deed of Settlement between USAID and Standard Chartered Bank Kenya Ltd. - June 30, 1987.
- "IPS Agreement" - Loan Agreement between Standard Chartered Bank Kenya Limited and Industrial Promotion Services (Kenya) Limited - January 28, 1988.
- "Equator Contract 1" - contract between USAID and Equator Advisory Services Ltd. and International Resources Group Ltd. (Number 615-0238-C-00-7032-00 of July 29, 1987).
- "Equator Contract 2" - contract between USAID and Equator Advisory Services Ltd. & International Resources Group Ltd. Number 615-0238-C-00-8039-00 of June 10, 1988 and modifications of November 12, 1992).
- "KEM Agreement" - Loan Fund Management Agreement between Standard Chartered Bank Kenya Limited and Kenya Equity Management Ltd. - February 13, 1989.

C. USAID Files

- All past and current USAID files related to Equity Capital component.

D. KEM Reports

- All KEM quarterly reports through June 1993.

E. SCB

- Audit Report of Trust - 1992.
- Quarterly reports up to December 1989.

DOCUMENTS OBTAINED AND REVIEWED

A. SCB

- Loan repayment schedules.
- Report for 2nd quarter 1993.

B. KEM

B1. Reports

- Quarterly Report - September 1993.

B2. Agreements and Accounts

- KEM Share Subscription and Stockholders Agreement - September 18, 1989.
- Management Agreement between Manufacturing and Industrial Services Fund (Kenya) Ltd. and Kenya Equity Management Ltd. - June 20, 1991.
- Management Agreement between Kenya Equity Capital Ltd. and Kenya Equity Management Ltd. - July 11, 1991.
- Fund Management Agreement between European Investment Bank and Kenya Equity Management Ltd.- May 22, 1992.
- Equity Group of Kenya Ltd. Share Subscription Agreement - March 26, 1992.
- KEM - Accounts 1987, 1990, 1991, 1992.
- KECL - Accounts - 1989, 1990, 1991, 1992

B3. Portfolio Documents

B3a. Punchlines Ltd.

- Prospectus Summary
- Loan Agreement
- Debenture
- Accounts - 1989, 1991, 1992

B3b. Gringos Ltd.

- Prospectus Summary, February 8, 1989
- Share Subscription Agreement, September 26, 1989
- Loan Agreement, October 16, 1989
- Debenture, May 22, 1990
- Accounts February 28, 1991, 1992, 1993

B3c. Windsor Golf - Nairobi Golf Hotels - Windsor Investments

- Prospectus Summary, April 24, 1989
- Loan Agreement (Windsor Investments) January 29, 1990
- Subscription Agreement August 20, 1990
- Accounts December 1992

B3d. Bins Ltd.

- Summary Investment Analysis - April 1991
- Loan Agreement - June 24 1991
- Share Ownership Agreement - June 24, 1991
- Debenture - June 24, 1991
- Accounts - July 1991, 1992, 1993

B3e. Siana Springs - Oltukai Mara - Windsor Investments

- Summary Investment Analysis August 1991
- Loan Agreement (Windsor Investments) June 5, 1992

B3f. Kenya Crocodile Farm

- Summary Investment Analysis - December 1990
- Loan Agreement - December 31, 1991
- Share Subscription Agreement - December 31, 1991
- Memorandum of Deposit of Shares - December 31, 1991

B3g. Central Glass Industries

- Summary Investment Analysis - June 1992
- Loan Agreement (Kenya Central Investment Holdings Ltd), June 3, 1993
- Accounts June 30, 1993.

C. IPS

C1. Agreements and Accounts

- Shareholders Agreement - July 29, 1992
- IFC Line of Equity Agreement - November 13, 1986
- Sample Management Agreement
- Accounts - 1990, 1991, 1992

C2. Portfolio Documents

C2a. Premier Food Industries

- Accounts - 1988, 1990, 1991, 1992

C2b. Premier Refrigeration

- Accounts - March 31, 1990, 1991, 1992

C2c. Frigoken Ltd.

- Loan Agreement, November 20, 1990
- Accounts 1990, 1991, 1992

C2d. Novaskins Tannery Ltd.

- Accounts - 1991, 1992

C2e. Ukulima Tools Ltd.

- Accounts - 1991, 1992

C2f. Allpack Industries Ltd.

- Appraisal Report - January 1991
- Shareholders Agreement - November 26, 1992
- Accounts - August 1993

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ANNEX B
PERSONS INTERVIEWED

I. USAID & TRUSTEE

Private Enterprise Office:	Tom Hobgood Alfreda Brewer Abu Khasiani Mary McVay
Ex-Private Enterprise Office:	Pete Ondeng James Dry
Regional Legal Office:	Anthony Vance
Legal Advisors:	Hamilton Harrison & Matthew - Michael Somen
Standard Chartered Bank:	Godfrey Chamungwana Charles Masheti

II. KEM RELATED

KEM Management Team:	Jack Thomas Fredrick Mwangi
Ex-KEM Management Team:	Bruce Bouchard
Equator Bank:	Frank Kennedy
Lonrho East Africa Ltd.:	Mark Newman Keith Atkinson
CODA International:	D. N. Mwaniki Eric Oburrah
Apollo Insurance:	Ashok Shah
Auditors:	Price Waterhouse - Julian Ince
Legal Advisors:	Kaplan & Stratton - K. H. W. Keith

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III. IPS RELATED

IPS Management Team:	Aziz Husain Mehboob Jesani S. Poonawalla
IFC:	Vincent Rague Michael Hooper
Auditors:	Coopers & Lybrand - Anne Ooga-Eriksson

IV. KEM PORTFOLIO COMPANIES

Punchlines Ltd.:	Neeraj Aggarwal
Gringos Ltd.:	Howard Crooks Nancy Crooks
Windsor Investments Ltd.:	S. G. Ngaruiya J. M. Wainaina
Bins Ltd.:	Tim Davis
Kenya Crocodile Farm Ltd.:	Yuval Regev
Central Glass Industries Ltd.:	M. J. Barlow

V. IPS PORTFOLIO COMPANIES

Premier Food Industries Ltd.:	C. I. Roy Iqbal Hajiyani
Premier Refrigeration and Engineering Ltd.:	S. Kurji Mr. Marathe
Frigoken Ltd.:	Amit Patel
Novaskins Tannery Ltd.:	L. R. Kassam Karim Peerbhoy
Ukulima Tools Ltd.:	Naser Noorani Nadir Dawoodani
Allpack Industries Ltd.:	Niazali Hirani Ali Jariwalla

VI. OTHER

Africa Project Development Facility:	John James
Barclays Merchant Finance Ltd.:	Kitili Mbathi
Barclay Trust Investment Services Ltd.:	Robin Mason Musyoka Mwilu
Capital Markets Authority:	Darin Gunesekera Catherine Kola F. W. Omollo S. Maina
Citibank N. A.:	Terence Davidson
Dyer & Blair:	J. Mbaru
Industrial & Commercial Development Corporation:	G. A. G. Kimaru
Industrial Development Bank:	B. W. Maina F. J. Maina F. K. Githaiga
Jacaranda Designs:	Susan Scull-Carvalho
Jubilee Insurance:	Abdul Jaffer
Kenya Commercial Bank:	M. J. Fazal T. K. Maingi
Kenya Finance Corporation:	Dickson Gachuche
Madison Insurance:	S. G. Ngaruiya
Rehabilitation Advisory Services:	Tom Detrie
Royal Card:	Mr. Macharia
Treadsetters:	Aashit Shah

ANNEX C
IPS PORTFOLIO

I. SUMMARY OF INVESTMENTS

IPS has to date invested in six companies. These are:

Premier Food Industries Ltd.
Premier Refrigeration and Engineering
Frigoken Ltd.
Novaskins Tannery Ltd.
Ukulima Tools Ltd.
AllPack Industries Ltd.

The details of the amounts invested are illustrated in the table on the next page. Below is a comparison of these investments to that anticipated by the project paper (page A-36). Amounts in Kenya shillings have been converted into U.S. dollars at the exchange rate prevailing when the transaction occurred.

Anticipated		Actual	
EQUITY	U.S. $ 000	**EQUITY**	U.S. $ 000
Financial Inst. (including IPS)	2,000	IPS	1,134
		AKFED Group	859
		Private Investors	270
IFC	1,500	IFC	757
		Other Donors	48
Entrepreneurs	4,500	Entrepreneurs	1,394
Total Equity	7,500	**Total Equity**	4,461
DEBT	U.S. $ 000	**DEBT**	U.S. $ 000
USAID Credit Line	3,000	USAID Credit Line	2,683
Other	12,000	Other	4,395
Total Debt	15,000	**Total Debt**	7,078

IPS - TOTAL INVESTMENTS

A) In Ksh Millions

Borrower	Date	DEBT USAID	DEBT Other	DEBT Total	EQUITY IPS (K) Ltd.	EQUITY AKFED Group	EQUITY Other Private	EQUITY IFC & Donors	EQUITY Entrep-reneur	EQUITY Total
Premier Food	Jun 88	5.00	18.00	23.00	2.25	0.00	0.00	1.50	2.25	6.00
	Jun 90	5.00	0.00	5.00	2.25	0.00	0.00	0.75	0.00	3.00
Premier Refrigeration	Aug 88	6.00	22.00	28.00	2.60	0.00	1.17	2.60	6.63	13.00
Frigoken Ltd.	Dec 89	8.00	0.00	8.00	4.62	1.40	0.70	1.40	5.88	14.00
	Jun 93	10.00	0.00	10.00	0.00	0.00	0.00	0.00	0.00	0.00
Novaskins Tannery	Jun 90	16.50	4.50	21.00	6.48	5.20	0.00	4.32	0.00	16.00
Ukulima Tools	Jul 92	4.00	0.00	4.00	2.08	2.08	0.00	1.28	2.56	8.00
AllPack Industries	Aug 92	24.00	88.00	112.00	9.75	23.40	7.80	11.70	25.35	78.00
Total		78.50	132.50	211.00	30.03	32.08	9.67	23.55	42.67	138.00

B) In US$ ('000)

Borrower	Date	Exchange Rate	DEBT USAID	DEBT Other	DEBT Total	EQUITY IPS (K) Ltd.	EQUITY AKFED Group	EQUITY Other Private	EQUITY IFC & Donors	EQUITY Entrep-reneur	EQUITY Total
Premier Food	Jun 88	17.36	288	1,037	1,325	130	0	0	86	130	346
	Jun 90	22.91	218	0	218	98	0	0	33	0	131
Premier Refrigeration	Aug 88	18.08	332	1,217	1,549	144	0	65	144	367	719
Frigoken Ltd.	Dec 89	21.53	372	0	372	215	65	33	65	273	650
	Jun 93	77.00	130	0	130	0	0	0	0	0	0
Novaskins Tannery	Jun 90	23.15	713	194	907	280	225	0	187	0	691
Ukulima Tools	Jul 92	40 25	99	0	99	52	52	0	32	64	199
AllPack Industries	Aug 92	45.20	531	1,947	2,478	216	518	173	259	561	1,726
Total			2,683	4,395	7,078	1,134	859	270	805	1,394	4,461

Note: For the purposes of this analysis it is assumed that the term entrepreneur refers to the project sponsor or primary joint venture partner. AKFED refers to the Aga Khan Fund for Economic Development. In Kenya, AKFED owns companies in three sectors : Industrial - IPS, Tourism - Tourism Promotion Services, and Finance - Diamond Trust & Jubilee Insurance. In the analysis above the investment by AKFED Group refers to investments made directly by the fund, Diamond Trust, or Jubilee Insurance. The term private investor refers to minority investors who are not connected to other parties.

II. DETAILS OF PORTFOLIO COMPANIES

The following pages provide details of the companies in the IPS portfolio.

As per the trustee's records the amounts outstanding on the USAID credit line at the end of June 1993 are as follows:

Company	K sh ('000)
Premier Foods (1)	2,951
Premier Foods (2)	4,407
Premier Refrigeration	4,023
Frigoken (1)	6,534
Frigoken (2)	10,000
Novaskins	14,544
Ukulima	4,000
AllPack	24,000
Total	70,459

The AID Trust Loan details on the following pages are for loans from the Trust to IPS. In related loans from IPS to its portfolio companies, it often provides no grace period and a maturity of only seven years.

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A. Premier Food Industries Ltd.

Nature of Business:

Activity/Product: Processing tomato sauces, fruit juices, and jams.
Market: Primarily Kenya.

Current Ownership:

Diamond Trust of Kenya (Nominee for IPS)	12.5%
IPS	62.5%
IFC	25.0%

AID Loan Details:

Loan 1 Amount	:	sh 5,000,000
Disbursement Date	:	June 1988
Term	:	8 years
Moratorium:	:	2 years
Interest rate	:	13%
Repayments	:	sh 608,865 half yearly
Outstanding (June 93)	:	sh 2,951,064

Loan 2 Amount	:	sh 5,000,000
Disbursement Date	:	June 1990
Term	:	8 years
Moratorium	:	2 years
Interest rate	:	13%
Repayments	:	612,840 half yearly
Outstanding (June 93)	:	sh 4,407,177

Use of Funds: Working Capital.

Viability:

After a period of rapid expansion, the Company is settling down. The financial ratios show that the Company is in a stable financial position but is not generating much cash. Like most enterprises tied to agriculture the Company's cash needs are cyclical and in 1992 the Company had to get short-term advances from its shareholders. The Company's main opportunities for better performance are in the export market which is opening up. Its primary threat is competition from South African products imported without payment of duty.

Likely Method and Timing of Divestiture: IPS expects a public flotation after about five years.

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COMPANY: PREMIER FOOD INDUSTRIES LTD.

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: December 31, 1992

Balance Sheet	KSH '000
Assets	
Fixed Assets	65,849
Current Assets	29,820
Pre-operating/ Formation Expenses	39
Total	95,708
Liabilities	
Long Term Debt	29,840
Current Liabilities	29,134
Total	58,974
Equity	
Share capital + Premium	9,000
Reserves + Retained earnings	27,734
Total	36,734
Liabilities + Equity	95,708
Income Statement (Profit & Loss Account)	KSH '000
Turnover (Sales)	64,959
Less: Cost of Sales	48,388
Gross Profit	16,571
Less: Interest Expense	6,866
Admin & Mktg. Expense	7,559
Depreciation	220
Total Expenses	14,645
Profit	1,926
Cash Flow from Operations	KSH '000
Net Profit before Tax	1,926
Add: Interest	6,866
Add: Depreciation	220
Total	9,012

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	1.61
Margin Ratios	
Gross Operating Margin	26%
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	1.31

B. Premier Refrigeration and Engineering

Nature of Business:

Activity/Product: Manufacturing refrigeration equipment and agricultural implements in Nakuru.
Market: Primarily Hire Purchase stores in Kenya.

Current Ownership:

Currently 100% Kurji family following liquidation of IPS equity interest.

AID Loan Details

Amount	:	sh 6,000,000
Disbursement Date	:	August 1988
Term	:	8 years
Moratorium:	:	2 years
Interest rate	:	13%
Repayments	:	sh 732,711 half yearly
Outstanding (June 93)	:	sh 4,023,219
Loan Details:		

Use of Funds: Rehabilitation of Company.

Viability:

The Company is the only local manufacturer of refrigeration equipment. It has a royalty and technical assistance agreement with Lec, a major British manufacturer with an established brand name. The Company competes with importers and assemblers of brand name refrigeration equipment. It has been experiencing problems due to a transition in family management. The financial ratios (for the year ending March 1992) indicate that it is highly leveraged and does not have a healthy cash position. The management informed the evaluation team that the accounts as of March 1993, while not available, did show a better picture.

Likely Method and Timing of Divestiture: Already divested although an AID Trust Loan is still outstanding.

COMPANY: PREMIER REFRIGERATION AND ENGINEERING

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: March 31, 1992

Balance Sheet	KSH '000
Assets	
Fixed Assets	29,860
Current Assets	37,604
Pre-operating/ Formation Expenses	5,097
<u>Total</u>	72,561
	=======
Liabilities	
Long Term Debt	38,937
Current Liabilities	36,809
<u>Total</u>	75,746
Equity	
Share capital + Premium	13,000
Reserves + Retained earnings	(16,185)
<u>Total</u>	(3,185)
Liabilities + Equity	72,561
	=======
Income Statement (Profit & Loss Account)	KSH '000
Turnover (Sales)	40,769
Less: Cost of Sales	25,920
Gross Profit	14,849
Less: Interest Expense	6,117
Admin & Mktg. Expense	6,106
Depreciation	2,066
<u>Total Expenses</u>	14,289
<u>Profit</u>	560
	=======
Cash Flow from Operations	KSH '000
Net Profit before Tax	560
Add: Interest	6,117
Add: Depreciation	2,066
Total	8,743

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	(23.78)
Margin Ratios	
Gross Operating Margin	36%
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	1.43

C. Frigoken Ltd.

Nature of Business:

Activity/Product: Canning and freezing of vegetable produce.
Market: Exported to Europe.

Current Ownership:

Yamada Investments (KHE)	29%
Redhill Estate (KHE)	13%
Esara Investments	5%
IFC	10%
AKFED	10%
IPS	33%

Note: KHE refers to Kenya Horticultural Exporters, one of the largest exporters of fresh horticultural produce.

AID Loan Details:

Loan 1 Amount	:	sh 8,000,000
Disbursement Date	:	December 1989
Term	:	8 years
Moratorium:	:	2 years
Interest rate	:	13%
Repayments	:	sh 980,545 half yearly
Outstanding (June 93)	:	sh 6,533,796

Loan 2 Amount	:	sh 10,000,000
Disbursement Date	:	June 1993
Term	:	8 years
Moratorium:	:	2 years
Interest rate	:	13%
Repayments	:	sh 1,225,681 half yearly
Outstanding (June 93)	:	sh 10,000,000

Use of Funds: Purchase of equipment.

Viability:

The Company is well managed and expanding rapidly. Financial ratios indicate it is financially sound. Besides increasing its exports of green beans the Company is also looking to expand its product line to include gherkins, broccoli, and potato products.

Likely Method and Timing of Divestiture: Sale to the joint-venture partner (KHE).

COMPANY: FRIGOKEN

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING:	December 31, 1992
Balance Sheet	KSH '000
Assets	
Fixed Assets	42,081
Current Assets	48,709
Pre-operating/ Formation expenses	0
Total	90,790
Liabilities	
Long Term Debt	16,902
Current Liabilities	48,278
Total	65,180
Equity	
Share capital + premium	18,666
Reserves + Retained earnings	6,944
Total	25,610
Liabilities + Equity	90,790
Income Statement (Profit & Loss Account)	KSH '000
Turnover (Sales)	167,282
Less: Cost of Sales	137,317
Gross Profit	29,965
Less: Interest Expense	2,922
Admin & Mktg. Expense	5,212
Depreciation	6,125
Total Expenses	14,259
Profit	15,706
Cash Flow from Operations	KSH '000
Net Profit before Tax	15,706
Add: Interest	2,922
Add: Depreciation	6,125
Total	24,753

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	2.55
Margin Ratios	
Gross Operating Margin	18%
Debt Service Coverage	
Cash Flow from operations/Interest Expense	8.47

D. Novaskins Tannery Ltd.

Nature of Business:

Activity/Product: Tanning goat and sheep skins.
Market: Primarily exports to Europe.

Current Ownership:

IPS	40.5%
Diamond Trust	12.5%
Leather Industries of Kenya (LIK)	20.0%
IFC	20.0%
Prefund (Donor)	7.0%

Note: IPS also has a 24.5% shareholding in LIK.

AID Loan Details:

Amount	:	sh 16,500,000
Disbursement Date	:	June 1990
Term	:	8 years
Moratorium:	:	2 years
Interest rate	:	13%
Repayments	:	sh 2,022,374 half yearly
Outstanding (June 93)	:	sh 14,543,685

Use of Funds: Equipment and working capital.

Viability:

The Company's current product, unfinished skins, is a commodity and subject to the vagaries of world commodity markets. In the future this will be less of a concern as the Company moves toward production of finished skins. The Company also experienced considerable raw material supply problems in 1990 and 1991. Financial ratios indicate that the Company was in a healthy financial position as of December 1992. However as the Company starts repaying the loan it may experience cash flow problems.

Likely Method and Timing of Divestiture: It is likely the Company will merge with LIK in preparation of a public flotation within 2-3 years.

COMPANY: NOVASKINS TANNERY LTD.

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: December 31, 1992

Balance Sheet	KSH 000
Assets	
Fixed Assets	17,455
Current Assets	30,359
Pre-operating/ Formation Expenses	959
Total	48,773
	=======
Liabilities	
Long Term Debt	16,596
Current Liabilities	14,803
Total	31,399
Equity	
Share capital + Premium	16,000
Reserves + Retained Earnings	1,374
Total	17,374
Liabilities + Equity	48,773
	=======
Income Statement (Profit & Loss Account)	KSH '000
Turnover (Sales)	36,185
Less: Cost of Sales	20,979
Gross Profit	15,206
Less: Interest Expense	3,893
Admin & Mktg. Expense	1,010
Depreciation	1,770
Total Expenses	6,673
Profit	8,533
	=======
Cash Flow from Operations	KSH '000
Net Profit before Tax	8,533
Add: Interest	3,893
Add: Depreciation	1,770
Total	14,196

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	1.81
Margin Ratios	
Gross Operating Margin	42%
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	3.65

E. Ukulima Tools Ltd.

Nature of Business:

Activity/Product: Manufacture of agricultural hand tools such as hoes, machetes, and shovels.
Market: Primarily Kenya.

Current Ownership:

Kassim-Lakha Abdulla Trust Co. (held in trust for original owners - Sidi family)	32.0%
Wire Products (WPL)	13.5%
Diamond Trust (Nominees for WPL)	12.5%
IPS	26.0%
IFC	16.0%

Note: WPL is an IPS Company.

AID Loan Details:

Amount	:	sh 4,000,000
Disbursement Date	:	July 1992
Term	:	8 years
Moratorium:	:	2 years
Interest rate	:	13%
Repayments	:	sh 490,272 half yearly
Outstanding (June 93)	:	sh 4,000,000

Use of Funds: Purchase of equipment.

Viability:

The Company runs a simple operation with good quality products. It is well placed for exports to neighboring countries. However, it continues to face strong competition from cheap imports from China. The Company experienced a few bad years due to poor equipment. The financial ratios indicate that the Company's position has improved.

Likely Method and Timing of Divestiture: IPS is likely to have difficulty divesting its shares unless the Company is sold to a competitor or to the original owners.

COMPANY: UKULIMA TOOLS LTD.

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: December 31, 1992

Balance Sheet	**KSH '000**
Assets	
Fixed Assets	23,963
Current Assets	18,001
Pre-operating/ Formation Expenses	373
Total	42,337
	=======
Liabilities	
Long Term Debt	10,128
Current Liabilities	15,462
Total	25,590
Equity	
Share capital + Premium	8,000
Reserves + Retained Earnings	8,747
Total	16,747
Liabilities + Equity	42,337
	=======
Income Statement (Profit & Loss Account)	**KSH '000**
Turnover (Sales)	26,757
Less: Cost of Sales	21,079
Gross Profit	5,678
Less: Interest Expense	1,704
Admin & Mktg. Expense	1,270
Depreciation	1,233
Total Expenses	4,207
Profit	1,471
	=======
Cash Flow from Operations	**KSH '000**
Net Profit before Tax	1,471
Add: Interest	1,704
Add: Depreciation	1,233
Total	4,408

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	1.53
Margin Ratios	
Gross Operating Margin	21%
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	2.59

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F. AllPack Industries Ltd.

Nature of Business:

Activity/Product: Manufacture of corrugated cartons for packing.
Market: Primarily horticultural export firms.

Current Ownership:

Yamada Investments (KHE)	20.0%
Redhill Estate (KHE)	12.5%
Vegpro	7.5%
Esara Investments	2.5%
IFC	15.0%
IPS	12.5%
Diamond Trust	12.5%
Jubilee Insurance	12.5%
AKFED	5.0%

Note: KHE refers to Kenya Horticultural Exporters, one of the largest exporters of fresh horticultural produce.

AID Loan Details:

Amount	:	sh 24,000,000
Disbursement Date	:	June 1993
Term	:	8 years
Moratorium:	:	2 years
Interest rate	:	13%
Repayments	:	sh 2,941,636 half yearly
Outstanding (June 93)	:	sh 24,000,000

Use of Funds: Purchase of equipment and working capital.

Viability:

The Company has captive customers in the horticultural industry (KHE & Vegpro). Its products are thought to be of high quality. However the Company is currently operating at only 20 percent capacity. It is still in a start-up mode. Although the Company appears to have potential, it may face cash flow problems when the loans become payable unless it can increase its production.

Likely Method and Timing of Divestiture: If the Company is successful IPS may be able to offer it for public flotation after five years.

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COMPANY: ALLPACK INDUSTRIES

SUMMARY FINANCIAL STATEMENTS FOR 8 MONTHS ENDING: August 31, 1993

Balance Sheet

	KSH '000
Assets	
Fixed Assets	153,518
Current Assets	110,178
Pre-operating/ Formation expenses	9,514
Total	273,210
Liabilities	
Long Term Debt	112,000
Current Liabilities	86,805
Total	198,805
Equity	
Share capital + premium	78,000
Reserves + Retained earnings	(3,595)
Total	74,405
Liabilities + Equity	273,210

Income Statement (Profit & Loss Account)

	KSH '000
Turnover (Sales)	81,457
Less: Cost of Sales	46,668
Gross Profit	34,789
Less: Interest Expense	18,439
Admin & Mktg. Expense	12,791
Depreciation	7,154
Total Expenses	38,384
Profit	(3,595)

Cash Flow from Operations

	KSH '000
Net Profit before Tax	(3,595)
Add: Interest	18,439
Add: Depreciation	7,154
Total	21,998

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	2.67
Margin Ratios	
Gross Operating Margin	43%
Debt Service Coverage	
Cash Flow from operations/Interest Expense	1.19

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ANNEX D
KEM PORTFOLIO

I. SUMMARY OF INVESTMENTS

KEC/KEM has to date invested in or arranged financing for six companies. These are:

Punchlines Ltd.
Gringos Ltd.
Windsor Investments
- Windsor Golf, Siana Springs & Windsor Retail

Bins Ltd.
Kenya Crocodile Farm Ltd.
Central Glass Industries

Details on the amounts invested are illustrated in the table on the next pate. Below is a comparison of these investments to that anticipated by the project paper (Page A-26). Amounts in Kenya shillings have been converted into U.S. dollars at the exchange rate prevailing when the transaction occurred. For the purposes of this analysis the entrepreneur is defined as the project sponsor or joint venture partner.

Anticipated		Actual	
EQUITY	U.S. $ 000	**EQUITY**	U.S. $ 000
Financial Inst. (including KEC)	2,000	KEC	914
		Other	5,438
Entrepreneurs	3,000	Entrepreneurs	7,962
Total Equity	5,000	**Total Equity**	14,315
DEBT	U.S. $ 000	**DEBT**	U.S. $ 000
USAID Credit Line	4,000	USAID Credit Line	2,983
Other	6,000	Other	8,640
Total Debt	10,000	**Total Debt**	11,624

KEC - TOTAL INVESTMENTS

A) In Ksh Millions

Borrower	Date	DEBT USAID	DEBT Other	DEBT Total	EQUITY KECL	EQUITY Other	EQUITY Entrep-reneur	EQUITY Total
Punchlines Ltd.	Nov 89	8.25	3.50	11.75	5.50	0.00	11.20	16.70
Gringos Ltd.	Dec 89	2.50	3.00	5.50	1.68	0.00	1.82	3.50
	Nov 91	1.50	1.80	3.30	1.00	0.00	1.10	2.10
Windsor Investments Ltd.								
(for Nairobi Golf Hotels Ltd.)	Apr 90	9.00	111.00	120.00	6.00	26.00	101.00	133.00
(for Oltukai Mara Ltd.)	Oct 91	36.00	0.00	36.00	0.00	0.00	20.00	20.00
(for Windsor Retail)	Aug 92	2.25	0.00	2.25	1.50	0.00	2.50	4.00
Bins Ltd.	Oct 91	0.90	0.00	0.90	0.60	0.00	0.00	0.60
Kenya Crocodile Farm Ltd.	Nov 91	9.90	6.20	16.10	6.60	0.00	3.50	10.10
Central Glass Industries	Jun 93	18.00	163.50	181.50	0.00	219.00	103.50	322.50
Total		88.30	289.00	377.30	22.88	245.00	244.62	512.50

B) In US$ ('000)

Borrower	Date	Exchange Rate	DEBT USAID	DEBT Other	DEBT Total	EQUITY KECL	EQUITY Other	EQUITY Entrep-reneur	EQUITY Total
Punchlines Ltd.	Nov 89	21.6	382	162	544	255	0	519	773
Gringos Ltd.	Dec 89	21.6	116	139	255	78	0	84	162
	Nov 91	28.4	53	63	116	35	0	39	74
Windsor Investments Ltd.									
(for Nairobi Golf Hotels Ltd.)	Apr 90	22.9	393	4,847	5,240	262	1,135	4,410	5,808
(for Oltukai Mara Ltd.)	Oct 91	28.6	1,259	0	1,259	0	0	699	699
(for Windsor Retail)	Aug 92	45.2	50	0	50	33	0	55	88
Bins Ltd.	Oct 91	28.6	31	0	31	21	0	0	21
Kenya Crocodile Farm Ltd.	Nov 91	28.6	346	217	563	231	0	122	353
Central Glass Industries	Jun 93	50.9	354	3,212	3,566	0	4,303	2,033	6,336
Total			2,983	8,640	11,624	915	5,438	7,962	14,315

Although it would appear that KEC's actual investments exceed the expectations, the figures are distorted by the investments in Central Glass and Windsor Investments. These two investments constitute 90 percent of the total debt and equity figures indicated above. However KEC provided none of the equity for Central Glass and less than 5 percent of the equity in Windsor Investments.

II. DETAILS OF PORTFOLIO COMPANIES

The following pages provide details on the companies in the KEC Portfolio.

As per the Trustee's records the amounts outstanding on the USAID credit line at the end of June 1993 are as follows:

Company	K sh ('000)
Punchlines	6,335
Gringos	4,000
Windsor Investments - 1	9,000
- 2	36,000
- 3	2,250
Bins	900
Kenya Crocodile Farm	9,900
Central Glass	18,000
Total	86,385

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A. Punchlines Ltd.

Nature of Business:

Activity/Product: Manufacture of computer stationery.
Market: Kenyan businesses - primarily large private banks.

Current Ownership:

100% ownership by Aggarwal family following divestiture by KEC.

AID Loan Details:

Amount	:	8,250,000
Disbursement Date	:	November 89
Interest Rate	:	10%
Repayments	:	sh 150,000 monthly
Outstanding (June 93)	:	sh 6,335,612

Note: Repayments have been accelerated following divestiture by KEC.

Use of Funds: Replacement of foreign currency-denominated loan from IDB.

Viability:

The Company has high quality products and is growing steadily. It faces stiff competition from cheap foreign products imported without payment of duties. The financial ratios indicate that the Company is highly leveraged but otherwise healthy. Based on current market conditions it should be able to make Trust Loan payments.

Likely Method and Timing of Divestiture: KEC has already divested its shareholding.

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COMPANY: PUNCHLINES LTD.

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: June 30, 1992

Balance Sheet	KSH '000
Assets	
Fixed Assets	15,385
Current Assets	12,834
Pre-operating/ Formation Expenses	0
Total	28,219
Liabilities	
Long Term Debt	14,225
Current Liabilities	11,470
Total	25,695
Equity	
Share Capital + Premium	11,167
Reserves + Retained Earnings	(8,643)
Total	2,524
Liabilities + Equity	28,219

Income Statement (Profit & Loss Account)	KSH '000
Turnover (Sales)	31,973
Less: Cost of Sales	26,531
Gross Profit	5,442
Less: Interest Expense	786
Admin & Mktg. Expense	3,483
Depreciation	192
Total Expenses	4,461
Profit	981

Cash Flow from Operations	KSH '000
Net Profit before Tax	981
Add: Interest	786
Add: Depreciation	192
Total	1,959

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	10.18
Margin Ratios	
Gross Operating Margin	17%
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	2.49

B. Gringos Ltd.

Nature of Business:

Activity/Product: Restaurant near Runda serving primarily Mexican food. Also does outside catering.
Market: For restaurant - high income patrons residing in the neighborhood or working at UNEP. For catering - primarily schools with international students.

Current Ownership:

Mr & Mrs. Crooks	52%
KEC	48%

AID Loan Details:

Amount	:	4,000,000
Disbursement Date	:	December 89
Interest Rate	:	13%
Repayments	:	sh 330,000 half yearly
Outstanding (June 93)	:	sh 4,000,000

There were two loans of sh 2.5m and sh 1.5m. During financial restructuring in 1991 the two loans were combined. The Trustee now regards this as one loan with a term of eight years.

The Crooks family recently brought its loan payments up to date by paying all interest arrears. On 12/17/93 a total of Ksh. 970,260 was paid. It has further been agreed that the family will pay Ksh. 400,000 by 4/30/94. The payments are coming from the Crooks' other businesses.

Use of Funds: Renovation of building, purchase of equipment, and working capital.

Viability:

The business experienced problems from the beginning. The management hired by the owners was inadequate and unaware of local conditions. The quality of food was inconsistent and the business got a lot of adverse publicity. The owners are now taking keener interest in the business but it is unlikely that they will be able to save it. Under current operating circumstances the Company is not in a position to satisfy its creditors including the Trust. Nor does it appear to be generating enough cash to cover costs. It may be forced to shut down even before foreclosure.

Likely Method and Timing of Divestiture: The owners of the company claim to be considering buy-out options for their and KEC's equity interests and the repayment of the Trust Loan including interest and penalties due.

COMPANY: GRINGOS LTD.

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: February 28, 1993

Balance Sheet	KSH '000
Assets	
Fixed Assets	4,441
Current Assets	3,954
Pre-operating/ Formation Expenses	1,161
Total	9,556
Liabilities	
Long Term Debt	14,043
Current Liabilities	7,622
Total	21,665
Equity	
Share capital + Premium	5,583
Reserves + Retained Earnings	(17,692)
Total	(12,109)
Liabilities + Equity	9,556
Income Statement (Profit & Loss Account)	KSH '000
Turnover (Sales)	18,049
Less: Cost of Sales	14,334
Gross Profit	3,715
Less: Interest Expense	1,235
Admin & Mktg. Expense	6,183
Depreciation	1,356
Total Expenses	8,774
Profit	(5,059)
Cash Flow from Operations	KSH '000
Net profit before Tax	(5,059)
Add: Interest	1,235
Add: Depreciation	1,356
Total	(2,468)

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	(1.79)
Margin Ratios	
Gross Operating Margin	21%
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	(2.00)

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C. Windsor Investments

Nature of Business:

Holding Company that has invested in the tourism industry. Its investments include:

Nairobi Golf Hotels Ltd. - operates the Windsor Golf & Country Club, a luxury hotel and golf club on the outskirts of Nairobi.

Oltukai Mara Ltd. - operates the Siana Springs game lodge at Masai Mara.

Windsor Retail Ltd. - operates retail stores at Windsor Golf and Siana Springs.

Current Ownership:

KEC owns about 13 percent of Windsor Investments while Madison Insurance owns 51 percent.

Windsor Golf & Country Club is owned by Nairobi Golf Hotels Ltd. This Company is owned by Fairview Investments Ltd (76 percent) and Windsor Investments Ltd (24 percent).

Siana Springs is owned by Oltukai Mara Ltd. This Company is owned 100 percent by Windsor Investments.

It was anticipated that Windsor Investments would have 50 percent ownership of Windsor Retail. However there have been some complications and the ownership status is not clear.

Sharehodlers' Breakdown:

Shareholders' Names	No. of Shares Held	Nominal Value of the Shares	Share Premium	Total Amount	%
D W Stockdale	1	1	99	100	--
PS Ngori	1	1	99	100	--
Windsor Holdings Ltd.	74,998	74,998	7,424,802	7,499,800	12.77
Madison Insurance Co (K) Ltd.	299,998	299,998	29,699,802	29,999,800	51.06
S G Mgaruiya	1	1	99	100	--
J M Wainaina	1	1	99	100	--
Leisure Fund (Kenya) Ltd.	75,000	75,000	7,425,000	7,500,000	12.77
Kenya Equity Capital Ltd. (As trustee of EIB)	137,500	137,500	13,612,500	13,612,500	23.4
TOTAL	587,500	587,500	58,162,500	58,750,000	100

C. Windsor Investments (cont.)

AID Loan Details:

Loan 1 Amount	:	9,000,000
Disbursement Date	:	April 90
Repayments	:	Income participation. Principal payable at maturity
Outstanding (June 93)	:	sh 9,000,000

No dividends have been paid to date.

Loan 2 Amount	:	36,000,000
Disbursement Date	:	October 91
Interest Rate	:	16%
Repayments	:	sh 7,056,000 - annually.
Outstanding (June 93)	:	sh 36,000,000

Moratorium on principal to October 31, 1994.

Loan 3 Amount	:	2,250,000
Disbursement Date	:	August 92
Interest Rate	:	16%
Repayments	:	as per Loan 2
Outstanding (June 93)	:	sh 2,250,000

This loan was rolled into Loan 2 and repayments combined.

Use of Funds:

Loan 1: Construction of hotel.
Loan 2: Purchase of existing lodge and renovation
Loan 3: Working Capital

Viability:

The Company is at the high end of a competitive industry. It has associated itself with experienced hoteliers and tour operators in the form of Windsor Holdings and Abercrombie & Kent. However it is vulnerable to swings in business depending on Kenya's perception in the world as a holiday destination. Both Windsor Golf & Siana Springs have also experienced security problems in their surroundings. The financial ratios indicate that the Company is well capitalized. As it is still in a start-up mode it is impractical to measure likely operating cash flow.

Likely Method and Timing of Divestiture: If the Company is successful a public flotation may be conceivable after about five years. In the meantime if KEC is not able to contribute to the additional equity capital needs of Windsor Investments its shareholding will be diluted.

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COMPANY: WINDSOR INVESTMENTS LTD.

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: December 31, 1992

Balance Sheet			KSH '000
	Assets		
		Fixed Assets	4,362
		Current Assets	26,485
		Investments	95,017
		Total	125,864
	Liabilities		
		Long Term Debt	53,010
		Current Liabilities	11,166
		Total	64,176
	Equity		
		Share Capital + Premium	58,750
		Reserves + Retained Earnings	2,938
		Total	61,688
	Liabilities + Equity		125,864
Income Statement (Profit & Loss Account)			KSH '000
	Turnover (Sales)		NA
Less:	Cost of Sales		NA
	Gross Profit		8,379
Less:	Interest Expense		8,042
	Admin & Mktg. Expense		176
	Depreciation		0
	Total Expenses		8,218
	Profit		161
Cash Flow from Operations			KSH '000
	Net Profit before Tax		161
Add:	Interest		8,042
Add:	Depreciation		0
	Total Cash Flow		8,203

FINANCIAL RATIOS

Capital Structure		
	Liabilities/Equity	1.04
Margin Ratios		
	Gross Operating Margin	NA
Debt Service Coverage		
	Cash Flow from Operations/Interest Expense	1.02

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D. Bins Ltd.

Nature of Business:

Activity/Product: Garbage collection and disposal.
Market: High income residential neighborhoods and industry.

Current Ownership:

The shareholding for Bins Ltd. is as follows: Tim Davis 6 percent, Wendy Davis 45 percent, J. Van der Wal 20 percent, and Manufacturing and Industrial Services Fund 29 percent.

AID Loan Details:

Amount	:	900,000
Disbursement Date	:	October 91
Interest Rate	:	13%
Repayments	:	sh 117,000 half yearly Principal payable at maturity
Outstanding (June 93)	:	900,000

Use of Funds: Working capital.

Viability: Because it is larger than the other two private garbage collection firms combined, Bins appears to have a strong strategic position in proposed bidding to take over a portion of the garbage collection from the City Council. City Council collection now represents 85 percent of total collection. However Bins will need to address its management, accounts receivable, and financial problems if it is to handle this opportunity successfully.

Likely Method and Timing of Divestiture: It is possible that Bins could be acquired by a large company interested in bidding for privatization tenders. In such a case the AID/KEC participation should be sold to such a bidder.

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COMPANY: BINS LTD.

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: July 31 1993

	KSH '000
Balance Sheet	
Assets	
Fixed Assets	1,732
Current Assets	3,126
Pre-operating/ Formation Expenses	12
Total	4,870
Liabilities	
Long Term Debt	1,051
Current Liabilities	4,671
Total	5,722
Equity	
Share capital + Premium	20
Reserves + Retained Earnings	(872)
Total	(852)
Liabilities + Equity	4,870

	KSH '000
Income Statement (Profit & Loss Account)	
Turnover (Sales)	10,562
Less: Cost of Sales	5,506
Gross Profit	5,056
Less: Interest Expense	175
Admin & Mktg. Expense	3,737
Depreciation	456
Total Expenses	4,368
Profit	688

	KSH '000
Cash Flow from Operations	
Net Profit before Tax	688
Add: Interest	175
Add: Depreciation	456
Total	1,319

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	(6.72)
Margin Ratios	
Gross Operating Margin	48%
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	7.54

E. Kenya Crocodile Farm Ltd.

Nature of Business:

Crocodile farming:
- export of skins
- sale of meat to restaurants in Kenya.

Entertainment:
- crocodile viewing & restaurant primarily catering to tourists staying at nearby hotels
- disco: popular with both local patrons & tourists.

Current Ownership:

The managers CLAL (Israeli Company) owns 50 percent. KEC owns 40 percent while Alico owns 10 percent.

AID Loan Details:

Amount	:	9,900,000
Disbursement Date	:	November 91
Interest Rate	:	8%
Repayments	:	sh 990,000 - Annually
Outstanding (June 93)	:	9,900,000

Moratorium on principal to November 30, 1994.

Use of Funds: Replacement of Alico loan.

Viability:

The Company is really running two distinct businesses. The entertainment side is doing well. Although it is subject to fluctuations in the tourism industry it has a large local customer base for the disco.

The crocodile skins business is not generating a lot of income. As the skins are sold to a CLAL tannery in Italy the low income may be more of a reflection of CLAL's transfer pricing policies than the viability of the business.

Likely Method and Timing of Divestiture: The most likely exit strategy would be to spin off the non-skins business into a new Company. If this is done KEC could exchange its shares in Kenya Crocodile Farm for CLAL's shares in the new Company. The new Company could then be sold to someone already in the entertainment business.

COMPANY: KENYA CROCODILE FARM

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: December 31, 1992

Balance Sheet	KSH '000
Assets	
Fixed Assets	18,185
Current Assets	19,145
Pre-operating/ Formation Expenses	0
Total	37,330
Liabilities	
Long Term Debt	4,452
Current Liabilities	21,590
Total	26,042
Equity	
Share capital + Premium	12,933
Reserves + Retained Earnings	(1,645)
Total	11,288
Liabilities + Equity	37,330

Income Statement (Profit & Loss Account)	KSH '000
Turnover (Sales)	25,480
Less: Cost of Sales	9,511
Gross Profit	15,969
Less: Interest Expense	1,890
Admin & Mktg. Expense	12,876
Depreciation	985
Total Expenses	15,751
Profit	218

Cash Flow from Operations	KSH '000
Net Profit before Tax	218
Add: Interest	1,890
Add: Depreciation	985
Total	3,093

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	2.31
Margin Ratios	
Gross Operating Margin	63%
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	1.64

F. Central Glass Industries

Nature of Business:

Activity/Product: Manufacture of glass bottles.
Market: Primarily local (Kenya Breweries, Coca Cola etc.).

Current Ownership:

The parent Company Kenya Breweries owns 76 percent. Africa Growth Fund (AGF) has 22 percent while the European Investment Bank has 2 percent. The AGF is a U.S.-based venture capital fund managed by Equator Bank.

AID Loan Details:

Amount	:	18,000,000
Disbursement Date	:	June 93
Interest Rate	:	20%
Repayments	:	sh 6,000,000 - half yearly
Outstanding (June 93)	:	18,000,000

Moratorium on principal to June 30, 1995.

Use of Funds: Expansion - new production line.

Viability:

The Company's shareholders, Kenya Breweries and Coca Cola (investors through the AGF), provide a strong 20 percent captive client base for its output. The Company has also started exporting to neighboring countries. As the Company plans to rebuild the furnace in the near future, it will require significant foreign currency and this will put a drain on its resources.

Note: The accounts of Central Glass provided by KEM do not show the cost of sales or gross profit figures.

Likely Method and Timing of Divestiture:

The Company would be a suitable candidate for public flotation in 2-3 years.

COMPANY: CENTRAL GLASS INDUSTRIES

SUMMARY FINANCIAL STATEMENTS FOR YEAR ENDING: June 30, 1993

	KSH '000
Balance Sheet	
Assets	
Fixed Assets	883,400
Current Assets	278,340
Pre-operating/ Formation Expenses	0
Total	1,161,740
Liabilities	
Long Term Debt	166,840
Current Liabilities	663,480
Total	830,320
Equity	
Share capital + Premium	384,320
Reserves + Retained Earnings	(52,900)
Total	331,420
Liabilities + Equity	1,161,740

	KSH '000
Income Statement (Profit & Loss Account)	
Turnover (Sales)	304,860
Less: Cost of Sales	NA
Gross Profit	NA
Less: Interest Expense	56,575
Admin & Mktg. Expense	NA
Depreciation	36,800
Total Expenses	NA
Profit	(14,424)

	KSH '000
Cash Flow from Operations	
Net Profit before Tax	(14,424)
Add: Interest	56,575
Add: Depreciation	36,800
Total	78,951

FINANCIAL RATIOS

Capital Structure	
Liabilities/Equity	2.51
Margin Ratios	
Gross Operating Margin	NA
Debt Service Coverage	
Cash Flow from Operations/Interest Expense	1.40

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ANNEX E
ENVIRONMENTAL IMPACT OF THE EQUITY CAPITAL COMPONENT

The potential of the investments to damage or preserve the environment is as follows:

Premier Foods Industries Ltd.: No impact.

Premier Refrigeration and Engineering: Refrigerant being used previously was toxic. Company is in the process of converting equipment to use newer environmentally friendly refrigerant. Company is also offering to convert equipment previously delivered to customers.

Frigoken Ltd.: No impact.

Novaskins Tannery Ltd.: There was potential for effluent to contaminate water supply in the area. The company has installed a fully integrated effluent plant which is used as a model by the municipality.

Ukulima Tools Ltd.: Possibly a positive impact as some of the new capital was used to replace an inefficient furnace.

Allpack Industries Ltd.: No impact. Liquid starch effluent is treated on site using integrated plant.

Punchlines Ltd.: Possibly positive impact as company is making efforts to use recycled paper.

Gringos Ltd.: No impact.

Windsor Golf: Possibly positive impact - land conservation.

Bins Ltd.: Possibly positive impact as service cleans up Nairobi city. There is potential for negative impact if new sites for sorting the garbage are not chosen with care.

Siana Springs: No impact.

Kenya Crocodile Farm Ltd.: Positive impact as company is rehabilitating an abandoned quarry. Skins production is controlled by regulations of CITES and Kenya Wildlife Service.

Central Glass Industries: No impact.

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ANNEX F
IMPACT ON EXISTING BUSINESSES OF THE EQUITY CAPITAL COMPONENT

On the whole there is no significant indication that the investments displaced existing labor intensive businesses owned by indigenous Kenyans or women. Where the new investments took away business from existing companies the affected businesses were primarily subsidiaries of foreign companies or large Kenyan companies.

Premier Foods Industries Ltd.: Primary competition is from large Asian-owned company and imports from South Africa.

Premier Refrigeration and Engineering: Only true manufacturer of refrigeration equipment in Kenya. Competitors are assemblers and importers.

Frigoken Ltd.: Primary competition is foreign. Local competitors doing exports are large companies owned by Asians or the government.

Novaskins Tannery Ltd.: No impact.

Ukulima Tools Ltd.: No impact - primary competition is from Chinese imports.

AllPack Industries Ltd.: Primary competition is subsidiary of Canadian firm.

Punchlines Ltd.: Success of this company may impact on lower quality producers who are operating at 50 percent capacity.

Gringos Ltd.: No impact.

Windsor Golf: May have take away some business away from other large luxury hotels.

Bins Ltd.: May have affected performance of smaller African owned companies, which nevertheless have survived.

Siana Springs: Possibly affected other large lodges.

Kenya Crocodile Farm Ltd.: No impact.

Central Glass Industries: Increased investment may have boosted Central Glass to the detriment of Kenya Glass. However Kenya Glass is now re-establishing its operations under new ownership.

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ANNEX G
LETTER FROM GRINGO'S RESTAURANT

September 10, 1990
Nairobi

Mr B K Nzioki
Investment Promotion Centre
National Bank Building
8th Floor
Box 55704
Nairobi

ASSISTANCE

Dear Ben:

1. This refers to our conversations over the past several weeks when we outlined for you some of the problems we have been experiencing with local authorities. This has all added up to a continual loss of business and has greatly increased our costs.

2. Let me outline for you a few of these problems:

a. We applied and paid for installation of business telephones six months before the first line was installed. We pleaded with telephone officials in the downtown offices, Banana Hill and Kabete offices on a daily basis. What we got is a series of false promises, and innuendoes that "chai" would help matters along. After the first line was finally installed, all of the foregoing was repeated again for line 2 and again for line 3.

At long last we have three lines. However, we can rarely use them because there is a continual busy signal registered on every line when you try to call in. Any number of phone people have told us they "would look into this." The only response we have received is that the lines are OK.

Last Thursday I talked to another man at Banana Hill and on Friday another engineer appeared at Gringo's who said our switchboard was faulty. We told them this several weeks ago. He brought another switchboard but that was also faulty. He is to return with yet another board but tells us they are very difficult to find (more chai?).

Meanwhile, our loss of business has skyrocketed because customers can never reach us by phone for reservations. Tour operators, a very important business group to us, have about given up on Gringo's. They can never reach us by phone.

b. Water - Gringo's premises was initially serviced by Rosslyn water estate. The estate's Charter makes them responsible only to deliver 250 gals of water per day per user. Since our requirements far exceed this we were advised by the estate to apply for city water. We did this. The estate fulfilled our requirements as best they could until the switch over was made.

At this point we again had to deal with the City Commission, whose reputation for mismanagement, inefficiency and corruption is unrivaled. In the first instance we were told by the Commission that we would have to work with an "approved City Commission contractor" who wanted to charge us Shs 110,000/ to connect us to city water. We questioned this and after weeks of hassle finally found an honest man in the Commission who told us that there was no need to involve a contractor since the switch over only involved a few extra valves which the Commission 's men would install and charge us. After weeks this was finally done, however, additional problems arose immediately. The contractor disconnected our water. After repeated calls to the water department in the industrial area they said they would straighten it out and send us water by their truck until they reconnected us. They finally did reconnect us but never sent us any water. Of course the City Commission is of no assistance.

We are continually without water and have virtually one full time man tracking down the enumerable reasons why we run out of water. We have been to the UNEP branch, to the Rosslyn branch, we have done midnight runs within a 10 kms radius of Gringo's with "officials" of the Commission attempting to turn valves off and on and we are still without water. The only way we can get water now is to hunt up an "official" and have him track down the problem. Of course this always happens on holidays and weekends and of course it costs us money. The alternative is no water and a restaurant cannot operate one day without water.

We have we have spent over Shs80000/ for contract water plus hundreds of wasted employee manhours.

c. Power- you are aware of our electrical problems which we have experienced from opening day. We asked the KP&L to give us a quote on installing 3 phase power. It took over a month to get them to come out and "study" the situation. It took two months with numerous phone calls and visits and whatever, to get them to give us a price. The price was Shs 78000/ which we paid with the proviso they would begin work immediately. We contracted out our portion of the work and are now waiting on the KP&L who have not even started but have had our money for months. They wouldn't start work until they were paid in full.

Because of the power problems we have had a generator on contract since opening. This costs us Shs 60000/ per month and we still can't run much of our equipment because the line won't take it. We've lost thousands of shillings in perishable food stuffs and have incurred thousands of shillings additional costs of other items. Only one example is the thousands of shillings spent daily for ice because our present power supply can't handle our two ice machines.

d. Additionally, we have been threatened by the City Commission for putting up signs, continually promised by the City Commission that they would remove sewage, (which is their job), audited by NCC officials and NHIF officials (after being in business only 7 months), harassed by a music group who demands payment for playing in-house music, and our managers threatened with jail by an arrogant Ministry of Health official because a garbage bin wasn't covered (yet our entire garbage facility is completely enclosed).

3. Our experience with the customs department is well documented. This department operates like a government within a government and its standard of corruption and the arrogance of certain officials is really unbelievable and a disgrace to Kenya. Treatment of our manager by customs officials because we refused to pay "chai" was absolutely degrading to her and should not have to be experienced by anyone.

4. The assistance we've received from IPC in obtaining the necessary licenses and permits was commendable. Without the help of the IPC we would not have invested. However, that's only the tip of the iceberg. There are so many factors working against IPC and against investment in Kenya in general that are very discouraging.

5. In my opinion, substantial and continual investment in Kenya, like any other country, equates to the survival and growth of this country. The Government is aware of this and appears anxious to have investment--local and foreign. Almost daily we read statements about positive Government attitudes towards investment and how good the investment climate is in Kenya.

6. Through the IPC the mechanics of investment have speeded up, and although there is still much to be done at this level, it is very encouraging. However, the problems facing business on a day to day operational level are still there and growing, and seem to be largely ignored by Government. The same massive bureaucratic obstacles and attitudes remain, and oppressive corruption continues to mount. The net result is the cost of doing business here skyrockets, and Kenya's attraction to investors diminishes. On a competitive scale, Kenya today is far down the list of attractive countries to invest in.

7. We need your immediate assistance in getting our problems with water, power, phones and sewage solved.

8. Thank you.

Sincerely,

Howard H Crooks
Director

cc: Silas Ita - Managing Director, IPC
Bruce Bouchard - KEM

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W.C.
HX

September 10. 1990
Nairobi

Mr B K Nzioki
Investment Promotion Centre
National Bank Building
8th Floor
Box 55704
Nairobi

ASSISTANCE

Dear Ben:

1. This refers to our conversations over the past several weeks when we outlined for you some of the problems we have been experiencing with local authorities. This has all added up to a continual loss of business and has greatly increased our costs.

2. Let me outline for you a few of these problems:

a. We applied and paid for installation of business telephones six months before the first line was installed. We pleaded with telephone officials in the downtown offices, Banana Hill and Kabete offices on a daily basis. What we got is a series of false promises, and innuendoes that "chai" would help matters along. After the first line was finally installed, all of the foregoing was repeated again for line 2 and again for line 3.

At long last we have three lines. However, we can rarely use them because there is a continual busy signal registered on every line when you try to call in. Any number of phone people have told us they "would look into this." The only response we have received is that the lines are OK.

Last Thursday I talked to another man at Banana Hill and on Friday another engineer appeared at Gringo's who said our switchboard was faulty. We told them this several weeks ago. He brought another switchboard but that was also faulty. He is to return with yet another board but tells us they are very difficult to find (more chai?).

Meanwhile, our loss of business has skyrocketed because customers can never reach us by phone for reservations. Tour operators, a very important business group to us, have about given up on Gringo's. They can never reach us by phone.

b. Water - Gringo's premises was initially serviced by Rosslyn water estate. The estate's Charter makes them responsible only to deliver 250 gals of water per day per user. Since our requirements far exceed this we were advised by the estate to apply for city water. We did this. The estate fulfilled our requirements as best they could until the switch over was made.

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7. We need your immediate assistance in getting our problems with water, power, phones and sewage solved.

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Sincerely,

Howard H Crooks
Director

cc: Silas Ita - Managing Director, IPC
Bruce Bouchard - KEM

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ANNEX H
SCOPE OF WORK

I. ACTIVITY TO BE EVALUATED

The activity to be evaluated is the Equity Capital component being implemented through "The Kenya Trust For Enterprise Development" (the Trust). This is a component under the Private Enterprise (PED) Project No. 615-0238. PED is $25 million project which began in 1987. The project purposes are to strengthen institutions that can improve Kenya's business environment; and to encourage growth of businesses directly through the financial and advisory assistance those institutions provide.

The objectives of the Equity capital component were to help establish a new equity capital company in Kenya in which local financial institutions would invest; to assist, both through the new and an existing capital company, in the financing for 30 to 40 business startups or expansions; and to contribute to the development of a mature equity capital market in Kenya. Although PED ends in 1994, the Kenya Trust for Enterprise Development, established on 30th June 1987, is envisioned to run for 18 years or as determined by USAID. The total funding obligated by USAID for KEM and the Trust component was $9,644,000 which was to be matched by investment by other investors to the tune of $36,244,000.

II. BACKGROUND

At the beginning of the project, equity capital in Kenya was identified as being in short supply for start-ups and major expansions among productive businesses particularly those of small to medium scale. This meant that investment was inhibited and also that growth in the number and size of productive business was slower than optimal.

Under the equity capital component, USAID/Kenya intended to provide credit and also to arrange for equity capital to be invested in Kenyan private enterprises. In order to provide for the management and administration of the loans and investments made, USAID/Kenya provided assistance for the establishment of The Kenya Trust for Enterprise Development and selected three entities to operationalize the Trust-- two equity capital companies (Kenya Equity Management [KEM] and Industrial Promotion Services Co. Ltd. [IPS]); and a bank (Standard Chartered Bank Ltd.), which acts as Trustee. These Kenyan enterprises are also referred to as the sub borrowers in project letters and documentation. KEM's participation in the Trust will be discussed first.

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Kenya Equity Management Ltd (KEM):

USAID initiated the founding of one new equity capital company. This new company consists of two related companies, Kenya Equity Management Ltd (KEM) and Kenya Equity Capital Ltd (KECL). KEM manages KECL which is simply a fund. KECL is a pool of equity capital invested by a cross section of investors such as insurance companies, pension funds, groups of private individuals, other financial institutions with KEM itself owning 12 1/2% of KECL shareholding. USAID provides $ 2,190,000 for KEM support, and a line of $4 million for KECL.

Initially, KECL was owned and funded by Equatorial Advisory Services Ltd., International Resources Group, Alico Kenya, Apollo Insurance company and Coda Management Consultancy Co. This may change soon.

According to the project paper the assistance from A.I.D. was to:

i) help establish a new equity capital company in Kenya in which local financial, insurance, pensions and other institutions and groups of individuals would invest.

ii) assist in the financing of ten to fifteen business start-ups or expansions and;

iii) contribute to the development of a mature equity capital market in Kenya.

INDUSTRIAL PROMOTION SERVICES LTD (IPS):

The other equity capital company, Industrial Promotion Services Kenya (IPS), already existed and is funded primarily by the Aga Khan Foundation.

USAID provides IPS with a $3 million line of credit for on-lending to businesses that IPS takes an equity stake in jointly with International Finance Corporation. Unlike KEM, USAID funds are loaned to IPS rather than the sub-borrowers. The terms are 8 years at 9%, repayable in Kenya shillings. USAID also provides a $275,000 technical assistance grant to fund two new project development teams. These teams identify potential investments, and review and revise proposals as needed.

The objective of A.I.D.'s assistance to Industrial Promotion Services (K) Ltd is to support the start-up or expansion of up to twenty productive businesses in Kenya, to assist the same number of developing entrepreneurs and to increase the number of project development personnel in Kenya.

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THE TRUSTEE: STANDARD CHARTERED BANK LTD.

The total line of credit to IPS and KEM is thus $7 million and is managed by a Trustee, Standard Chartered Bank (K) Ltd. acting through its subsidiary The Standard Chartered Investment Services Ltd.

The Trustee has these responsibilities:

1) requesting payment of funds into the trust by A.I.D.
2) disbursing and collecting the funds
3) monitoring loan payment status
4) instituting any necessary collection procedures in the event of default
5) investing the reflows in securities.
6) Paying the fees due to KEM and IPS either out of the balance in the Trust or by requesting additional funds from USAID.

III. PURPOSE OF EVALUATION

The purpose of this evaluation is to provide USAID/Kenya with an independent assessment of the progress made so far in meeting the objectives for setting up and funding the respective institutions under the Trust. In addition the evaluation will assist USAID/Kenya in determining its future funding of equity capital in Kenya. This evaluation will:

i) Determine how successful or unsuccessful the equity component has been in contributing towards meeting the private enterprise project and equity component goals. In so doing the evaluator will analyze the impact of the loans made under the project on the Kenyan businesses as well as the Kenyan equity market.

ii) Determine whether the Trust arrangement is a feasible instrument for the provision of equity capital, and one that should be repeated, or avoided, in future AID projects.

iii) Recommend any changes in implementation of the current project.

iv) Provide general lessons learned for equity capital as a development tool in Kenya.

D. Briefly, is there significant indication that the investments of KEM or IPS displaced existing businesses? If so, approximate the extent of the displacement and the characteristics of the sector and people who were displaced. For example, were the displaced businesses more labor intensive than the new businesses? Were the owners predominantly indigenous Africans or women? Did the displaced businesses use more local resources?

PROJECT MANAGEMENT:

The following questions are designed to assess project management by KEM, IPS, SCB, and USAID. They should help the evaluator examine management's contribution to project successes and limitations.

A. KEM:

1. How much of the intended equity capital from other investors and entreprenevrs did KEM raise? If less than the estimated target of $5 million, why wasn't the full amount raised? If more, what facilitated the above-target performance? Did it matter that the target was or was not reached?

2. Did KEM identify, evaluate, select and structure investments according to the project paper guidance?

3. In putting the loan and equity deals together did KEM practice " due diligence"? How does the evaluation team assess the "due diligence"?"

4. What is the viability of each of the businesses receiving loans, both at the time they received the loans and at present? Assess their long term sustainability, taking into account their market and economic environment.

5. Did KEM provide appropriate managerial and support services to its sub-borrowers? Did KEM make divestment decisions according to guidance? For example, the fund was to sell its equity in each investment in about 5 to 7 years. The methods of divestment were to be various types of private placement. Was this process followed?

6. Did KEM take appropriate action on non-performing loans?

7. Describe the structure of KEM funds, particularly with regard to the shareholders. How do the various funds being managed by KEM relate to KECL? Does the present

structure differ from the intended structure at the beginning of the project? What effect does the present structure have on project objectives and goals?

8. What was the nature, cause and impact of shareholder/management problems in KEM? How were they addressed or solved, and what was their impact on the project? Were the problems specific to KEM, to the particular structure of KEM or to equity investments in Kenya in general?

9. Assess the sustainability of KEM. What are the prospects for KEM becoming sustainable, and how long would this take? What are the possibilities for KEM creating a new ongoing equity capital company in Kenya and a second fund along the same lines as the first? Explain.

B. Industrial Promotion Services Ltd (IPS)

1. How much of the intended equity capital from other investors and entrepreneurs did IPS raise? If less than the estimated target of $7,500,000, why wasn't the full amount raised? If more, what facilitated the above-target performance? Did IPS invest in up to twenty productive businesses in Kenya?

2. Did IPS expand its Kenyan project management staff? What observations can the evaluation team make in respect to the project management staff role at IPS? For example, what are their responsibilities?

3. Did International Finance Corporation (IFC) support for IPS continue at the anticipated level? For example, over the first 5 years IPS and IFC were to jointly make equity investments of $3 million in industries at the rate of $600,000 a year.

4. Did IPS identify, evaluate, select and structure investment according to the project paper guidance?

5. In putting the loan and equity deals together did IPS practice "due diligence"? How does the evaluation team assess the "due diligence"?

6. What is the viability of each of the businesses receiving loans, both at the time they received the loans and at present? Assess their long term financial viability, taking into account their market and economic environment.

7. Did IPS provide appropriate managerial and support services to its sub-borrowers? What are the prospects for IPS divesting which, according to guidance, is to take place between 1995 to 2000 and with significant capital gains?

8. What management issues arose during the project, and how were they addressed? Did they interfere with sourcing and rapidly concluding solid investments?

9. Assess the long term sustainability of IPS as an institution.

10. Compare the strengths and weaknesses of IPS and KEM. How could each institution's performance be improved?

C. Standard Chartered Bank LTD:

1. Did the SCB manage the Trust funds according to the agreement?

2. Was the agreement appropriate? Can any specific amendments be made now to improve the project performance?

D. USAID:

1. Did USAID/Kenya meet all of its responsibilities in the various project agreements?

2. Were USAID agreements appropriate, sufficiently specific, or too specific? For example, USAID did not provide guidance regarding the terms of the loans to sub-borrowers. KEM established a practice of a one-time disbursement of the full loan amount, rather than gradual disbursements, which could imply less control over how a sub-borrower actually spends the funds. Should USAID have been more specific about loan terms?

VIABILITY OF EQUITY CAPITAL MODEL:

The following questions are designed to take a broad, strategic look at the project. The questions should help the evaluator to assess the viability of the equity capital model used in this project and the general viability of equity capital in Kenya now and in the future?

A. Compare the structure and operational guidelines of IPS and KEM to each other, and to other equity capital companies worldwide. In general, are these companies up to international standards? Are they an improvement over other companies in Kenya that offer equity financing? Look at the following aspects of the equity financing process:

1. Provision of capital by investors and by USAID: First, was the capital provided to the equity companies (IPS and KEM) by USAID and the shareholders appropriately packaged? Were the terms and quantity suitable for the companies' purposes? Second, were the terms and conditions of capital offered by the equity companies to the entrepreneurs suitable? How did the two packages compare with the terms and conditions offered elsewhere?

2. Structure of the equity capital companies: the ownership structure, management structure and institutional by-laws of IPS and KEM. For example, what in practice was the role of the shareholders in the equity companies, and what was their relationship to KEM and IPS management and to the firms invested in? Did the number or type (institutionally, ethnically, or politically) of shareholder affect project success? What was management's role and interest in the equity company? What was the role of SCB vis-a-vis IPS and KEM, and was it appropriate? How did these arrangements affect project performance, and how does it compare to other equity capital companies?

3. Firms receiving investments: Did the selection criteria, terms and conditions of investment, or role of management and investors affect the success of the businesses? Were these practices typical of other equity capital investment practices? For example, "Venture" capital is usually associated with high risk, high return investments. Was this the case in IPS and KEM, and did it affect project success?

4. Divestment and profit allocation: were the rules and processes surrounding divestment and profit allocation well designed? How do they compare with procedures in other equity capital arrangements?

B. Were there significant economic, social, or political factors in Kenya affecting the success of the project?

1. Are there institutional constraints in Kenya that prevent equity financing from operating successfully? Are conditions conducive enough for equity financing to be viable? For example, the last evaluation pointed out several institutional and governmental impediments to divesting firms. One such observation was that the stock exchange was not functioning well enough to be a viable market for selling shares in mature companies. Another referred to the high Government tax on profits from business resale. Finally, there is a general lack of legislature surrounding this type of finance. What is the status of these and other institutional barriers to equity finance in Kenya, and what are the prospects for their removal?

2. Were there extraordinary economic constraints facing the firms in Kenya, or were there economic conditions and policies that were conducive to equity capital investments? For example, how did economic policies and economic recession affect performance? In what way might the economic environment affect the future potential for long-term investments?

3. Did political instability affect investor confidence significantly, and is this likely to continue?

4. Were there social or ethnic issues surrounding the success or limitations of KEM and IPS? For example, how did IPS's strong association with the Ishmaili community affect its performance?

V. METHODS AND PROCEDURES

The Contractor shall:

1. Meet with USAID/Kenya to review the scope of work and the proposed work plan.

2. Review relevant documents and records as follows:

   a) USAID/Kenya:
      - Project paper
      - All project related agreements & amendments
      - All Reports from IPS and KEM
      - All loan and investment agreements with IPS and KEM of USAID funds beneficiaries.

   b) KEM and IPS:
      - Documents and letters relating to successful and rejected sub-borrowers

c) Loan and equity documentation of sub borrowers:
   - Equity certification documents
   - Debentures and or other security for loans
   - Loan repayment records
   - Audits

d) SCIS records:
   - The original Trust Deed and amendments
   - Disbursement and loan repayment records
   - Project description documents
   - Audit comments if any in the Trustee files

3. Conduct key informant interviews with:

   a) USAID/Kenya project manager(s).
   b) IPS and KEM key personnel and managers.
   c) The managing Director Standard Chartered Investment Services.
   d) The managing directors of the loan recipient companies.
   e) The Shareholders of KEM and IPS.
   f) Other donors and firms involved in venture capital such as Capital Markets Authority, Nairobi Stock Exchange, Africa Project Development Facility, Kenya Finance Corporation and others as appropriate.
   g) Potential investors, such as insurance companies and pension funds.

4. Conduct financial evaluations of the investments at the time of investment and at present, and comment on their long term viability.

5. Conduct a survey of all loan recipients to collect the necessary quantitative data on the loan recipients specifically

   a) increase in investment,
   b) increase in output
   c) increase in assets,
   d) increase in sales,
   e) increase in foreign exchange,
   f) increase in taxes paid to GOK
   g) increase in employment - gender-disaggregated.

This data should be compared with the data before loan figures to determine changes since receiving project assistance. The evaluator will conduct appropriate statistical analysis of the data collected including calculating average annual growth rates (using real financial values, weighted as per company

IV. STATEMENT OF WORK

The Contractor shall examine the project's impact and management, and assess the viability of the equity model used, and of equity investment in Kenya generally. First, the evaluator shall assess the performance of the project since inception and the extent to which the project met the objectives set out in the project paper. Second, the evaluator shall assess project management and its contribution to project success or failure. Third, the evaluator shall analyze viability of the model of equity capital employed by the project and give recommendations as to whether equity capital is viable in Kenya at this time.

For each of these broad themes, the Evaluator shall provide:
-Empirical findings based on qualitative or quantitative data, as appropriate.
-Conclusions, and the analysis leading to them.
-Recommendations, including suggestions for future funding for the institutions in the project.

Finally, the evaluator shall provide general lessons learned arising from the above analysis.

IMPACT:

This set of questions focuses on whether the project reached its stated objectives, and whether there were any additional, positive or negative, impacts of the project.

A. Did the Equity component achieve its objectives and did it contribute to the achievement of overall PED project objectives, as set out in the project paper? Report separately on IPS and KEM performance.

B. How has USAID assistance to KEM and IPS affected development of the equity capital market in Kenya? Did the project provide Kenyan firms with increased access to equity capital? Did it improve the equity market in Kenya? Or, for example, were subsidies to IPS and KEM a disincentive to other equity capital companies? Why or why not? Were there alternative sources of equity and loan capital finance provided by the project? Are there now? Or, is the mix of equity and loan financing offered by the project unique? Does it fill a needed market niche?

C. Briefly, were there any investments that had the potential to damage or preserve the environment, and, in broad descriptive terms, what was the extent of the impact in either case?

size), percentages, cross-tabulations and range of data set, and any other relevant statistical analyses that will assist in answering the questions in this scope of work.

CHEMONICS

INTERNATIONAL
CONSULTING
DIVISION

February 10, 1994

Center for Development Information and Evaluation
Acquisitions
Room 209, SA-18
Agency for International Development
Washington, DC 20523-1802

Reference: Deliverables produced by the Chemonics Consortium under the Indefinite Quantity Contract (IQC) for World Wide Technical Assistance in Private Enterprise, Contract No. PCE-001-I-00-2051-00.

To whom it may concern:

Enclosed, as stipulated in reference Contract, Section C.3.(b), Distribution, please find two copies of the following report:

Final Report: Evaluation of the Kenya Trust for Private Enterprise Development-Equity Capital Component, USAID/Kenya, Delivery Order No. 13.

If you have any questions or require additional copies, please contact me at your convenience.

Sincerely,

Andrea Frolich
Project Assistant
Central Region

2000 M Street, N.W.
Suite 200
Washington, D.C. 20036

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