



THE POWER OF ESG COMPLIANCE

THE KEY TO LONG-TERM SUCCESS FOR BUSINESS

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In Kenya, it is increasingly clear that sustainability is vital to any company's long-term success. Companies are actively striving to incorporate ESG principles into their operations and investments to remain competitive in the marketplace and protect their bottom line. ESG considerations now play a significant role in decision-making in both the public and commercial sectors, solidifying their place in the global conversation on climate change.

Many businesses are now proactively setting ESG targets and tracking key performance indicators. In light of this, it would be wise for businesses, especially those in financial distress, to be cognizant of the potential effects of ESG on lenders, borrowers, and stakeholders.

Understanding the impact and role of ESG will be prudent for businesses undergoing restructuring, as one can anticipate increased ESG scrutiny from buyers, investors, and lenders. This scrutiny will range from assessing a company's environmental impact and commitment to corporate social

responsibility to evaluating its governance structure and management systems.

At the core of ESG is the concept of corporate governance, which ensures that businesses are managed responsibly and effectively when financial decisions are made while having the best interests of all stakeholders in mind.



responsibility to evaluating its governance structure and management systems. Many corporations have had to declare bankruptcy or undergo reorganization as a result of inadequate or absent corporate governance. Consider the 2015 failure of the Imperial Bank of Kenya, which, among other causes, was due to poor corporate management and control.

When considering the potential restructuring options available to distressed businesses, the attitudes of lenders and investors towards risk will be fundamental.

For investors, ESG factors will be considered to evaluate a company's sustainability and long-term performance or to lower risk in their portfolio by avoiding companies with subpar ESG standards. For businesses, ESG standards will aid in establishing a favorable reputation, drawing in more investors, and identifying possible areas for development or improvement. For consumers, ESG will be utilized in choosing brands and businesses that align with their values and beliefs and to make wiser purchase decisions.

With this in mind, stricter ESG disclosure and reporting requirements are now being imposed by regulators and governments on financial



institutions, investors, and advisers. These entities, in turn, are scrutinizing their investments and portfolios more closely to ensure compliance with their own requirements. Before investing additional money in a distressed company, potential investors will also want to make sure the company is adhering to all pertinent regulatory obligations.

To this end, Kenya, as part of its Vision 2030 has made progress by enacting rules and regulations that encourage environmental stewardship and social responsibility. The Companies Act, 2015 requires companies to report on their social and environmental impact, while the Business Registration Act, 2015 promotes the incorporation of corporate social responsibility into the operations of companies and organizations. Regulators such as the Capital Markets Authority (CMA) require businesses to publish their ESG policies and performance, which promotes responsible investment. A Corporate Governance Code was also set up by the CMA, which stipulates that organizations must have an effective board of directors, adhere to the Code of Corporate Governance, and create and use internal controls.

Similarly, the Central Bank of Kenya has provided banks with guidelines on how to manage climate-related risks, forcing them to take into account the borrowers' potential business impacts on the environment.

The borrower's ability to show how their company combats climate change becomes a crucial component of enterprises seeking bank financing.

With these regulations, the demand for ESG reporting and performance continually grows, resulting in companies that implement ESG practices positioning themselves to fulfill the expectations of their stakeholders and contribute to sustainable development. Businesses across industries will increasingly recognize that partnering with companies with strong ESG profiles will result in more sustainable values for stakeholders in the long term.

By taking ESG into account, especially during the restructuring process, companies can better ensure that their operations are aligned with the highest standards of ESG principles, allowing them to recover from any restructuring more quickly and remain competitive in the long term.

Even though there is a pressing need for businesses to move toward ESG compliance, there are still obstacles in the way of its implementation, such as a lack of knowledge and comprehension of ESG principles among businesses and stakeholders. Companies also lack the necessary technical expertise to effectively implement ESG principles. These obstacles can sometimes lead to the imposition of hefty fines by regulators such as the Nairobi Securities Exchange and the CMA for failing to comply with corporate governance and ESG requirements.

However, with the right policies and measures in place, companies can work towards adapting and conforming to the evolving ESG and sustainability legal and regulatory landscape across a broad range of sectors, ensure they reduce their environmental footprint and navigate towards developing and reshaping ESG strategies to create, preserve, or unlock value of distressed businesses attempting a restructuring.

