NAVIGATING IMPACT

A QUALITATIVE STUDY ON IMPACT INVESTING IN KENYA'S VENTURE CAPITAL LANDSCAPE

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Navigating Impact: A Qualitative Study on Impact Investing in Kenya's Venture Capital Landscape

Abstract: Impact investing has the potential to allocate capital and innovation to address some of the most urgent and complex problems facing humanity and the planet. The purpose of this thesis is to study how impact investing is practiced and perceived in Kenya, mainly from a venture capital professional's perspective. We performed 21 interviews with investment professionals active in the local venture capital market in Kenya and found that funds tend to adjust both their pre- and post-investment impact evaluation to the individual investment opportunity rather than following a standardised impact framework. Furthermore, impact-specific risks and challenges seem to be closely related to market-specific risks and challenges, and the most frequently mentioned are currency risk, institutional voids, weak infrastructure, and inexperienced management teams. Finally, various stakeholders' general perception of impact investing is positive, and our findings indicate a convergence between traditional investing and impact investing in the local venture capital landscape in Kenya.

Keywords: Impact Investing, Venture Capital, Kenya, Measuring Impact, Convergence
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1. Introduction

Despite having experienced surging economic growth for numerous years, Kenya has seen a long-standing downward trend in net-inflow of foreign direct investments, and the country is currently suffering from high unemployment rates, corruption, and poverty (The World Bank, 2023a). There is a widespread consensus that aid alone will not be enough to tackle the challenges facing many developing economies, and this has led investors to look for alternative allies to spur growth and innovation in a sustainable way.

Impact investing represents a relatively recent investment thesis that has gained significant exposure propelled by the changing economic environment globally. It occupies a unique position between philanthropy and conventional business endeavors, and investors strive to optimize their investments to maximize returns, manage risks, and deliver substantial positive societal change (Lortie and Cox, 2018). In short, impact investing can help allocate more capital and innovation to address some of the most urgent and complex problems facing humanity and the planet. This pursuit is guided by clearly defined social and financial targets, collectively aimed at fostering a flourishing impact market that yields tangible outcomes, ultimately improving the daily lives of the public (GSG, 2019). Considering the ever-evolving global market conditions, capital allocation towards mitigating the adverse externalities that currently affect society is imperative. Impact investing allows individuals to partake in this transformative journey that holds profound significance for the future.

Moreover, venture capital's (VC) role in driving innovation within the value chain is vital. Venture capital has a major impact on economic development as it creates jobs, stimulates innovation, and acts as a catalyst for competition, thereby contributing to enhanced economic prosperity (Gerken and Whittaker, 2014). Thus, it provides great potential for impact investors to find and fund sustainable ventures that will generate positive social and environmental returns. However, these activities confront numerous challenges, primarily stemming from insufficient infrastructure and regulatory frameworks in developing markets (Jones and Mlambo, 2013). Furthermore, venture capital in the context of developing markets is rather unexplored since both local and foreign investors are reluctant to take on that level of risk. If Kenya and the African market at large wish to develop a more attractive venture capital market to spur innovation and economic development, more research is needed.

The body of research on impact investing applied in a VC context is close to non-existent. Most research focuses on impact frameworks, how to measure impact, and the performance of impact funds. However, less focus is put on how funds actually use these frameworks, what they think about the impact and financial return trade-off, and how impact is perceived by different stakeholders. There is also limited research on impact-specific risks and challenges faced by fund managers and founders. Thus, the primary objective of this thesis is to study how impact investing is practiced in Kenya, mainly from a VC fund manager's perspective, and its perceived role in promoting social welfare and private sector development. Building upon the existing literature, this study aims to address the following research questions:

(I) *How do VC funds operating in Kenya evaluate and measure impact?*

(II) *What challenges do these VC funds face, and what specific risks are associated with impact investing in this region?*

(III) *How do investment professionals at VC funds think about the trade-off between impact and financial return?*

(IV) *What do investment professionals active in the VC space in Kenya think about impact investing? Does it interfere or provide opportunities for VC funds?*

The scope of this thesis is limited to these research questions and will neither address the financial performance of impact funds nor the accuracy of current impact measures. Because of the relatively novel research topic and limited availability of data, we aim to broaden the knowledge of impact investing in venture capital through a qualitative approach. To provide comprehensive answers to these research questions, we conducted field research in Nairobi, Kenya. We interviewed 21 people active in the local VC market using a semi-structured approach. These interviews serve as the foundational data for a deep and thorough investigation into the current state of the venture capital market in a developing economy.

Our preliminary findings can be summarized as followed:

- Local fund managers seem to have varying perceptions of what impact investing entails and how to best practice it. Thus, like previous literature suggests, impact investing still seems to be rather subjective, and funds tend to pick and choose between tools and frameworks that fits their purpose. This decision seems to largely depend on the limited partners (LPs) of the fund.
- Risks and challenges mentioned tend to be the same for impact funds and traditional funds, and they seem to be dominated by market-specific risks such as weak institutions, lacking infrastructure, and currency risk. Additionally, due to the young nature of impact investing, there are challenges related to comparability and transparency.
- Due to increasing demand from LPs, traditional funds have started to incorporate an impact agenda into their investment strategy. On the other side of the investing spectrum, impact funds have started to adapt a commercial-first mindset to ensure a sustainable financial future and thus a greater impact. Thus, the trade-off between impact and financial returns seem to become less evident, and we see signs of an ongoing convergence between impact investing and traditional investing.
- The general perception is that impact investing is important for the continent as it is more patient than purely commercial investing and helps companies transition into profit-generating enterprises. It is also seen as superior to philanthropic capital as it aligns incentives and prevents founders to be wasteful.

The remainder of this paper is organised as follows. Section 2 provides a background on venture capital and the economic development of Kenya. Section 3 provides an overview of the relevant academic literature and theory. Section 4 outlines our methodology and data sample. Section 5 presents the empirical findings. Section 6 discusses the results and limitations of the study and provides suggestions for future research. Finally, section 7 provides the conclusion.

2. Background

2.1 Venture Capital

2.1.1 Key Features of Venture Capital

A venture capital (VC) firm is a financial intermediary receiving capital from investors and investing that capital in private, early-stage companies. A VC fund is typically organized as a limited partnership, with the investors acting as limited partners (LP), and the venture capitalists who manage the fund acting as general partners (GP). The aim of a traditional VC fund is to maximize financial returns by eventually exiting the investment, typically through an IPO or sale to another company or fund. LPs pay a yearly management fee to the GPs, which should cover the fixed fees of managing the fund. On top of this, GPs are usually entitled to a share of the excess profits which acts as a "performance fee". By having this compensation structure, the GPs' incentives are aligned with those of the LPs. The management and performance fees are typically around 2 and 20 percent, respectively (Metrick and Yasuda, 2010).

GPs put most of their time into two main activities: the fundraising process and the investment process. When fundraising, GPs approach different investors and ask them to commit a certain amount of capital to the fund. These investors can be institutional investors such as pension funds, mutual funds, insurance companies, and university endowments, family-offices, or high net-worth individuals. VC has reached around 8% of total allocation for university endowment funds and has become a more important asset class over time (Lerner et al., 2020). Fundraising can be affected by both internal and external factors, overall economic growth and capital gains tax rates being examples of the latter. High historical returns lead to larger capital commitments to both old and new funds, although successful funds attract additional capital (Gompers and Lerner, 1998).

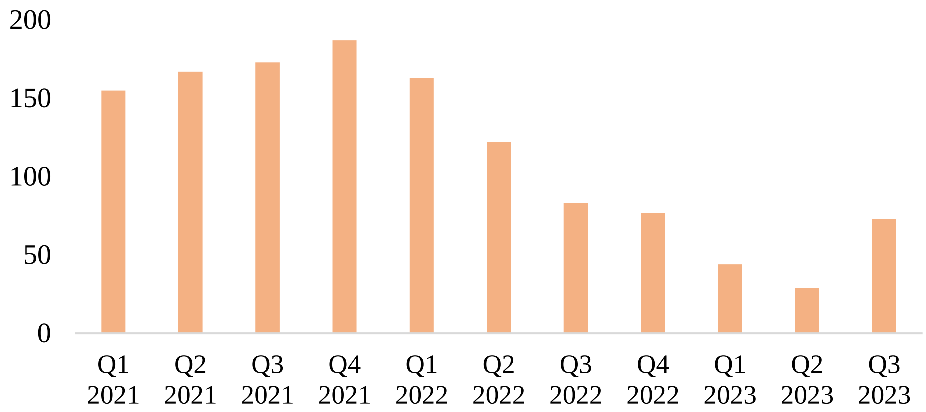
The investment process can be divided into three phases: investing, monitoring, and exiting. VC funds typically engage in minority investments, which means that the fund has non-controlling equity ownership, and there are two main reasons for this. Firstly, companies that receive VC funding are generally at an early-stage, sometimes even pre-revenue, and aim to disrupt industries, which means that the risk is substantially higher than when investing in later-stage companies. By taking minority stakes in many ventures, the VC fund is more diversified while still being able to reap a significant return in case of a successful investment. Secondly, by letting the founders keep a significant share in the venture, they are incentivized to put a lot of effort into it (Metrick and Yasuda, 2010). Seeing as venture capital is a highly risky asset class, investors require a significant return for the investment to be worthwhile, which means that a steep revenue growth rate typically is of highest priority. However, a study by Gerken and Whittaker (2014) shows that only 20 percent of all ventures generate a desired return and end up generating most of the value for the fund. 40 percent of ventures eventually break even, and the remaining 40 percent are not able to reach a positive return.

During the monitoring phase, VCs engage in various activities that they believe will add value to the portfolio company. These activities include, but are not limited to, attending board meetings, recruiting, and advising the founders. It is also common for GPs to outline certain KPIs in the term sheets that they expect the portfolio company to report on. These KPIs can be linked to incentive schemes and future funding from the VC. When the time comes to exit the investment, VCs usually consult with investment bankers on how to execute it. The most lucrative exit opportunity has historically been through an IPO. However, it has not been as common as the alternatives, which are either an acquisition or secondary sale (Metrick and Yasuda, 2010).

2.1.2 The Venture Capital Market

Gerken and Whittaker (2014) argue that venture capital has a major impact on the global economy. They are the catalyst of the creation of jobs, advancement of technology, innovation, and increased competitiveness. In 2010, venture capital in the United States represented 11 percent of employment and 21 percent of the total GDP. Over the last decade, venture capital has reached historical levels in terms of money raised. Annual capital invested worldwide increased by nearly 13x between 2010 and 2019 and reached over $US160 billion. 2021 was a record year, reaching $US671 billion across 38,644 deals. This increase is believed to be fueled by the IPO market, an increasing number of mega-rounds, and billion-dollar exits. The share of up-rounds and median deal sizes, as well as pre-money valuations for A to D+ rounds, are at their highest level since 2014 (KPMG, 2022).

Figure 1. Global VC investments per quarter (US$ billion)



Note: Crunchbase (2023)

However, the ongoing uncertainty about the economy, projected interest rate hikes, and the lingering aftermath of bank failures continue to interfere with the startup ecosystem (Grabow, 2023). Venture capital is turning increasingly in favour of investors, with falling valuations and tougher term sheets.

The performance of venture capital is a highly debated topic. As previously stated, many ventures that receive VC funding do not break even. This means that just a handful of VC funds generate nearly all the sector returns, which is why the expression "moonshot investing" is often mentioned. Furthermore, some argue that VC investing does not generate appropriate returns given the risk. Researchers have looked at historical returns and concluded that VC does not reliably outperform the average stock. They continue by arguing that identifying promising public companies should be relatively easy compared to private companies, considering the number of tools to filter and compare public stocks (Bruce, 2023).

Another critique that the global VC market is facing is the inequality and non-diversity, both in the VC firms and the ventures that are seeking funding. A recent report found that 93% of all funds raised in 2018 by European companies backed by venture capital went to companies with all-male founding teams. This is due to unconscious biases and the importance of networks (Atomico, 2018).

2.2 Kenya

2.2.1 Country Overview

Kenya is a country in East Africa with coastline towards the Indian Ocean. It is classified as a low-income economy and has had an average annual economic growth rate of 4.67% since 2003 (The World Bank, 2023a). The agriculture sector employs more than 40 percent of the total population and contributes approximately a fifth of Kenya's GDP (Central Bank of Kenya, 2023). Despite efforts made to implement political and economic reforms, the country still struggles with poverty, inequality, unemployment, corruption, and vulnerability to internal and external economic shocks. In Transparency International's 2022 Corruption Perception Index, Kenya ranked 123rd out of 180 countries, 25th of all African countries (Transparency International, 2022).

Table 1. Kenya overview as of 2022

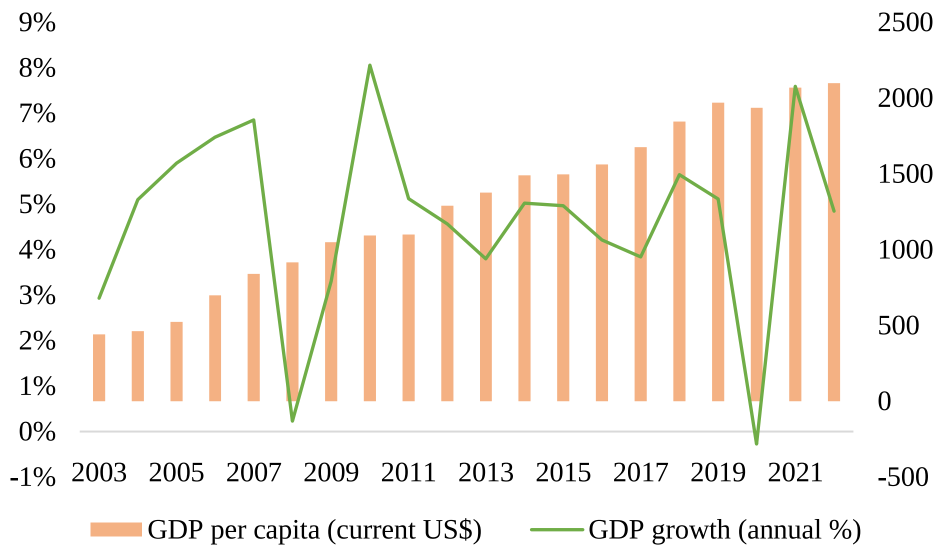
Capital	**Nairobi**	Population	**54 million**
Independent since	**December 12, 1963**	% living in rural areas	**71%**
Official languages	**English and Swahili**	GDP per capita (US$)	**2,099**
Government	**Presidential republic**	Poverty rate ($2.15 a day)	**36.1%**
President	**William Ruto**	Inflation	**7.6%**
Ease of doing business	**Rank 56 / 190 (2020)**	Unemployment rate	**5.5%**

Note: The World Bank (2020; 2022a; 2023a)

Since its independence in 1963, the Kenyan government has executed several strategies to stimulate investment growth. While the country attracted a significant amount of foreign direct investments (FDI) in the 1960s and 1970s, the levels dropped in the decades to come because of poor economic policies and inconsistent efforts at structural reforms, growing problems of corruption and governance, and the deterioration of public services (Lloyds Bank, 2023). The FDI inflows have steadily decreased, from $1,404 million in 2017 to $759 million in 2022. The country saw the lowest levels in 2021, a total of $463 million (UNCTAD, 2023). This decline bucks a trend seen elsewhere in East Africa, where average FDI inflows increased by 35% between 2019 and 2021.

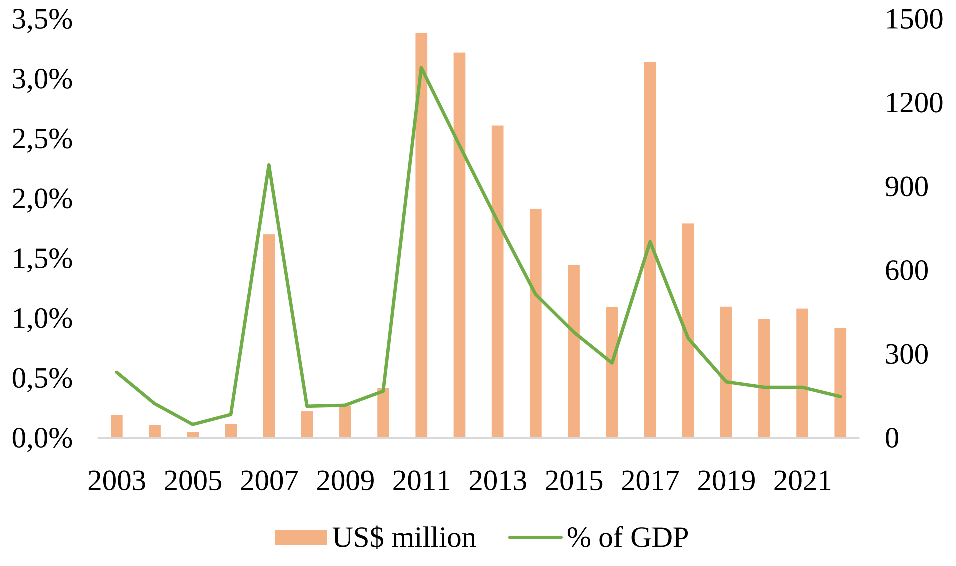
The main investors are United Kingdom (13.5%), Mauritius (11%), the US (10.3%), South Africa (9.8%), and France (5.2%). One third of the total FDI inflow is concentrated in finance and insurance, followed by information and communication (16.1%), wholesale and retail (15.4%), and manufacturing activities (14.8%). Energy is also a popular recipient of investor capital and Kenya is regional leader in clean energy with more than 90% of its on-grid electricity coming from renewable sources (KNBS, 2020).

Figure 2. GDP growth and GDP per capita in Kenya



Note: The World Bank (2022b; 2022c)

Figure 3. Foreign direct investment in Kenya (net inflow



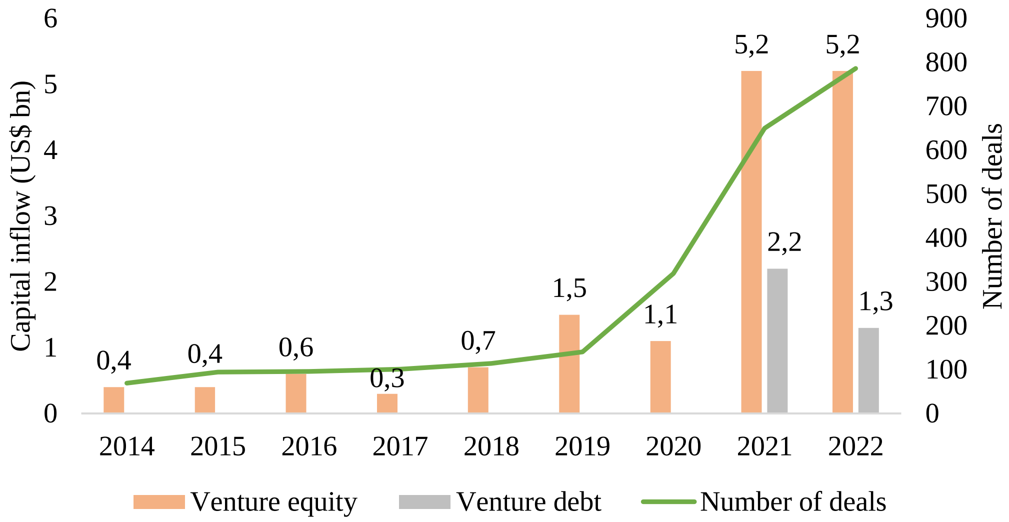
Note: The World Bank (2022e), Trading Economics (2022)

The World Economic Forum's country competitiveness report ranked Kenya as Africa's number one country in terms of human capital quality and the ability of research and innovation. According to the World Bank's ease of doing business scoring in 2020, Kenya ranked 56th out of 190 countries, fourth of all African countries (The World Bank, 2020).

2.2.2 Venture Capital in Kenya and Africa at Large

Venture capital activities have started to become a big part of the African economy, as is evident in Figure 4. Between 2014 and 2022, the number of deals made per year increased by a CAGR of 31 percent. This shift is partly due to the macroeconomic environment, which has increasingly favored equity financing, but it is also due to the increasing interest in emerging markets. In 2022, 77 percent of investors in Africa's venture landscape were international investors. Despite the rapid growth in both capital inflow and number of deals, Africa receives only a fraction of the total venture capital amount worldwide: in 2021, the African share of global VC funding was 0.8 percent of a total of US$671 billion, and in 2022 that share increased to 1.2 percent of a significantly smaller total of US$445 billion. The average deal size increased from US$1.4 million to US$2 million, and the number of super-sized deals decreased from 16 to 15. The most active sector in terms of received VC funding was financials, which attracted 41 percent of venture capital deal value (AVCA, 2023).

Figure 4. VC investments and number of equity deals in Africa per year



Note: (AVCA, 2023)

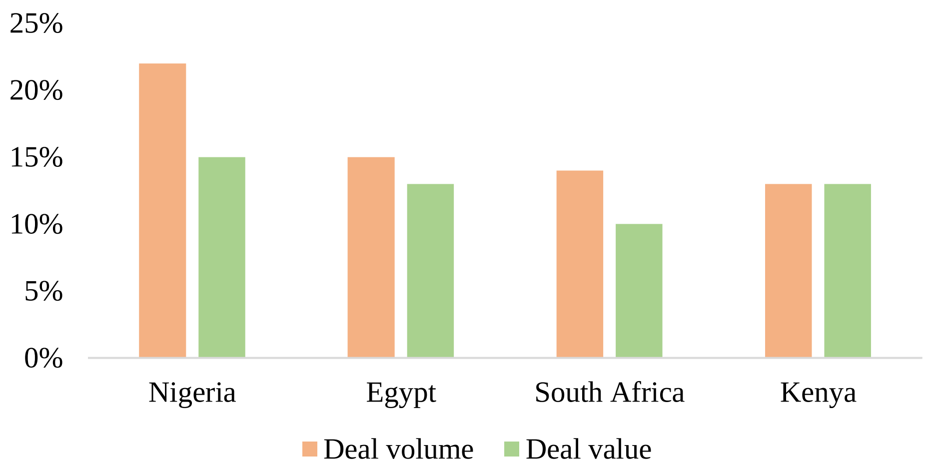
While far from unaffected by recent market instability, aggravated by geopolitical crises, supply chain disruptions, and unprecedented inflationary pressures, Africa remains one of the fastest growing VC markets globally. When graded against the global performance of venture capital, African VC activity proves strong and resilient. Although tech-related job losses in 2022 were reported in many African countries, mirroring the development in other parts of the world, job creation by funded African tech startups far outweighed layoffs. In 2021, 81 percent of VC deals in Africa were in technology or technology-enabled companies, a 92 percent increase in growth year on year compared to 2020, making African tech VC the world's fastest-growing ecosystem. In 2022, 619 out of 786 deals were in the tech or tech-enabled sector and a total of 14 megadeals were made, constituting 48 percent of total equity funding. Additionally, 2021 saw a record of five African unicorns being born, all of which in the technology sector and four in the fintech sector. 25 percent of all tech and tech-enabled startups that were funded in 2022 were in the fintech sector, six percent in E-commerce, four percent in edtech, four percent in cleantech, three percent in supply chain tech, and three percent in healthtech (AVCA, 2023).

Venture debt has emerged to become a key component of the African investment ecosystem in recent years. Of the US$6.5 billion market size in 2022, US$1.3 billion was venture debt. This trend is believed to be a result of the need to stay private longer and seek creative ways of financing that minimizes founder dilution. Lower cost of capital and flexible repayment terms has made the asset class an attractive alternative to equity financing, allowing startups to scale without sacrificing ownership. They make use of a variety of instruments including mezzanine financing, direct lending, and convertible notes (AVCA, 2023)

Venture deal activity in Africa with participation from at least one impact investor fell significantly from 42 percent in 2021 to 26 percent in 2022. Of all venture capital deals that took place in 2022, about 11 percent were climate-related deals supporting the development of low-emission energy solutions. Companies advancing financial inclusion (17 percent), sustainable agriculture (16 percent), and clean energy (16 percent) attracted the most impact capital, followed by access to quality education (10 percent) and access to quality health care (eight percent). Furthermore, the funding gap between male and female founders in Africa remains significant, with only seven percent of deals made in 2022 was with companies founded by women, 13 percent was with female-led companies, and 26 percent was with startups with at least one female founder. However, the cumulative amount invested in the last-mentioned category increased from US$150 million in 2021 to US$950 million in 2022. In addition, this share is higher than in the US, where the equivalent share was only 17.2 percent in 2021 (AVCA, 2023).

Around US$845 million of venture capital was invested in Kenya in 2022, ranking it third of all African countries in terms of deal value received. In the East Africa region, Nairobi has the status of being a financial hub and a supply of skilled and young labor, and 82.9 percent of VC investors have their headquarters in Kenya. Analysis of investment activity done by the East Africa Venture Capital Association shows that the country accounted for 69 percent of the 478 private equity and development finance institution (DFI) investments made in the region between 2013 and 2022. Furthermore, the number of venture capital deals made in Kenya increased from 29 in 2021 to 66 in 2022, surpassing the number of private equity deals by far (AVCA, 2023).

Figure 5. Top deal activity by country in 2022 (% of total)



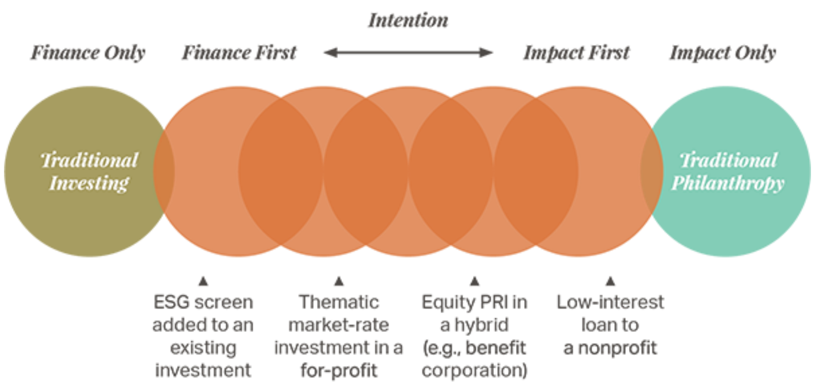
Note: (AVCA, 2023)

3. Literature Review

3.1 Impact Investing: Definition, Development, and Current Situation

In recent decades, there has been a shift toward consideration of non-financial factors in investment decisions. Nowadays, there are several investment themes with both subtle and distinct differences in the sustainable finance and impact investing space. According to the Global Impact Investing Network (GIIN), impact investing can be defined as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return" (GIIN, n.d.). ESG investing, in contrast, does not proactively target positive impact but rather only considers ESG factors in the decision making. Socially responsible investment (SRI) "focuses on the impact of companies in specific areas of interest. It most commonly involves investing using a negative screen which would exclude companies engaging in activities the investor finds undesirable" (Hill, 2020). The main difference between impact investing and SRI investing is that the latter aims to minimize negative impact instead of maximising positive impact. Finally, there is venture philanthropy. This type of investing is a high-engagement and long-term approach in which the investor supports a social purpose organisation to help it maximise its social impact. The two main differences between impact investing and venture philanthropy are that the latter only focuses on social causes and more or less disregards financial return (EVPA, 2020).

Figure 6. The Sustainability Investing Spectrum



Note: Rockefeller Philanthropy Advisors (n.d.)

Impact investing has emerged as an "ethical" investment strategy and the term was coined at the Rockefeller Foundation in 2007. While the GIIN's definition of impact investing is broad and leaves room for interpretation, two key elements should be present: intentionality and measurement. While all investments have unintentional impact on society, an impact investor should intentionally pursue investments that lead to positive social and environmental impact. The investor should also aim to measure this impact, although there is less consensus around impact metrics compared to metrics for financial return (Saltuk et al., 2015).

Investors' expectations for financial return and impact return differ depending on the fund's objectives, and funds can broadly be characterized as "financial first" or "impact first" (Freireich and Fulton, 2009). "Financial first" impact-focused funds often aim to generate market-rate returns from investments that fulfil certain impact criteria, while "impact first" funds are satisfied with below-market returns if they achieve their impact objectives. GIIN makes a similar contribution, categorizing impact investors into those targeting market-rate returns and those targeting below-market-rate returns. Investors targeting below-market-rate returns can further be divided into those seeking a return closer to the market rate and those seeking a return closer to capital preservation (GIIN, 2020a).

Today, there is a long list of players active in the impact investing space, such as institutional investors, development finance institutions (DFIs), high net worth individuals, and private banks. Furthermore, there are several supporting organizations that contribute to the ecosystem through market-building activities, such as governments and non-governmental organizations (NGOs). Governments have dual roles as both capital providers and facilitators and play a key role by fostering an enabling environment and catalysing market development (Wilson, 2014). They can provide tax incentives to stimulate the impact investing market, facilitate investment products, and increase the amount of capital via development policies. For example, the UK pioneered in modelling tax incentives for social investors and introduced the Social Investment Tax Relief (STIR) program in 2014 (GOV.UK, 2017).

A report by Saltuk et al. (2015) revealed that the total investment in impact initiatives reached $10.6 billion USD in 2014, facilitated by 82 organizations, and recent global developments have sparked heightened interest in these endeavors. According to a 2021 study by Burze Yasar, the world currently grapples with more challenges than ever before, including the COVID-19 pandemic, severe environmental issues, and escalating interest rates and inflation. Consequently, this underscores a significant shift in investment focus in recent times. The GIIN estimates that the size of the global impact investing market currently stands at US$1.164 trillion in assets under management managed by over 3,349 organizations (Hand et al., 2022). This estimate only includes investors who met the criteria laid out in the GIIN’s definition of impact investing.

As previously mentioned, there has been an increase in the amount of capital allocated to companies focusing on SRI and social and/or environmental impact. This is a result of increased sensitivity of investments in society today due to an overall increase in risk, which amplifies the requirements among investors and other stakeholders on sustainability. Sudheer Chava (2014) has researched environmental externalities and the cost of capital and finds that investors are demanding higher expected returns on companies that exclude any environmental screenings. Additionally, lenders are charging a significantly higher interest rate on debt given to companies that exclude environmental screening. These findings indicate that not having an ESG agenda may both lower the valuation of the company and infer higher costs and external pressures which may hurt the company long term. The same study mentions that companies without environmental screenings have lower institutional ownerships and fewer banks involved in loan syndications in comparison to companies that are environmentally conscious.

3.2 Measuring Impact

There are many ways to measure impact, on different levels and at different times of the investment process. An investor should always reflect on the purpose, that is, what the intended goal is for measuring impact. GIIN (2020b) reports that one of the main purposes of a framework is attaining standardization and comparability across investments, portfolios, and peers. To underscore the challenge of heterogeneity, the TRASI database (Tools and Resources for Assessing Social Impact) documented approximately 150 distinct approaches to impact assessment (Saltuk et al., 2015).

Maas and Liket (2011) analyzed 30 different social impact measurement methods and came up with six classifications: purpose, time frame, orientation, length of time frame, perspective, and approach (see Table 2).

Table 2. Characteristics of Social Impact Frameworks

Characteristics	Types
Purposes	Screening, Monitor, Reporting, Evaluation
Time Frame	Prospective, Ongoing, Retrospective
Orientation	Input, Output
Length of Time Frame	Short Term, Long Term
Perspective	Micro (Individual), Meso (Corporation), Macro (Society)
Approach	Process Methods, Impact Methods, Monetarization

Note: Maas and Liket (2011)

Block et al. (2021) have investigated which criteria are deemed important by impact investors when screening social enterprises. After analyzing a sample of 179 impact investors, they find that the three most important criteria are the authenticity of the funding team, the importance of the societal problem targeted by the venture, and the venture's financial sustainability. Furthermore, when comparing the importance of the screening criteria across different types of investors, they found that donors prioritized the importance of the societal problem, while equity and debt investors prioritized financial sustainability higher. Additionally, equity investors cared more about large-scale implementation of the social project than debt investors.

To complement the GIIN's initial definition of impact investing, they developed four Core Characteristics to provide clear reference points and practical actions: *Intentionality, Use Evidence and Impact Data in Investment Design*, *Manage Impact Performance*, and *Contribute to the Growth of the Industry* (GIIN, n.d.). Furthermore, GIIN launched the IRIS+ system to help investors measure, manage, and optimize their impact. It provides investors and companies with metrics and reporting standards, as well as frameworks and assessment tools. One example is the Gender Equality Scorecard (GES), which is a tool used to assess women's economic empowerment and gender equality within individual investment opportunities and portfolio companies (GIIN, 2018).

The Impact Management Project (IMP) has developed five dimensions of impact to help investors design relevant metrics: what, who, how much, contribution, and risk. *What* tells us the outcomes the business activities drive and whether the outcome is positive and negative, *who* tells us which stakeholders are impacted, and *how much* tells us the scale, depth, and duration of the outcome. *Contribution* tells us whether the efforts resulted in outcomes that were likely better than the alternative, and finally, *risk* tells us the likelihood that the outcome will be different than expected (Impact Frontier, n.d.). The IMP further suggests that the investor or enterprise should design standardized stakeholder surveys to collect data across each dimension and make use of both "subjective self-reported data", "Objective self-reported data", and "Objective non-self-reported data".

Metrics and KPIs are used to monitor and measure progress and performance and could play a central role in creating incentive schemes. The social enterprise Sopact has developed an impact management platform to help organizations measure impact. They make the distinction between activity metrics, output metrics, and outcome metrics, all of which can be both quantitative and qualitative. Activity metrics are directly linked to the activity or project and enable stakeholders to assess the implementation and reach of the project. For example, a project could be to offer a coding program for girls to help them get a job. One example of such an activity metric could then be "number of girls registered in the coding program". Output metrics are essential in measuring the tangible results and deliverables of a project, and one example could be "number of girls coding an app post-program". Finally, outcome metrics measure the project's ultimate impact and success, and could for example be measured as "% of girls that earn more than the median salary for the position based on the location" (Sopact, n.d.)

Another organization that has developed specific criteria is 2X Challenge, an initiative launched in 2018 with the mission to increase investments in women. The total amount of investments made since its start is US$27.7 billion (2X Challenge, n.d.).

Table 3. 2X Challenge Criteria

Criteria	Explanation
Leadership	Share of women in senior management exceeds 30% or share of women on the board or IC exceeds 30%
Entrepreneurship	Share of women ownership exceeds 51% or business is founded by a woman
Employment	Share of women in the workforce exceeds 30% and one “quality” indicator beyond compliance
Investments through FIs	Percentage of investor/FI loan proceeds that meet the direct criteria exceeds 30% or portfolio companies that meet direct criteria exceeds 30%
Consumption	Product or service specifically or disproportionately benefits women

Note: 2X Challenge (n.d.)

3.3 Risks and Challenges with Impact Investing

3.3.1 Institutional Voids and Limited Talent Pool

According to the GIIN Annual Impact Investor Survey 2020, a considerable share of impact capital is directed at emerging markets (EMs): 43% of respondents are focused on investing in EMs. This poses many challenges associated with these specific markets, two of which include institutional voids and limited local talent pools needed to manage assets, both of which create barriers to investments. While the labour force in Africa is large, people with skills and training relevant to key sectors are rare (Van Leeuwen and Freinberg, 2018). In a study on early-venture capital in South Africa, Jones and Mlambo (2013) had similar findings. There was a broad consensus among their respondents that lack of specialised fund managers and low entrepreneurial skillset in the country were two of the main challenges faced by early-stage investors. When diving deeper into the issue with lacking entrepreneurial skillset, respondents ranked general business skills, lack of understanding VC, and education levels as the most significant issues.

Institutional voids are constraints that make institutions fail to support functioning markets. Examples of institutional voids are the absence of specialized intermediaries, regulatory systems, and contract-enforcing mechanisms, all of which are hindering international companies and investors from investing in emerging markets (Khanna et al., 2005). Other examples of “soft” infrastructure that are often underdeveloped or absent are companies that do market research, talent acquisition, and end-to-end logistics.

3.3.2 Perceived trade-off between impact and financial returns

Not only does the perceived trade-off between financial performance and social impact pose a challenge to impact investing, so does the stickiness of the skeptical perception of a successful alignment of impact investing and financial performance. Despite existing studies proving that this alignment can be achieved, there is a bias towards perceiving a multiple-purpose efforts – making money and having a positive impact – to be less effective than focusing solely on one goal or purpose (Caseau and Grolleau, 2020).

There are many types of investors active in emerging markets, often referred to as DFIs and non-DFIs which includes other institutional investors, high-net worth individuals, and private banks. DFIs are government-backed institutions that are actively investing in private markets with societal impact and development as their primary interest. However, in contrast to grants and philanthropic capital, they do mostly expect their money back or a certain return. Due to their extensive research and practical experience, DFIs have today established their own investment procedure in the impact investment space. With the institutional pressure, these entities have early found a reasoning for impact investing, whereas non DFIs are not as experienced with these types of investments. However, in recent times, non-DFIs have also started to increase their exposure to impact investments (Ducastel and Anseeuw, 2020).

Investor attributes play an important role regarding willingness to invest in impact funds. A study by Barber, Morse and Yasuda (2020) finds that there are three main attributes that inform about the willingness to pay for impact. The first aspect relates to having a mission objective. These objectives usually circulate around a desire to generate social good. The second aspect relates to having political or regulatory institutional pressure which also has a positive effect on the willingness to pay for impact. The third aspect they found was that laws of fiduciary duty have a negative effect on impact investments. A fiduciary duty is a legal responsibility to act in the best interest of another party – in this case, the fund needs to act in the best interest of their LPs. Thus, the fund cannot push an impact agenda if their LPs only care about financial returns. This means that there are not only intrinsic values that affect the decision to invest in impact, but also outside factors that play a vital role in the incentives to invest in impact.

The same study finds that investors have a positive willingness to pay for impact when considering investment activities in environment, poverty, and minority issues. When investing in these impact categories, they are willing to forego 3 to 4.7 percentage points in excess IRR for the greater good. These lower excess returns would thus imply that there is a lower cost of capital for these portfolio companies. Though, despite their willingness to achieve lower returns for positive externalities, these investment categories do not necessarily have to generate lower excess return. As discussed, impact investing is a young phenomenon with a lot of different opinions on this trade-off. According to some authors, impact funds do have a historically lower excess return compared to traditional VC funds (Barber, Morse and Yasuda, 2020). When investigating publicly listed impact firms there seems to be a similar conclusion regarding financial performance. What this means is that some studies prove that investors must sacrifice some financial returns to invest in accordance with their values (Bernal, Hudon and Lerdu, 2021). Other researchers argue that there could be synergies and automatic "spillovers" if there is a successful alignment of the two (Mogapi, Sutherland and Wilson-Prangley, 2019).

3.3.3 Lack of Standardisation and Transparency

In recent years, a growing consensus has developed concerning the potential alignment between impact investing and financial performance. This alignment serves as a bridge between social and financial incentives. However, a significant challenge persists due to the absence of a unified accepted framework for assessing impact. As asserted by Viviani and Maurel (2019), the current frameworks for evaluating social impact can become a substantial hurdle for companies with an impact-oriented focus, seeking to attract capital. Despite the underlying belief that a company's activities can indeed yield positive societal outcomes, the lack of an efficient tool to substantiate these claims introduces an element of uncertainty among stakeholders (Wilson, Silva, and Ricardson, 2015). Consequently, the absence of objective measures can open the door to subjective decision-making, potentially leading to inaccurate investment decisions and the risk of overlooking top-performing companies, both in terms of profit and impact.

Despite the apparent demand for an objective, universal tool for measuring the societal impact of companies across different sectors, it took a long time for investors to employ existing tools to inform their decisions. According to Kroeger and Weber (2014), this reluctance stems from the difficulty in establishing comparability with peers, thus offering limited value to external investors. The absence of a "common currency" for evaluating social impact complicates the decision-making process, particularly when rooted in traditional profit-centric thinking (Mulloth and Rumi, 2021).

3.3.4 Macroeconomic Developments

Finally, macroeconomic developments have a significant impact on investments in developing markets. Recent data from the United Nations Conference on Trade and Development (UNCTAD, 2022) indicates a significant increase in debt burdens, particularly for developing countries, in the wake of the pandemic. In 2022, almost 30 percent of the global public debt level of US$92 trillion is owed by developing countries. These countries have a public debt to GDP ratio of 60 percent, potentially diverting funds from essential areas such as education and healthcare.

The World Bank report on the global financial market highlights rising inflation, prompting central banks to raise interest rates further to curb these upward trends. These developments have had huge effects on the financial strains and have even led to defaults in numerous countries. The Covid-19 pandemic has had the most extensive effects on the debt levels in emerging markets and developing economies (EMDE) , and the government debt levels reached a record high in 2022. To attain global inflation rates of approximately 2 percent, central banks may need to implement even higher interest rates moving forward. This scenario could have profound implications for financing activities in developing countries. As borrowing becomes more expensive, investment activities may stagnate, potentially adversely affecting economic development in Africa. As the risk of financial distress increases, so does equity risk (The World Bank, 2023b).

3.4 Impact Investing in Kenya and Africa at Large

Almost 14 percent of all global impact capital was allocated to Africa in 2015, a total of US$9.3 billion. Of this, US$7.9 billion came from DFIs and the remaining US$1.4 billion came from other investors. In the Sub-Saharan Africa region, there has been a year-on-year growth of 14 percent in impact investing between 2017 and 2022 (Hand et al., 2023). These figures underscore the growing significance of the African impact investing market.

As agriculture plays a central role in the African economy, it makes sense that a large share of impact initiatives is directed to this sector. Watts and Scales (2020) have found that social impact investing in African agriculture has grown over the last decade, and that it is driven by both financial and ethical motives. Their study also shows that social impact investing is bringing in new actors, such as private capital funds and institutional investors, which allows for a developed supply of blended financing[1] solutions. Other sectors that have attracted impact capital in Africa are financial services, energy, tourism, and consumer goods.

Kenya continues to be the most attractive destination in East Africa for impact investors. Up until 2015, US$4.25 billion of impact capital has been invested in the country, of which 85 percent has come from DFIs. At least 136 impact capital vehicles were active in Kenya, managed by 95 private impact investors excluding DFIs. The preferred sectors for DFIs and non-DFIs differ somewhat: DFIs tend to heavily invest in the financial services and energy sectors, focusing on green and accessible electricity and financial inclusion, while non-DFIs invest in financial services, agriculture, housing, and other (Saltuk et al., 2015). Furthermore, angel networks and investing platforms are gaining momentum, something that many deem is needed in the local entrepreneurial ecosystem (GSG, 2019).

Despite the high traction in recent decades, there are several barriers hindering capital from flowing into impact investments in Kenya. One key challenge is the limited availability of unique and scalable enterprises. Investors have voiced concerns about high rates of duplication of business ideas and little innovation, lacking skills among management teams, and the preference for informality of their business by not paying taxes nor keeping formal business records. Another major challenge in Kenya, and in Africa at large, is finding exit opportunities. Impact investors typically rely on the stock exchange or private equity sector for potential exit routes, but as both these markets are still nascent on this continent, their options are limited (GSG, 2019) Looking ahead, raising interest rates could imply continuously low buyout activities in the African economy. Buyouts have never been a prioritized approach in the African economy due to high interest rates historically, which are now higher than ever (Saigal, 2015). Finally, the growth of sustainable enterprises in Kenya is typically slower than expected, which means investors must wait

[1] Blended finance entails combining official development assistance with other private or public resources.

longer until they reach desired returns and exit their investments. This can be attributed to external factors such as a fluctuating currency and bureaucratic regulations as well as internal factors such as young and unexperienced entrepreneurs with limited business experience.

4. Methodology

In this section, the choice of methodology and data collection is described. It also discusses the reliability and validation of our methodology and the data collected.

4.1 Research Design and Methodology

As discussed in the literature review, there currently is no clear objective tool that creates an alignment between parties on how to report their impact results to outside investors. Not only does this affect the perception of the term, but also the understanding of the biggest challenges, risks, opportunities, and incentives when investing. Thus, there is still need for improvements and greater understanding to elevate in the field and to remove this ambiguity (GIIN, 2020b).

An appropriate approach is a qualitative study deep diving into the field, which is the method that is the most frequently used to explore Impact Investing (Agrawal and Hockerts, 2018). Having structured interviews discussing the most important aspects around impact investing will be vital in the understanding of the market at current state. A field study to Nairobi was done and 21 interviews were conducted. By interviewing investment professionals from different funds and with different roles and backgrounds, we hoped to get a thorough understanding of the impact investment activities currently conducted in the African market. With these interviews, there will be an increased awareness around the rationale and arguments for the benefits as well as risks of being active within the impact investment market. The purpose is to achieve a cumulative effect on previous findings to increase the knowledge of the investment decisions that VCs take when investing. The interviews shed light on what the VCs consider when having the objective of not only achieving a positive financial return but also a positive impact.

4.2 Data Collection

The primary data for this study comes from interviews conducted with various people active in the VC space in Kenya and other African countries. For a summary of all interviews, see Table 6 in the appendix. All interviews were conducted in the summer of 2023, of which seven were conducted online and 14 were conducted in person in Nairobi. By meeting the interviewees in person, we are able to develop a more personal connection and consequently achieve more complex answers. As the interviews are the primary data collection for this study, we aimed to do a semi-structured approach to enable each person to answer the core question but elaborate on their own experience to capture a more nuanced angle to each issue we presented (Bryman and Bell, 2015). We developed an interview guide and framework to collect data that were relevant to the scope of this study. For each interview, we had the same structure to enable comparisons between answers and to create continuity (Bickman and Rog, 1998).

All interviews were recorded and transcribed to enable thorough, nuanced, and reliable analysis and citations of everything being said. The interviews were held with people working with venture investments in the local market, for different companies and in different positions. Of the 21 interviews conducted, 17 were with VC funds, one PE fund, one fundraising foundation, one development agency, and one accelerator. The interviews had a duration between 30 to 90 minutes depending on the availability of the recipient.

To make sure the selected people were relevant for our study, we did an initial screening. Our two main screening criteria were 1) the person is or has been exposed to VC investments in Africa, and 2) the person is directly exposed to the Kenyan market. The sampling is critical when conducting a qualitative interview, and we put much effort into this process before moving on with the study (Bickman and Rog, 1998).

Choosing to conduct semi-structured interviews following an interview framework (see Appendix A) meant we could ask open-ended questions and adapt the interview to the respondent's line of thought. At the same time, the framework ensured that all relevant questions were covered, making the interviews horizontally comparable (Saunders et al., 2019). To avoid both participant and researcher biases, we made sure to not phrase the questions in ways that would lead the respondents to give certain answers.

4.3 Reliability and Credibility

Qualitative studies tend to be difficult to conduct due to subjectivity compromising reliability. Only conducting a few interviews could provide a biased picture of the true situation that is studied. For this reason, we made sure to conduct a minimum of 20 interviews to widen the perspectives of the data source and to reach objectivity in all statements (Ali and Yusof, 2011). According to Rose and Johnson (2020), reliability relies on consistency between interviews. By basing all interviews on an interview framework, we ensured both comparability and consistency.

Credibility refers to the quality of the research and the accuracy of the findings. It is important to demonstrate familiarity to the topic that is investigated, and that there is enough data provided to make claims with substance. There is also a need for a logical linkage between our observations and categories or theories that allows the reader to investigate whether they agree to the claims (Kihn and Ihantola, 2011). When conducting all interviews, we were careful to reach out to relevant people and to have at least 20 interviews to feel comfortable presenting relevant and interesting findings. Furthermore, we transcribed all interviews. This enabled us to go back and analyse each interview which provides us with an internal validity, and to provide citations that is used in the research with high accuracy, which enables us to reach high external validity (Lincoln and Guba, 1985).

5. Empirical Findings

5.1 Evaluating and Measuring Impact

As outlined in the previous literature section, there are many frameworks and tools to evaluate and measure if and how impactful an investment is or can be. Based on the findings from the interviews, we have identified five categories of how the funds evaluate and measure ESG and impact pre- and post-investment. We mapped out the participating VC funds accordingly and the results can be found in Table 4. “X” indicates that the fund does the indicated activity. The first four are pre-investment activities and the last category “Impact KPIs” is a post-investment activity. We chose to include negative screening and ESG due diligence to gain a better understanding of the sustainability investment spectrum seen in Figure 4 (p.17) in the previous literature section.

Table 4. Summary of Sustainability and Impact Categorisation

Company	Negative screening	ESG due diligence	Impact criteria	High-impact sectors	Impact KPIs
Acumen	X	X	X	X	X
AHL Venture Partners	X		X	X	
Catalyst Fund	X		X		X
Chui Ventures	X		X		X
Cornerstone Enterprises	X			X	
E3 Capital	X			X	
Enabling Qapital	X		X	X	
Enza Capital	X				
FrontEnd Ventures	X		X		
Goodwell Investments	X	X	X	X	X
LoftyInc Capital Management	X	X			
Norrsken22	X	X		X	
Novastar Ventures	X	X	X		X
Renew Capital	X	X	X		X
TLcom Capital LLP	X				
VU Venture Partners	X				
Zephyr Acorn	X			X	

5.1.1 Negative screening

Negative screening is the process of excluding companies based on certain criteria and seems to be a common part of VC funds' evaluation of investment opportunities. All interviewees mention industries that are most commonly excluded, such as tobacco, alcohol, oil, gambling, weapons, and pornography. Almost all funds explicitly add the criteria "the business should not exploit people or the environment". Harrison Gitau at Cornerstone Enterprises gave the example of a fintech company that charged its customers usurious interest rates, around 20 percent per month. Although the monthly amounts were not high, over time, the customers end up paying substantial amounts of money. Other examples given by the interviewees were companies polluting the environment or exploiting natural resources in an unethical way.

Several interviewees mention British International Investment (BII) and the International Finance Corporation (IFC), both of which have guidelines for fund managers on how to assess and exclude investments that are not ethically justifiable and how to identify risks. The IFC Performance Standards provide guidance on how to identify risks and impacts, and are designed to help avoid, mitigate, and manage risks and impacts as a way of doing business in a sustainable way, including stakeholder engagement and disclosure obligations (IFC, 2012).

Table 5. IFC Performance Standards

Performance Standard	Description
Performance Standard 1	Assessment and Management of Environmental and Social Risks and Impacts
Performance Standard 2	Labour and Working Conditions
Performance Standard 3	Resource Efficiency and Pollution Prevention
Performance Standard 4	Community Health, Safety, and Security
Performance Standard 5	Land Acquisition and Involuntary Resettlement
Performance Standard 6	Biodiversity Conservation and Sustain. Mgmt. of Living Natural Resources
Performance Standard 7	Indigenous Peoples
Performance Standard 8	Cultural Heritage

Note: IFC (2012)

5.1.2 ESG due diligence

The next category is whether the fund conducts ESG due diligence when evaluating a potential investment, which includes uncovering what ESG policies the company employs and what ESG risks they face. Only six out of the 17 interviewed VC funds do this. Five funds say they do this in-house, while only one receives external support. The interviewees stated different reasons for why they do not conduct ESG due diligence. The most common answer was that, given the early stage investing the fund does, the ventures are simply too small and do not have enough resources to provide the needed information for such a due diligence. One of the interviewees argued that the kind of companies they invest in - companies with tech-enabled business models - have inherently low ESG risks, which is why they only take "soft measures". They also claim they consider some risk factors in their commercial and legal due diligence processes.

The ESG due diligence is not solely conducted to evaluate if the venture has a sound ESG performance, it is also to evaluate what support the venture would need in terms of resources and what potential there is to introduce an ESG agenda. For instance, Esther Mwikali at Renew Capital explains that they include ESG-related clauses in the terms if they deem the business is not doing enough. One such clause could be that the company needs to decrease emissions emitted.

5.1.3 Impact criteria

Employing impact criteria when evaluating potential investments is a form of positive screening. About half of the interviewees said that they do this, but they had a hard time giving examples of specific criteria. "Solving a critical problem", "reaching many people" and "serving people at the bottom of the pyramid" are a few common responses, but few people can mention a specific criterion, such as a maximum amount of CO2 being emitted by the company. Investment criteria tend to revolve around financial performance, team, and business model. Only if these criteria are met, the VC starts evaluating the impact potential, either through a framework or guidelines, or through a "soft" analysis adapted to the specific company. However, a majority of the funds state that they do not invest if they do not see a clear impact case.

"We look at the business case. [If] the business case makes sense, then we proceed. But the business case itself has to have impact around it."

- Harrison Gitau, Cornerstone Enterprises

Thus, it seems as if few funds have a list of standardized criteria, but that they rather evaluate each company individually. When asked how they define impact, they give a number of examples of what the business could or should do, of which the following list consists of the top five:

1. Providing employment opportunities
2. Contributing to financial inclusion
3. Lowering household expenses
4. Providing access to and affordable internet
5. Reduce carbon emissions

Some VCs do not have an impact framework in place but are in the process of developing one. The reason for this, the majority of them report, is because their LPs have started to ask for it. Historically, if the LPs cared about impact and sustainability, they would require the fund to follow certain guidelines. If the LPs did not demand this, it was unlikely that the fund would do it. Institutional investors tended to require specific screening or reporting criteria, while family offices and high net-worth individuals did not. This has at least been the case historically, but many fund managers witness a shift in LP behaviour, also amongst private investors.

Furthermore, it is important to note that some VCs have a person or team responsible for the impact evaluation, working parallel but separately from the investment team. This could likely imply that the interviewee is probably not fully knowledgeable about the impact evaluation process. Finally, some VCs state that they use frameworks developed by third parties, such as the 2X criteria and the IFC Performance Standards. However, they do not use these as hard criteria, but rather only as guidelines.

5.1.4 High-impact sectors

This category is defined as "The fund exclusively invests in high-impact sectors". A high-impact sector can be described as a sector that people and society are dependent on, such as food, energy, and healthcare. Some sectors are becoming increasingly important as our society evolves, such as transportation, financial services, and education. For a fund to be put in this category, the fund manager should have explicitly said "We invest in selected sectors that have high impact in society." However, they do not need to invest in a certain list of sectors. Goodwell focuses a lot on access to basic goods and services, and strongly advocates investing in industries where people spend a lot of their resources. For example, the agriculture sector is facing many challenges such as post-harvest losses as a result of lacking infrastructure. The farmers suffer because they end up losing their output, and the consumers suffer because they pay high prices. By investing in a logistics company that aims to reduce these difficulties, the fund can achieve great impact.

"We think impact is embedded in the sector that we invest in."

- Bitta Wycliffe, Goodwell Investments

However, a few VC funds argue that by investing in these specific sectors the fund automatically sacrifices financial return, and that they therefore tend to avoid them. They give two reasons for this: these sectors have a lot of capital expenditures and making money takes longer, both of which have a negative impact in the return.

5.1.5 Impact KPIs

This category includes companies that actively track their portfolio companies' impact performance. Some firms have certain KPIs that they expect the venture to report on and improve overtime, and these could be industry specific or applicable to any industry. Most common are KPIs related to the environment and diversity, such as "CO2 avoided", "waste reduction" or "percentage of leadership positions that are held by women".

However, many interviewees explain that they struggle to develop a standardised set of KPIs applicable to any industry. Instead, they have to adjust and tailor-make KPIs for every industry and most of the time for every new company they evaluate. To shed light on the challenge, Bitta from Goodwell gives an example. Say you want to invest in a logistics company that is directly exposed to the agriculture sector, and the aim of the company is to reduce post-harvest losses. You would then want to evaluate whether this actually was the case, and one relevant KPI could therefore be "post-harvest losses avoided". Another way of evaluating the investment is to measure the actual impact compared to post-investment. A few examples that Bitta gives are "Over X period of time, how many successful deliveries has the company made?", "Compared to before this venture offered their services, how much has the farmer's level of income changed?" and "How has the livelihood of the farmer improved and why?”. Another example given by one interviewee is the impact of a financial services venture that aims to increase access to basic financial services. Similar to the previous example, the fund could ask for reporting on how many people have been reached and how their lives have been impacted. Furthermore, according to Bitta, it is important to understand what impact is intended and what is not intended. He says that unintended impact is common, and that they strive to understand why this happened and if they can leverage it.

A significant number of funds reveal that they must often support the ventures with the reporting, either financially or through the fund’s own expertise and time. The list of KPIs the fund wants to track is often long, and while some are aligned with the operations, some are not, and require extensive resources to be tracked. Taking the earlier example with the farmer’s income, this would have to be collected through surveys, often by visiting the farm in person.

Finally, one interesting point made by Anthony Kimani at Enza Capital is that impact KPIs and financial KPIs are often linked, thus making impact KPIs less of a reporting chore and more of an operational/financial insight. He gives the example of a lending business evaluating the credit risk of its customers. Avoiding default on a loan is beneficial for both the customer and the business, so by tracking the credit risk and evaluating how to lower default rates, the company has an impact on the lives of the customers and improves their cash flow.

5.2 Risks and Challenges

5.2.1 Currency risk

One major challenge that most interviewees mention is currency risk, creating constant uncertainty around the performance of the company. Since many companies in Africa measure performance in dollars, their reported profit could be wiped out by the depreciation of the local currency. Therefore, the volatility of the exchange rate is a big uncertainty for the companies operating in Africa. In Kenya, the currency has depreciated vastly in the last two years. Even if the operating results have been good, after adjustments to the currency losses, the net results have been negatively affected in the country. This is very much correlated to the macroeconomic uncertainties prevalent at the time. When the currency depreciates, the prices become higher. This increases inflation, and there is a need for increased interest rates to hinder this upswing. When we asked about the general economy in the country, they told us that a lot of people do not have enough disposable income to consume other things than food and accommodation, creating a difficult situation for the companies. They talk about the need for a business model which considers purchasing power amongst the customers to satisfy their needs and still create a scalable business.

"In Kenya, the currency depreciated very significantly over the last two years. The value of the currency has fallen over 50%. So that can wipe out any gains they make. Same if you're an equity investor."

- Sebastian McKinlay, AHL Venture Partners

With the currency risk and weakened exchange rates, the general economic power of the country is deteriorating, making it more expensive to attract capital. As the cost of capital increases, the risk increases, which means that risk averse investors will choose to avoid investing in this market. Another issue with this is that a lot of companies borrow money in dollars, and in turn lend in shillings and get paid in shillings, Kenya´s currency. Because of this, the attractiveness of investing in Africa due to this negative currency exposure decreases. This creates a negative spiral where there is less capital inflow from outside investors than it should be, which stagnates the improvements in the country, which is essentially what contributes to less capital inflow from the beginning. Sebastian at AHL Venture Partners explains that, in the last few years, the operating return has doubled, but the Shilling has depreciated in half, which has led to the fund having no net results in US dollars. Furthermore, many LPs are investing in their own currency but measure the returns in the fund's local currency, which further increases the risk. Consequently, investors have been cautious to expose themselves to the Kenyan market due to the prevalent difficulties with the weakening economy.

5.2.2 Funding risk

The risk of not being able to raise capital to fund the venture rounds is critical for both companies and VC funds. The rising macroeconomic uncertainties have made it much more difficult to attract capital from foreign investors, and the funding activity that has been high for the last five to ten years has now started to stagnate. This means that many

VC funds and companies risk not getting any follow-on investments and the lack of capital has contributed to more companies failing. Many investors believe this vicious cycle will continue unless there is a shift in how investors think about investing in African markets. We will discuss this shift further in a later section.

A few interviewees point out that the rising scepticism amongst American investors has had a big impact on the VC market in Kenya. Although American investors tend to have a higher risk appetite than their European peers, US capital inflow has slowed down significantly. Furthermore, the majority of capital flowing into the market comes from institutional investors. Although they do invest some capital in VC funds, the interviewees suggest that they are generally not adept at diversification. They tend to allocate most of the committed capital to only a few funds, limiting the scope but also increasing the risk. Many interviewees explain that securing capital from institutional investors is a demanding and time-consuming project that can take years. As a result, many VC funds only receive capital from family offices and high net-worth individuals, all of whom often have high return requirements.

The majority of institutional investors come from outside of Africa, and most African institutional investors are pension funds. One issue highlighted by many interviewees is that pension funds are very conservative in their investments and only invest a small fraction of their wealth in the private market. In total, pension funds in Africa have assets under management of about US$20 billion. However, only roughly one percent is allocated to the private market, of which the majority is invested in the PE market. This is most likely a result of their risk aversion and lack of knowledge of the private capital market, as pension fund managers are frequently re-elected.

Furthermore, all investors have different preferences, and with the rising awareness and trends around sustainability, many investors are today requiring that the fund has an impact scope. When asked if it is easier to raise capital if the company has a clear impact case, most interviewees say that it is. The main reason they give for this is that the share of FDI coming from DFIs is large, and these institutions have relatively high impact requirements. DFIs tend to invest heavily in high-impact sectors such as financial services and energy, and they typically have large ticket sizes. Additionally, they require impact and/or ESG reporting. However, many interviewees report that private investors are increasingly asking for this as well.

Nevertheless, in the current market environment, raising funds is challenging for all companies, no matter what their sustainability profile looks like. Even companies in the high-impact sectors are struggling to get funding because of previously mentioned sector-specific dynamics. As they require heavy investments and longer holding periods, they are less attractive than fast-growing and tech-enabled ventures, and even more so in times of high cost of capital. These sectors have also started witnessing failures which makes investors even more hesitant, particularly first-time investors.

"It's just difficult to build in Africa because you're not only building a business, but you're also building the underlying infrastructure. And that's why most ones are telling you, these sectors are hard… Because now they start to see that they are losing money. Then the result of all this is that it makes fundraising slightly harder."

- Bitta Wycliffe, Goodwell Investments

5.2.3 Infrastructure deficiencies and execution risk

Infrastructure deficiencies refer to lacking infrastructure resulting in a less functioning society and include transport, education, communication networks, logistics, and law enforcement. When these areas are not offering support functions and services, running a business becomes significantly harder. Without a functioning law enforcement, corruption can be a great challenge. Lagging in the development of Internet of Things, Artificial Intelligence, and Machine Learning amplifies vulnerabilities in security and infrastructure reliance. This poses a major risk for the public and can infer less efficient and less profitable companies.

Because of the lacking infrastructure in African economies, many companies are facing significant problems when trying to launch and scale. VC firms are not only investing in and building companies, but they are also investing in and building the infrastructure needed. Since they are paving the way for the creation of market efficiency, significant capital expenditure is needed. As discussed previously, this increasing the cost of each project which in turn increases risk. The lack of established infrastructure also leads to a lot of supply chain risk. Without decent integration of systems and storage solutions, supply chains are generally not functioning as good as initially anticipated.

"Because of the infrastructure deficiencies, the biggest risk is actually execution. We don't have a lot of the infrastructure that exists in other markets."

- Anthony Kimani, Enza Capital

5.2.4 Market size and inexperienced management

The market size poses another challenge for investors in Kenya and Africa at large. Due to the generally low purchasing power, companies are struggling to scale. Many companies are targeting the middle class, and although this segment is growing, it is still relatively small. Hence, B2C companies face a greater challenge than B2B companies. As previously mentioned, it is becoming increasingly common to target the so-called "bottom of the pyramid" segment to reach a bigger market. This is challenging as they have less disposable income to spend, and the majority of their money goes to food and housing. However, by improving access to goods and services and tailoring solutions to the poorest, many interviewees witness large business opportunities.

Furthermore, the market does not only lack purchasing power, but also people suitable to build and manage businesses. Although Kenya has a young and skilled labour force, there is a significant gap in skills and experience needed to successfully start businesses. Because of the slow market that is difficult to navigate, the country does not attract many experienced founders. Another observation some of the interviewees share is that many founders and business people in general leave the continent to work in the US, Europe, and Asia. Once they come back home, they run into all kinds of obstacles that they had not experienced in developed countries. Evidently, both the culture and corporate environment in African economies are very different compared to other parts of the world.

Additionally, the education sector faces several difficulties. For instance, one interviewee tells us there is an on-going pause in governmental funding to public schools, extending from January 2023 until the end of the year. This fiscal interruption creates a barrier to the continuous improvement of the educational system and, as a result, hinders the cognitive development of students.

5.2.5 Weak institutions

Weak institutions have many implications to the investment environment, and it often forces investment firms to take responsibility and develop structures needed themselves.

Institutions are "the rules of the game" that ensure, amongst other things, the enforcement of laws and the growth of the economy. Without these rules and someone to ensure they are followed, doing business becomes non-transparent and unequal since people can take advantage of the system. A few examples of this given by the interviewees are corruption, taking advantage of customers and employees, and polluting the environment, and the funds become obligated to ensure that their portfolio companies are not doing any of these unethical activities. Johnni Kjelsgaard from GrowthAfrica mentions that there is an increasing awareness of politicians "*selling out their own population*" by approving brown companies for their own benefit. Thus, there is a crucial need to demand more responsibility from investment activities in Africa. Since there is no one currently tracking these activities, there is a big ambiguity around the work that companies actually are doing. Further, Johnni says that we need to create better incentive structures on the reporting side that aligns with the interests of institutions and organisations. This is to achieve greater transparency to improve the intentions of parties that can contribute to a positive change.

5.3 Combining Impact and Financial Returns

The majority of the interviewed fund managers make it clear that their fund is "commercial first", meaning they must deliver a return to their investors and exclusively look at the business case before evaluating any potential impact of an investment. Some funds explain that they try to avoid being branded as an impact fund as they have experienced that entrepreneurs expect different terms from an impact fund. Furthermore, as mentioned in section 5.1, a few funds argue that by investing in high-impact sectors the fund automatically sacrifices financial returns because these sectors are time- and resource inefficient. However, this sacrifice is argued to be short-term. By having a long-term approach, this issue is somewhat mitigated.

"Of course you're sacrificing financial return but you're sacrificing it in the guise of time. Right? So, it's going to take longer for you to make money."

- Bitta Wycliffe, Goodwell Investments

"I wouldn't say we are impact focused, but every company that we invest in has to have an impact. ... We are not impact investors because the problem with impact investing is [that it's] now seen as if it's a charity."

- Harrison Gitau, Cornerstone Enterprises

Furthermore, many VCs say that their fund's strategy historically have depended on the preference of their LPs. If the LPs cared about impact and sustainability, they would require the fund to adapt to certain investment mandates. If the LPs did not impose impact specific mandates, it was unlikely that the fund would incorporate these voluntarily. One observation that emerges from the interviews is that institutional investors have for a longer time required specific impact screening criteria and reporting, while family-offices and high-net-worth individuals have tended to only prioritize high financial returns. However, LPs rarely lower their return requirements because of a larger focus on impact. Rather, the interviewees experience that both impact requirements and financial requirements are rising.

"Financial returns have become a lot more important for LPs, whether it's DFIs or some of the family offices and all that. But right now, essentially, everyone is asking for DPI [2], like return on investment."

- Abel Boreto, Novastar Ventures

One interviewee recounts the fund's historical strategy which initially engaged in a philanthropic investment approach. At its inception, the organisation's predominant emphasis on social impact disregarded almost all considerations of financial viability. This investment philosophy led to a deteriorating result of corporate liquidation or negligible profit generation among the invested companies. This unintended consequence made them realise, as articulated by the interviewee, that their business model lacked a sustainable financial foundation. He underscores the importance of including financial aspects also as a direct consequence of their inability to perpetuate investments or sustain business operations. This serves as an illustration of the inherent risk associated with an exclusive focus on philanthropic objectives. The fund has since adopted a refined approach which revolves around an initial scrutiny of financial criteria: the evaluation of product quality, their ability to prove a viable concept, and the assessment of market conditions. Only when these financial prerequisites are met does the fund proceed to evaluate the social impact potential of prospective investments. This sequential approach reflects a prevailing paradigm in contemporary impact investing, which has attracted significant recognition

[2] DPI = Distributed to Paid-In Capital, which represents actual returns net of fees and expenses.

and acceptance. As this transition unfolds, we see indications of a growing convergence between social impact and commercial orientation within the context of VC investment decision-making in Kenya.

Although clearly identifying as “commercial first” funds, most interviewees explain that impact is something they value highly, and many even argue that they do not sacrifice financial returns for the sake of impact. Section 5.1 describes how funds try to incorporate sustainability and impact into their investment evaluation, and although far from every fund explicitly state that they use impact criteria, most of them indicate that potential impact generated by the company is a central part of their evaluation for two reasons: because it provides opportunities to reap higher returns and because it mitigates risk. By investing in companies that have a high impact on the sector, the customers, or society at large, it often implies high demand which in turn makes it possible to scale the business. Furthermore, by targeting the bottom of the pyramid or other underserved segments, companies can potentially penetrate profitable markets with low market concentration. Thus, impact can lead to commercial viability.

“They work hand in hand. If a company is more impactful and they don't have commercial viability, we don't invest. If a company has a lot of commercial [viability] but it doesn't have any impact, we don't invest. So it needs to be balanced.”

- Harrison Gitau, Cornerstone Enterprise

Some funds explain that another benefit of incorporating impact into their investment evaluation is that it enables them to mitigate some risks, both pre and post investment. Impact provides a useful dimension in their risk assessment when evaluating potential investments, and one example given by an interviewee is an investment in a company producing organic fertilizer, fuel, and animal feed from waste, resulting in cleaner cities. This is a clear impact case as the company introduces a sustainable alternative to fertilizers while contributing to waste reduction and generating profits. Additionally, the company will be less exposed to risks such as tightening regulations and higher taxes on inorganic fertilizers. Hence, by looking at impactful investments, the fund can identify new types of risk that can be avoided. It also allows for a more holistic risk assessment. Another example of this is an investment in a logistics company that aims to make the value chain of agriculture more efficient. This investment decreases the fund’s exposure to risk associated with weak infrastructure.

Furthermore, by embedding impact aspects into the monitoring and management of portfolio companies, funds can further reduce risk. As mentioned in section 5.1.5, several funds have a set of impact KPIs enabling them to track the companies' impact work, and these KPIs often give shed light on related risk. For instance, by tracking the 2X Criteria and encouraging a higher share of female employees, managers, and founders, the funds diversify their holdings. One final rationale for impact investing is the concern of potentially increasing reporting requirements in the future which will benefit impact funds and their portfolio companies. Additionally, a lot of LPs are actively looking for an impact agenda, and they also mention that by addressing these concerns they become less exposed to the above problems in the future, which decreases risk for them. However, only a minority of them have an exclusive ESG due diligence.

Although funds are increasingly trying to look past the suggested trade-off between impact and financial returns and combine the two, they struggle to do so. As described in a previous section, some funds actively pursue KPIs that comprehensively address both commercial considerations and societal impact. Their objective is to establish a symbiotic relationship between these dimensions. By formulating KPIs in such a manner, they aim to create a system of incentives to generate optimal outcomes where there is no need for preference between the two. However, because of the ambiguous approaches to measuring impact, implementing an impact agenda is difficult. Therefore, there is a risk of a disconnection between these aspects. This disjunction introduces an apparent dynamic where, depending on circumstances, funds may begin to prioritise one set of KPIs over the other. Consequently, there is a risk for an "either/or" thinking, meaning that funds are starting to emphasise either financial performance at the expense of societal impact or vice versa.

5.4 Market perception

This section will outline the respondents' general opinion on impact investing, if they believe it is important, how the market reacts, as well as if and how it affects the investment process.

Impact has undoubtedly become more important to both LPs and founders, and most interviewees agree that the continent needs more impact capital. One interviewee argues that the majority of capital flowing to the continent should be impact capital and explains that the most important thing is that the capital is patient. This is a recurring statement in the interviews, and patient capital is believed to be good for several reasons. One reason is that, because of lacking infrastructure and weak institutions, companies take longer to scale and, consequently, investments generate returns later in time. According to Bitta Wycliffe, a mismatch occurs when funds that intend to have a positive impact have the same close-ended holding periods as traditional funds. They must acknowledge that they cannot enforce the same investment cycle from impactful investments and adjust their expectations. Furthermore, patient capital facilitates more support from the funds in the form of knowledge and time. Because of the large share of inexperienced and first-time founders, this additional support is much needed and often critical for success. Another common perception is that impact capital is superior to grants and philanthropic capital because it prevents the recipients from becoming wasteful. By having financial requirements, the founders are incentivized to build a sustainable business while at the same time striving to have an impact on society.

Nevertheless, not everyone seems thrilled about the increasing importance of impact. One interviewee describes how some founders explicitly decline impact investors because they do not believe impact investors would be able to help them grow and improve their operations. Linked to this is the fact that many interviewees believe there is a mismatch between supply and demand of capital in the VC market in Kenya. There are many entrepreneurs seeking capital, and there is an abundance of capital ready to be invested. However, there is a discrepancy between what investors and entrepreneurs think is a viable business, and this discrepancy tends to be bigger for businesses with a clear impact agenda. Fund managers struggle to find knowledgeable founders and sound business models that are scalable, and they witness that the motivation of some founders seem to be questionable.

There is also a common perception among fund managers that the new demands and expectations on funds are not purely contributing positively. Some describe how they feel they are “stretched thin” as they need to incorporate the impact lens into their everyday work, which implies both educating themselves and adding extra layers to the investment process.

"I think it's interfering with my work. But it would help if there was someone assigned to do that specifically and then I could stick to my job."

"My personal opinion is that we are better off with investments that are more aligned with the business case. Impact will just bubble itself up. That's my personal opinion. Many have the same opinion."

- Anonymous

When touching upon the concept of greenwashing[3] in some interviews, we notice the common perception that all capital flowing to Africa is impact capital. As mentioned in section 5.1, a frequent statement made is that a business providing employment opportunities is impactful to society, since unemployment is a major challenge in Kenya. Similarly, one interviewee disregards the issue of green washing by referring to the high share of energy coming from renewable resources in Kenya. He describes an e-mobility venture his fund has been evaluating and states that it can be seen as impactful because it operates in Kenya and Kenya has a lot of renewable energy. Evidently, the idea of what is impactful seems to vary significantly between investment professionals.

[3] Greenwashing is the process of conveying a false impression of misleading information about how a company's activities are sustainable.

6. Discussion

6.1 Discussion on the Results

In this section we discuss our findings in the light of previous literature. The purpose of this section is to highlight and problematise interesting findings and introduce new ideas and hypotheses for future research.

6.1.1 Evaluating and measuring impact

As mentioned in section 5.1, the purpose of conducting ESG due diligence is to uncover a company's ESG policies and risk factors, providing the investment company with insights into how to mitigate these risks. Particularly in a country with weak institutions and infrastructure, this ought to be an important part of the investment process. The interviewees who reportedly did not conduct ESG due diligence stated different reasons for this. The most common answer was that, given the early stage investing the fund does, the ventures are simply too small and do not have enough resources to provide the needed information for such a due diligence. Furthermore, one interviewee argued that the kind of companies they invest in - companies with tech-enabled business models - have inherently low ESG risks, which is why they only take "soft measures". These companies are often platform companies in logistics, transport, energy, education, financial services, and e-commerce, sectors that undoubtedly could be exposed to ESG risks. Given the above reasoning around developing countries, particularly issues such as corruption and labour rights should be scrutinised. Furthermore, although tech-enabled companies have low emissions, there is no guarantee that scope 2 and 3 emissions[4] will also be low. Hence, there are many ESG risks and considerations that are important no matter the business model and disregarding them could lead to undertaking unnecessary risk.

When discussing impact criteria with the fund managers, it became evident that they struggle with both developing a standardised set of criteria and defining what an "impactful investment" actually is. On the one hand, one could argue that using a standardised set of

[4] Scope 2 are emissions that a company causes indirectly and come from where the energy it purchases and uses is produced. Scope 3 are emissions that are produced by activities in the value chain.

investment criteria is too simple, when it is obvious that each investment is unique and should be evaluated thereafter. Furthermore, it is arguably unreasonable to ask startups to declare and report certain metrics when they barely have enough resources or knowledge to run the business. Here, we see an opportunity to provide new support and resources to the startup, such as knowledge on impact and how to effectively report and measure it. On the other hand, KPIs and metrics encourage discipline and transparency, both of which are needed in the field of impact investing. If investors allow startups to loosely handle these questions, evaluations and monitoring will become even more subjective and eventually lose its credibility. Thus, there is a balance between not dividing the founders' attention too much yet require credible reporting.

Finally, one apparent yet noteworthy observation is that impact investing is still very subjective. Some fund managers argue that as long as the company creates jobs in a market where there are few jobs, the investment is impactful. But what if this societal benefit comes as an expense of the environment? Although it is clear that all funds we have interviewed conduct negative screening to some extent and most follow guidelines such as the IFC Performance Standards, we cannot help but notice that the concept of an "impactful" investment is subject to flexibility. If we take a step back and remember what previous literature say about impact investing, two key elements are important: intentionality and measurement (GIIN, n.d.). For the funds that explicitly call themselves impact funds, which according to Freireich and Fulton (2009) would be called "impact first" investors, there is undoubtedly intentionality. However, the measurement methods do not fully follow the GIIN's recommendation of attaining standardization and comparability across investments. They are still being adjusted to each individual investment, which increases the risk of green washing.

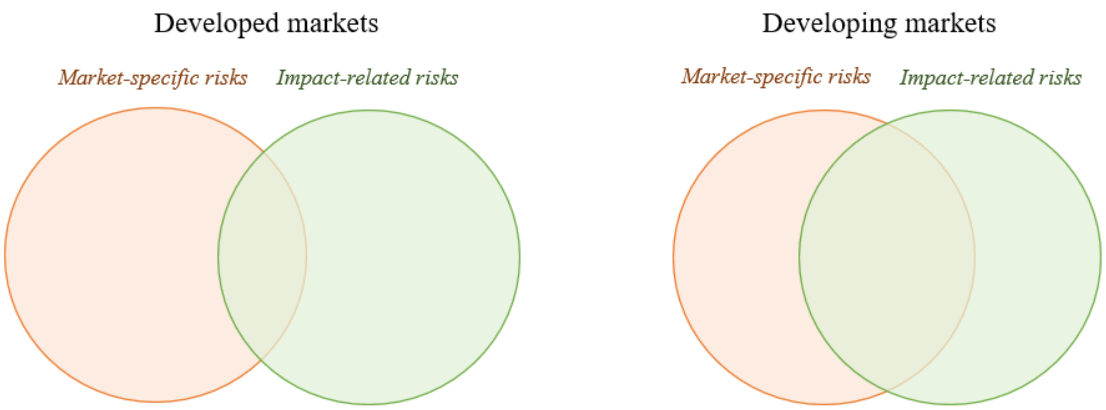
6.1.2 Risks and challenges

Amongst the interviewed investment professionals, the general perception of impact-specific risk is that it very much overlaps with market-specific risk. The risks and challenges brought up during the interviews more or less coincide with those described in previous literature, with the exception of any impact-related challenges. Although not mentioned by any interviewee, the lack of standardisation and transparency in their impact evaluation and reporting is undoubtedly a challenge, as discussed in the section above.

Additionally, one could argue that the market-specific risks observed in Kenya amplifies the impact-specific risks. People and companies may take advantage of inexperienced employees and management as well as inadequate infrastructure and institutions, resulting in green washing, corruption, and other unethical activities. As impact-driven companies and funds intend to direct their resources towards activities benefiting society and doing this in an ethical and transparent way, they are automatically at a disadvantage.

Impact and traditional funds alike, both mainly consider risk factors associated with the African market. This means that there are only small distinctions between the overall risk for an impact fund and a traditional fund. In comparison, developed markets do not have these specific market risks to the same extent, and we can therefore assume greater distinctions between impact funds and traditional funds in those markets. We try to convey our line of thinking below in Figure 8. This observation leads us to conclude that, in order for impact investment activities to flourish in Africa, there is a significant need to diminish the overall market risks to increase the attractiveness to invest.

Figure 7. Market-specific risks and impact-specific risks

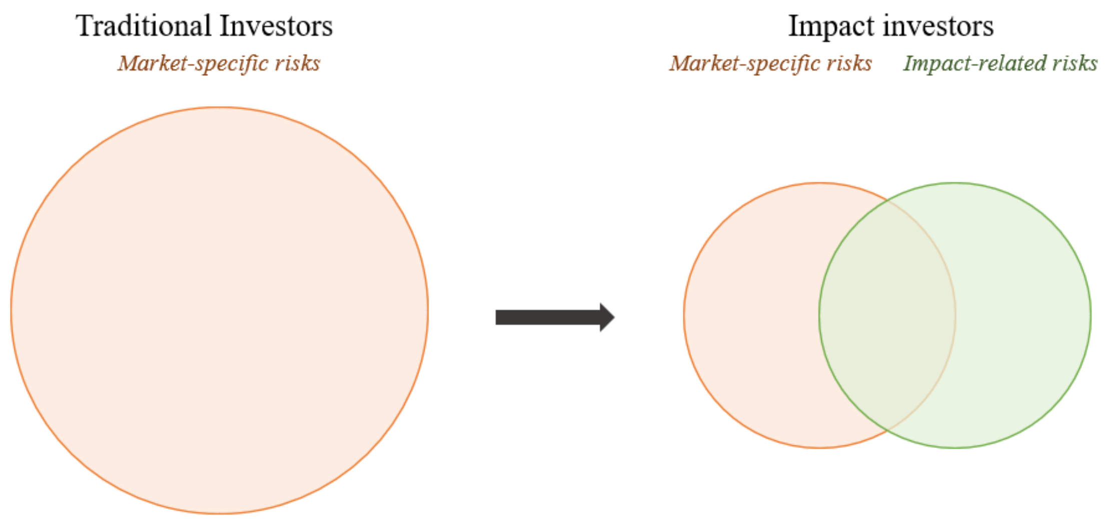


Note: Diagram to showcase our observation that market-specific risks and impact-related risks may be more overlapping in developing markets compared to the case in developed markets.

6.1.3 Trade-off between risk and return

Many of the interviewees extensively discussed the risks and challenges associated with the macroeconomic environment and the African market. Although these issues are linked to the market and not the company per se, many of the interviewees argued that funds can reduce risk by incorporating impact into their business model. Throughout the interviews, we explored the fund managers' opinion on the potential trade-off between impact and return, and it became evident that many funds disregard the idea of this trade-off when making investment decisions. Instead, by incorporating impact into their strategies, they believe they can reduce overall risk. This reduction in risk, in turn, leads to a decrease in the cost of capital and, consequently, the required return. In essence, by addressing impact, they aim to make an economically reasonable adjustment. Therefore, their focus is not on a trade-off between impact and return but rather on a trade-off between risk and return, with the impact agenda playing a significant role. The above argument that taking impact into consideration in their investment evaluation process would result in a reduction in cost of capital is well aligned with previous research described in section 3.1. As discussed in the section above, impact-specific risk is to a large extent the same as market-specific risk. However, by incorporating impact, the fund could decrease their exposure to overall market-specific risk.

Figure 8. Market-specific risk for traditional investors and impact investors

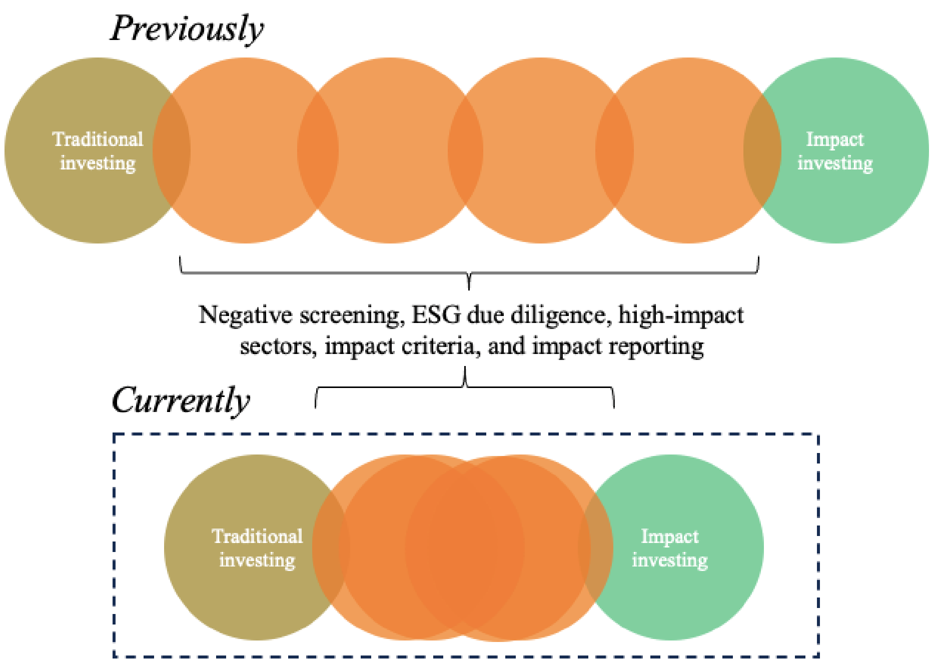


Note: Diagram to showcase our hypothesis that impact investors are exposed to less market-specific risk compared to traditional investors.

6.1.4 Convergence

When analysing our empirical findings, we observe an emerging trend moving from both ends of the investment spectrum. On the one hand, impact funds are recognising the importance of sustainable financial performance of their portfolio companies and how this is a prerequisite for impact. If the company is not eventually generating profits, it will not survive to have a lasting impact on society. On the other hand, traditional funds are starting to incorporate impact considerations in their investment process. There are many given reasons for this, such as minimising risk, finding new and lucrative business opportunities, attracting more capital, and meeting the demand of various stakeholders. We recognise this as a *convergence* of investment theses. This means that traditional VC and impact VC seem to be moving closer to each other and have a more similar approach when evaluating and investing in companies today.

Figure 9. The convergence between traditional investing and impact investing



6.2 Limitations and Future Research

We recognize that there are many limitations to our study. Venture capital, as it is part of the private capital market, consists of private information and low transparency. The publicly available market data is rather limited, particularly in a developing market context, which reduces the reliability of the venture capital market and country overview. Furthermore, there is a limited amount of impact VCs in Kenya. All identified impact VCs were contacted, but all could not participate in interviews. This means that the sample of "impact first" funds is smaller than what is desirable. Although the purpose of this study partly was to investigate how investment professionals perceive impact investing, one drawback with the sample is that the interviewees were not always informed about their fund's impact strategy or agenda. This, together with the fact that the group of interviewees was rather homogeneous, could give a misinforming or skewed view about impact investing in Kenya.

The process of preparing and conducting our study has shed light on several areas we believe to be of particular interest and importance for further research. Firstly, the concepts of blended finance and patient capital should be further explored. It is evident that companies in African markets have unique funding needs that should be considered in order to facilitate sustainable and impactful growth. Secondly, our convergence hypothesis needs to be further investigated. If it is indeed true that traditional investing and impact investing are starting to converge, it has several implications. As discussed throughout this thesis, the subjectivity of impact investing could potentially lay the ground for green washing, which makes it important to develop a standardised impact framework for investors to use that is value creating. The opposite case is important as well – how to make sure social enterprises and impact-driven companies grow and generate sustainable returns. Finally, we believe that it is critical to investigate further how to mitigate market-specific risks in African economies to facilitate a higher future flow of foreign direct investment to the continent, as well as lowering the barrier for local institutional investors to invest in the private capital market.

7. Conclusion

This study on how impact investing is practiced and perceived by VC professionals in Kenya highlights how funds measure impact pre and post investment, what market- and impact-specific risks and challenges they face, what venture capital professionals think about the impact-financial return trade-off, and what stakeholders' general perception of impact investing is. 21 interviews were conducted, in which the interviewees expressed both optimism about their activities and concern about some of the major challenges affecting the market. One finding is that, in general, VCs in Kenya seem to be rather flexible with their impact requirements, and their definition of impact varies. Due to the subjectivity and lack of a clear definition, many of the participating investment professionals believed themselves to generate impact with their investments, despite their very different approaches. Due to this ambiguity, it becomes problematic to measure the improvements in the field which results in many people remaining sceptical towards it.

When discussing what risks and challenges VC funds in Kenya face, the interviewees almost exclusively mentioned market-specific risks and challenges. Most African countries struggle with lacking infrastructure, weak institutions, an inexperienced workforce, and volatile local currencies. Not only do these challenges provide obstacles to building companies, but they also result in the continent attracting less capital from investors, leading to significant funding risk. Thus, it seems as if market-specific risk and impact-specific risk significantly overlap in the context of developing economies.

Regardless of if they considered themselves to be an impact fund or not, all interviewees perceived impact investing to be important for the continent. Not only to spur private sector development and sustainable economic growth, but also to decrease risk and meet the new demands of LPs and other stakeholders. By incorporating impact into their pre and post investment evaluation, funds experience that they can mitigate risk and attract more capital from investors. On the other side of the investing spectrum, impact funds have started to adapt a commercial-first mindset to ensure a sustainable financial future and thus a greater impact. Thus, the trade-off between impact and financial returns seems to become less evident, and we see signs of an ongoing convergence between impact investing and traditional investing.

Africa has attracted significant amounts of capital in recent years, of which millions of dollars have been allocated to the venture capital market, spurring economic growth and job creation. Impact investing has also grown in importance and popularity and has the potential to provide new lucrative and impact-generating business opportunities and enable companies to mitigate risk. However, due to market-specific risks and challenges in African economies, VC funds and companies still find it difficult to scale and attract investor capital. Therefore, it is critical to conduct further research on how to develop financing solutions adapted to their needs as well as how to mitigate these market-specific risks and challenges to allow for more capital flowing to private capital markets. Finally, more research is needed to investigate what a potential convergence of the sustainability investment spectrum would entail, if it is indeed converging, and if it is converging for the better.

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9. Appendix

Table 6. Summary of Performed Interviews

Interviewee	Role	Company Name	Company Type	HQ	Founded
Johhni Kjelsgaard	Founder	GrowthAfrica	Accelerator	Nairobi	2002
Amos Ganhuiri	Senior Investment Manager	FSD Africa	Development Agency	Nairobi	2012
Anne Partridge	CEO	Optimizer Foundation	Fundraising Foundation	Stockholm	2017
Interviewee 1	Senior Investment Analyst	Enabling Qapital	VC fund	Zurich	2020
Ceasar Nyagah	Investor	Admaius Capital Partners	PE fund	Kigali	2021
Ruth Wairimu	Senior Investment Associate	Acumen	VC fund	New York	2001
Sebastian McKinlay	Head of New Investments	AHL Venture Partners	VC fund	Nairobi	2007
Karen Serem	Chief Investment Officer	Catalyst Fund	VC fund	Nairobi	2016
Mukami Kamau	Senior Investment Associate	Chui Ventures	VC fund	Nairobi	2021
Harrison Gitau	General Manager	Cornerstone Enterprises	VC fund	Nairobi	2013
Diane Yakovlev	Associate	E3 Capital	VC fund	Nairobi	2015
Anthony Kimani	Senior Investment Associate	Enza Capital	VC fund	Nairobi	2019
Steven Wamathai	Partner	FrontEnd Ventures	VC fund	Nairobi	2022
Bitta Wycliffe	Investment Manager	Goodwell Investments	VC fund	Amsterdam	2006
Victoria Wanjiku	Venture Analyst	LoftyInc Capital Management	VC fund	Lagos	2017
Maina Murage	Investment Manager	Norrsken22	VC fund	Stockholm	2022
Abel Boreto	Associate Director	Novastar Ventures	VC fund	London	2014
Esther Mwikali	Investment Manager	Renew Capital	VC fund	Addis Ababa	2007
Wairimu Muriithi	Investment Analyst	TLcom Capital LLP	VC fund	London	1999
Hope Wandera	Investment Analyst	VU Venture Partners	VC fund	San Francisco	2018
Mike Mbari	Investment Principal	Zephyr Acorn	VC fund	Nairobi	2016

Appendix A. Interview Framework

Personal

- What is your role in the company?
- How long have you worked at the company?

Company

- How much assets under management does the company have?
- How many portfolio companies do you have?
- Is your company investing in specific industries and geographies? Why?
- How many exits have you made?
- What types of investors do you have?
- What are the most important factors you look at when deciding to invest or not?

Market

- What risks are more prominent in this market?
- How has the VC market in Kenya and Africa at large changed during the last few years?
- Is VC in Kenya and Africa at large competitive?

Impact

Pre investment

- How do you define impact?
- Do you do negative screening?
- Do you do ESG due diligence? How? Internal or external?
- Do you have ESG related requirements/criteria pre investment? Which ones?
- Do you have specific impact criteria that your investments need to fulfill?
- Are you using any impact framework when assessing potential investments? Which one?
- Do you exclusively invest in high-impact sectors?

Post investment

- Do you have impact KPIs? Can you give examples?
- Do you have different KPIs for different sectors and companies?
- Are you putting less operational/financial pressure on companies in “high-impact” sectors?
- How and how often do you scrutinize your portfolio companies? E.g. visits.
- What do you provide to the firms to enable them to create more impact?
- Does the impact focus imply additional costs for the fund, such as reporting costs?
- Is there anything that you as impact investors provide that traditional investors don’t provide?

Risks and challenges

- What challenges and/or limitations do you face that are related to your focus on impact (anywhere in the investment process)?
- Do you believe impact investing poses different risks/more risk? Why?
- Does impact companies require different investors?

- According to your experience, does the presence of impact capital change the motivations and aspirations of entrepreneurs?

Perception

- Do you believe impact investing is important?
- How do you believe impact investing will develop in the future?
- Do you think traditional funds should measure impact? What will it lead to?